

FINAL TRANSCRIPT

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Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Rackspace conference call. (Operator Instructions). As a reminder, I would like to say that this conference call may be recorded. I would now like to introduce your host for today's conference, Mr. Erik Suppiger. Mr. Suppiger, you may begin.

Erik Suppiger - *Signal Hill Group LLC - Analyst*

Thank you, Jessica. Hello. This is Erik Suppiger. I am the Internet infrastructure analyst for Signal Hill, and I want to thank all of you for joining us on the conference call today.

On the line with us is Lew Moorman, the President of Rackspace's Cloud Operations and Rackspace's Chief Strategy Officer, and we also have Jason Luce, the VP of Finance for Rackspace.

Before I turn the call over to Lew to discuss cloud computing services, I want to emphasize that the intention of this call is to provide you, our clients, the opportunity to ask whatever questions you have about cloud computing in general or as it relates to Rackspace in particular. So please feel free to ask whatever questions come up as that is the primary purpose of this call.

In terms of the timing, the call should last 30 to 40 minutes. If anyone wants to follow up with me afterwards, you can reach me at 415-364-0367.

And so with that, I'm going to turn the call over to Lew for a brief introduction to Rackspace's cloud services, and then we're going to spend the remainder of the time on Q&A. So, again, please prepare whatever questions you have. We do invite you to join in the call by way of asking questions. With that, I will pass it over to Lew. Please go ahead.

Lew Moorman - *Rackspace Hosting - President Cloud Operations, Chief Strategy Officer*

Thanks, Eric. Happy to be on the call. Appreciate the opportunity. I'll keep my comments pretty brief and just share some perspectives we have on this space, which is obviously getting a lot of attention, and we think rightly so. I will tell you just a little bit about where we stand in terms of our offerings.

First thing I would say is we have sort of a different way of thinking about cloud computing, and what I would encourage everyone to do is think about it as two real things. One is a paradigm shift in the way computing is consumed by businesses. And the second area is really -- it is a set of technologies that are making that paradigm shift happen faster.

I think that because it is both of these things, there is often a lot of confusion around it, and people talk the concepts over each other quite a bit and it creates a lot of confusion.



Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

So let me just talk about the paradigm shift and what we think is the real revolution, which is, put simply, the idea of companies not running servers ever again. We think that in the future the vast majority of companies won't buy servers anymore. They will consume it from service providers, centralized at-scale service providers, and consume computing power over the Web.

And it's really that simple, which is that this is a non-core activity for the vast majority of companies. It's incredibly capital-intensive and complex to run, and given the increases in bandwidth in the advances of the Web, consuming it over the Web and over the Internet becomes an incredible viable option for companies. And we think it's going to become the predominant model over the next 10 or 15 years, and it will be a long-term trend to shift.

Now what we would say is that this really started 10 years ago with the dawn of Websites and Web hosters, and we were one of the early dedicated hosting companies out there. Companies started to use service providers for Web computing because they needed to be close to very large Internet pipes.

What's happening today is companies are seeing that that model works very effectively, and they are thinking about how do we move all of our computing operations onto the Web and consume it that way to save costs and to focus the business on their core operations?

So now, what's speeding this up is what everyone's talking about, which is these set of technologies that are making this super-compelling and the fact that you have lots of major, major technology players coming into this space. And what I would say is there is a couple of things to sort of -- to note about this.

One is the reason why you are getting so much interest is when you talk about 25 million to 30 million servers in the world, all going over the next 15 years from server closets into centralized service providers, this is a major trend that upsets the way all of the major IT vendors do business today. So it really is something to try and understand and get your head around.

The thing I would also say is that there is these new set of services, and the way I would think about these new set of services, and the reason why they are so compelling and they are speeding up the paradigm shift, is basically the idea of pooling computing has become very mature and become something that is ready for enterprises and businesses to consume.

So what do I mean by pooling? It's just the very simple nature of taking lots of computers, linking them together, and using software to divide them up amongst a variety of different businesses or business units. And this has a couple major benefits. One is it lowers the capital required to run computing because you are sharing computing and you're able to get higher utilization, and two, it lowers the operating costs because it's all done via software in an incredibly automated fashion.

So suddenly, you can get computing power by the hour, incredibly cheaply, from a variety of service providers, and this has made sort of the idea of consuming from service providers even that much more compelling.

Now one of our basic fundamental beliefs is that these new technologies provide new tools, and they are important tools and they are going to be part of the equation, but the old tools that exist will remain. We think dedicated hosting will continue to exist and be an important element. In fact, we think the combination of dedicated hosting with cloud technologies is going to really be a terrific combination for lots of companies trying to run all of their IT infrastructure over the Web.

What I would say sort of very briefly about Rackspace is we started investing in these new technologies several years ago. We are very proud of our offers. We've been doing them under a multitude of brands. We are now really consolidating everything under the Rackspace brand.

And we really do believe that we are in a great position. We are -- if you look at some of the categories of cloud computing -- in dedicated computing, we really do feel like we are the largest in the world in that space.



Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

If you look at infrastructure as a service, which is a form of cloud computing, we feel like we are in the number two spot, from everything we can tell, behind Amazon who has been a real pioneer and effective at this.

There is also a flavor called platform as a service, where we are the biggest -- there is a service by Google called App Engine. They announced they are supporting 80,000 applications. We are currently supporting over 130,000 applications.

And then in the software as a service space, we are an e-mail provider. We provide business e-mail for businesses, and we are number one; if not, number two. It's hard to tell how many paying customers there are of Google that are really getting the business class service but we are supporting over 1.2 million business seats.

So we think that this suite of services really provides an amazing toolkit for IT departments to pull from to try and solve all their computing needs, and we think the combination of them, combined with a great service stance and what we call fanatical support, is -- really sets us up to help take advantage of this great paradigm shift that's happening.

So Erik, that's a high-level overview. I am happy to dig into as many details and answer any questions that anyone has.

Q - A N D - A .

Erik Suppiger - *Signal Hill Group LLC - Analyst*

Okay. Before we get to the investor questions, let me just throw out a couple while people get some of their thoughts together. First, there is discussions about public versus private cloud computing, and specifically how those would differ from the managed hosting. Can you just provide a little definition in terms of what is meant by public and private cloud computing, and how they relate to managed -- to the traditional dedicated hosting? Are they in fact a replacement or an augmentation?

Lew Moorman - *Rackspace Hosting - President Cloud Operations, Chief Strategy Officer*

Yes, so that's a good question. And this is part of the confusion. So, traditional managed hosting is dedicated in nature, so every customer that comes to us, we deploy a set of infrastructure that is dedicated to them.

So they say I need a network with this many servers and this many files and load balancers, and we deploy that, and it's a private network for them. And they are able to run their infrastructure and customize it basically to their hearts' content.

We also have public cloud offers, which are completely pooled and completely automated by software. So you will sit on machines with other companies. You get the benefit of scale because it's all one big cloud, for lack of a better word, that is shared and the software is used to optimize it. So that is our public cloud offer.

Now private cloud is a concept that is used in multiple ways. We have something we call private cloud, which is really virtualization sitting on top of dedicated machines. So a customer is able to get hosts or servers that belong to them, and they can use our VMware-powered virtualization software to carve it up and to get some benefits by getting higher utilization and more automation on their own, without the benefits of the larger pool.

I think the -- when you look at Cisco or VMware in general, and IBM and others, when they talk about private cloud, they really talk about how do we bring some of the tools -- virtualization, multi-tenancy, all of these kinds of automation tools, how do we bring them to your internal infrastructure to make it more effective and more efficient, and to equal the economics you can get from a service provider?

Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

And I think it's a very interesting debate. Is it going to be worth it for companies to make that shift or to just move to service providers? I think ultimately you have to believe that companies should run their own server farms. Is that if you are going to turn your internal infrastructure into private cloud, you have to have a very, very large commitment to really becoming world-class at running infrastructure.

And I think that that's the fundamental question of does the paradigm reach critical mass and really change the way people consume IT or not. We certainly think that it will. We think it's very non-economic for the vast majority of companies to build expertise around all these different technologies and tools, especially at a time when they need to consume more and more computing.

The opportunity to do it from service providers creates lots of benefits. So I think it's going to be an interesting debate about does internal IT transform fast enough in order to keep up with public cloud providers? And again, our bet is that it won't because it's not core for companies to do this.

Erik Suppiger - *Signal Hill Group LLC - Analyst*

Okay. I've got more questions, but let me check with Jessica. Do we have any questions in queue at this point?

Operator

(Operator Instructions). Our first question comes from David. Your line is open.

Unidentified Audience Member

Thanks for doing the call. If we think in terms of the very large enterprises, and here I'm thinking of financial services companies, a la JPMorgan Chase or something, or it could be a large retailing operation where you've got hundreds of thousands of customers, or millions of customers, most of the feedback we get is that they may do it on a cloud procedure but they will do their own cloud.

Now does that mean, though, that you think they will literally have their own, or will they go to someone like you to do a private cloud? I would assume somebody like Morgan does their own, but I'm really thinking of the mid-sized, but mid to large enterprises.

Lew Moorman - *Rackspace Hosting - President Cloud Operations, Chief Strategy Officer*

Yes, look, I think that this -- it takes a long time for people to move to new models, so this is not a trend that's going to happen overnight.

I think that what's going to happen, though, is that as the economy picks back up and companies no longer have a bunch of sunk costs and underutilized equipment, when they go to build that next data center and they go to their CFO and say, hey, look, I need a \$15 million check to build the next data center, I think that's going to be a very interesting conversation because I think that at that point, it's very non-core.

It's a huge amount of capital, and everyone is going to know about the ability to buy these services over the Web at variable costs, sort of that hit your income statement and you pay as you go. And there's no need to hire the staff and all the other things to support it.



Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

So I think this is going to take time for mid-sized companies. I will say I think companies of all sizes, and we see this today, are experimenting with it. I think that's the start of it. I think -- is there going to be a wholesale shift? It's going to take a long time, but they are experimenting with it.

I mean, HSBC is a company -- excuse me, a customer of ours that has been running infrastructure with us for a long time. That is part of the experimentation.

You bring up Morgan Stanley. I sat on a panel with one of the IT leads at Morgan Stanley, who said that they had actually done a very comprehensive total cost of ownership of running computing, and they were shocked at how expensive their actual costs were. And they said that they think that they can consume it as a service from the cloud cheaper than they can build it.

That's Morgan Stanley. That's one of the most at-scale, largest companies in IT that exists out there.

Now again, they are not going to move wholesale to it, but they are definitely experimenting with it and I think that that's the start of this shift. So, whereas small companies, and it's implied in your question -- I think it's a no-brainer very quickly.

Erik Suppiger - *Signal Hill Group LLC - Analyst*

Jessica, there are more questions?

Operator

Our next and last question in the queue is from Eric. Your line is open.

Unidentified Audience Member

Erik, thanks for setting this up and Lew, thanks for your time. You mentioned on the call that you think in the future there is room for dedicated hosting. So you see a type of, I guess, hybrid where customers will use dedicated hosting, and have and consume cloud computing resources. Computing resources via the cloud.

In your total customer base right now, how many of your dedicated customers have also -- are also using the cloud?

Lew Moorman - *Rackspace Hosting - President Cloud Operations, Chief Strategy Officer*

It's a good question. I will be honest with you. We -- until recently, we've sort of been running them somewhat separately and you have to sort of sign up separately.

So the overlap, I would say -- I wouldn't say we have total confidence in it. I would say right now it's relatively low in terms of people using both, but a lot of the conversations we are having with our new sales side are definitely with people that want to use both.

And there's lots of different reasons to want to use dedicated over cloud in terms of the ability to customize, the ability to isolate data and not intermingle it in any way, even if it's secure, but to physically isolate it. The ability to use different technologies like physical firewalls and load balancers that have capabilities you can't replicate in the cloud.

All of these kinds of things, when you are talking about really complex mission-critical applications, they are still very relevant. They are going to continue to be relevant because technologies will evolve and they will be easier to implement in a highly customized model like dedicated hosting for some time to come.

Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

So it's something that is very prevalent in our conversations. I can't give you hard facts on how many people are experimenting with both. I will say for something like, I believe, 20% of our -- around 20% of our dedicated customers are running mail with us in our shared service, in sort of our cloud service in mail, so that's one data point that we do talk about internally quite a bit.

So it's starting. And I think people are starting to get comfortable with the concept of it.

One last point I will make on this, and sorry for the long answer, is we've also seen a number of companies that -- Amazon certainly pioneered this space and we had a lot of companies that were experimenting with Amazon. and we've seen a number of them sort of -- even though they were using Amazon for specific purposes, maybe it's archiving, maybe it's running test development, we find them wanting to do this in our facilities on our network because the ability of having close proximity to their mission-critical core applications is really powerful.

Just imagine if you are archiving a whole bunch of data, to be able to push it across a private network inside the same facility much, much faster, much, much cheaper, much more effective to be able to access that data, etc..

Likewise, if you are running test development, to be able to do it in the same facility that is where your core application is, you can then push production code out much easier and much more simply. So the synergy between these two offers we think is very, very powerful.

Unidentified Audience Member

Yes, that's a great point about the kind of the co-locators or the having the two in the same facility. Is Rackspace working -- you said there were separate sign-ons in this case right now. So if you sell both, the client has separate sign-ons. Does Rackspace plan to come out with a platform that would allow a customer to access dedicated hosting and cloud computing services -- well, basically, if you are running dedicated hosting, this is right from the website or right from that server, can you send jobs into the cloud? Are you working on something like that?

Lew Moorman - Rackspace Hosting - President Cloud Operations, Chief Strategy Officer

Yes, so we have sort of the technology that we are working on in terms of making the cloud available even behind your firewall.

So this is something we announced to some customers. We are going to be posting a video of it. We did a demonstration -- or we didn't do a demonstration, we sort of announced, pre-announced some things to customers a week or so ago.

This is one of the big pieces we're talking about is how do we expose the dynamic resources of the cloud securely to you, and even behind your firewall and your load balancer, so it can be part of your private network, but you get all the benefits of the cloud in terms of rapidly deploying it, scaling it on demand, paying for what you use, all those kind of things. For parts of the application like the web layer or the application layer that sort of can be dynamic.

So this is something we absolutely plan to do. And are actively working on. And over time, we do have a path to sort of integrate it and make it all more seamless. So, in terms of one bill and all those kinds of things. So all that is in the works. And we'll do sort of over time and tackle the most important ones first.

But I will tell you, just being in the same data center has already reaped big benefits for a number of companies because of the latency issues and the ability to sort of connect things without bandwidth charges out to the public Internet. So, already being in one place has yielded fruit for us.



Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

Unidentified Audience Member

That's a great point. Congratulations, Lew. It sounds like -- you are, I think -- it definitely seems like Rackspace is on the right path. So that's the end of my questions. Thank you, Lew, and thank you, Erik.

Lew Moorman - *Rackspace Hosting - President Cloud Operations, Chief Strategy Officer*

Thank you. Appreciate it.

Erik Suppiger - *Signal Hill Group LLC - Analyst*

Say, Lew, just following up on that, maybe you could comment a little bit about what applications are getting the most traction these days. We hear a lot about test and development sites using cloud services. What do you think is going to be the big driver if you look out another year or two?

Lew Moorman - *Rackspace Hosting - President Cloud Operations, Chief Strategy Officer*

In terms of what is obvious today, archiving huge amounts of data, test development, what we call high-performance computing jobs, so things like genetics research or Monte Carlo simulations in the banking space that are just incredibly compute intensive, these are perfect applications for the cloud and I think a lot of what you are seeing that's happening out there.

I think what's going to drive it over the next couple of years is a couple of things. One is I think you are really starting to see people with video and large data sets being out in the Web, using some of these cloud technologies and especially the linkages we have into CDN providers. So we have connected our storage into the Limelight CDN network.

Really provides a powerful tool for any company running any kind of video or large image or audio or any kind of sort of media-type files, which are becoming much more prevalent. This becomes a very, very cost effective and powerful and fast way to do it. So I think that that's one area.

I do think, also, any public-facing applications is going to come very, very clear cloud -- a clear opportunity for the cloud in the near term. And I think you are already starting to see it. I do think that we are getting lots of folks -- we had -- look at someone like Wendy's, who we've done some case studies on, or the Teen Choice Awards on Fox Network.

These are both big companies that are doing promotion and public websites in our cloud because they can do it much more effectively and quickly, as well as there they are unpredictable. A lot of these are promotion sites that they don't know how much infrastructure they are going to need for them. So the ability to sort of scale out on demand really makes a difference.

So I think all this public Web activity is a sort of the next big piece to go. I then think you'll start to see, as the security models mature and the comfort level grows with cloud, you start to see some of the back-office stuff get out there as well. Because these are tools that are extremely powerful.

Erik Suppiger - *Signal Hill Group LLC - Analyst*

And then, in terms of the customers, typically -- the early adopters have been these -- the smaller and mid-sized companies. Is that correct? Or do you think this is something that will also get equal interest from the large enterprise?



Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

Lew Moorman - Rackspace Hosting - President Cloud Operations, Chief Strategy Officer

Well, look. I think that, in terms of sort of using it in a very sort of sophisticated way, where you are taking some real risk, there is no question that belongs to the small businesses.

But I think given all the discussion around cloud computing and all the hype and the dominance it has in the IT world, every single IT leader has to have a point of view and a strategy around cloud, and I think that that means that they are really actively experimenting with it.

I get a list every week of the high-profile names that have signed up for our cloud service, and it's pretty impressive every week. They are not spending a lot of money, they are not doing major things, but it's a list of what you would think of as pragmatic buyers that are really experimenting with it and trying to figure out how to bring it into their IT mix and to use it as a tool to be more flexible or to bring costs down.

So, I really think that it's every IT leader's responsibility to figure out how to do it. And I think that we are seeing that because it's unavoidable and every IT leader is being asked about it from their business leaders.

Erik Suppiger - Signal Hill Group LLC - Analyst

Jessica, any more questions in the queue?

Operator

We do have one more question on the line. The question comes from Scott. Your line is open.

Unidentified Audience Member

Lew, thanks for doing the call. This is helpful.

Lew Moorman - Rackspace Hosting - President Cloud Operations, Chief Strategy Officer

You bet.

Unidentified Audience Member

I'm wondering if you could talk about demand for servers, virtual machines versus dedicated, and what you think that means for market size.

I'm thinking -- in its simplest sense, virtual machine is going to cost half or less of a dedicated box. Clearly, the capital cost is a lot better for you, but in that simple example the revenue opportunity is lower. Do you guys see demand elasticity that comes from the lower cost or extra services that get the revenue up, or do you agree with my kind of unit pricing analysis? How do you see the overall hosting market size being impacted by the shift to the cloud?

Lew Moorman - Rackspace Hosting - President Cloud Operations, Chief Strategy Officer

Yes, it's a great question and it's one we get quite a bit. And there's no question, there are small businesses that are spending \$400 a month with us that can get on the cloud and spend \$100, and accomplish their goals just as effectively, and some of that is happening. No doubt about it.

Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

And I will tell you, we have a strategy internally called customer fit that is all about how do we help customers get to the right solution. Because in the long run, we think that that's going to create lasting customer relationships, so there's no question there are some cannibalization issues.

Now there's a couple of things offsetting it that we think are much more powerful and are much more exciting. One is that sort of just the general idea and the emergence of these tools has, I think, raised awareness of consuming -- computing in general over the Web. So I think in terms of the whole universe starting to think about using providers like Rackspace, I think that trend is just going much faster because of these new tools.

Secondly, I think the other piece is that because -- when powerful things become really cheap and readily available and easy to deploy, people find lots of new uses for them. So I think that what you are seeing is a whole bunch of innovation in companies, and that next set of projects that they could never get to, they are finally getting to them.

So I think -- overall, we think it's going to create an increase in demand and an increase in the market size because computing is becoming just sort of not a bottleneck to getting projects done. And that is a major change from what is going on in the average IT department today.

The average IT department today, when you call IT, let's say you are in the marketing department and say I want to get a server to run this project or to test this software or to try something new, they say, look, go through the approval process and we will get it to you in 30 days. It's just incredibly liberating and opens up the sort of the opportunity for innovation when you can just go, deploy it, and get access to it within five minutes.

And it's really not very -- it's actually going to be half the price of what your internal IT department would charge you.

So we think that the positives on this outweigh the cannibalization pieces, but time will tell. So far that's what we've seen, and we also don't see that there's going to be -- this is not an overnight everyone drops their dedicated server. That's the other piece about it is that it is a trend that's going to take time.

Unidentified Audience Member

Agreed. Thanks. That's a great answer.

Erik Suppiger - *Signal Hill Group LLC - Analyst*

Say, Lew, could you talk a little bit about the importance of brand in the market? We've got Amazon that's a major player, but Google and Microsoft, even IBM, they're coming after this market. Is this going to be a market that's dominated by a select few major brands out there? How do you envision that this market will evolve?

Lew Moorman - *Rackspace Hosting - President Cloud Operations, Chief Strategy Officer*

Yes, it's a good question. If I had all the answers, I would probably just play the stock market all day, I guess. But I will do my best to sort of give our point of view on it.

I do think that there is a scale -- there is definitely a scale barrier to entry in this space. Building these new offers and building them at scale and building the capabilities to do them really, really effectively is expensive. And I think that we are sort of at the scale where we can make those investments and know that we are going to get great long-term returns.



Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

But I think that if you look at sort of -- hosting has traditionally been highly fragmented because it's been very easy for someone to just go out and get 100 square feet of data center space and say, I will take on customers and support them and do the best I can.

I think to try and really do this new market and use these new technologies requires real investment. So I think that it really is going to be a smaller set. I don't think it's going to be one or two, but it's going to be a smaller set of bigger players that I think really thrive in this space.

I think brand power -- look, I think brand for Microsoft, to Amazon, Google, this cuts both ways. In the positive for them, they just have enormous recognition and they clearly have technical chops. I think that no one would deny that they are technically extremely competent.

I think where it's a negative is that everyone recognizes this is not their core business. When you think about outsourcing, in many cases, just absolutely essential elements to keep your business running and to thrive and to -- in some cases, it's your whole business because you're e-commerce or an online SAS company or whatever it might be.

I think it's a little scary to go with a company that is not completely focused on it, has never been in the business services space, and is not really great at client relations. I'm not saying they can't build those capabilities, but it's not core to who they are. It's not really what they've been focused on and in many cases, it's a new business model.

So I think that -- again, I think that it's going to be bigger brands. I think it will be interesting to see how committed and how focused some of these other companies are that it's not a core activity for them.

Erik Suppiger - *Signal Hill Group LLC - Analyst*

Jessica, do we have any more questions in the queue?

Operator

You do have another question on the line and it comes from Greg.

Unidentified Audience Member

Thanks for doing the call. Lew, in terms of the storage on demand offering, how does this paradigm change data storage equipment requirements? And in your mind, who is geared best to fit those needs?

Lew Moorman - *Rackspace Hosting - President Cloud Operations, Chief Strategy Officer*

That's a good one. You know, I do think there are multiple flavors of storage out there, and I do think this has been extremely disruptive to that space.

So, Amazon has an offer called S3. We have an offer called Cloud Files, and it is file-based storage that is -- it is infinitely scalable and it is replicated multiple times, so the data is [compacted] very effectively. And it's also -- both of us connect them to a CDN so it's accessible quickly in a public use case.

So this is sort of one type of storage that is very competitive to sort of, I would say, is the NAS market in some spaces and some other storage flavors.

Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

The interesting thing about both of us is that we both built the underlying technology and we both run it on commodity hardware. So, and I think that that's part of the reason why it's disruptive, is that the costs of it are radically lower than you can get out of the market.

Now in the long run, I think that you are going to see a lot of innovation in this space from a lot of storage leaders. We hope so.

Net App and EMC are both great partners. We'd love to partner with them on these things. We don't want to build anything we don't have to. We'd love to use best-of-breed, but we didn't find that anyone had anything that would live up to all the requirements we had for this cloud world. So we'll see.

I think that there's going to be other flavors of storage we want to go into -- around block level storage and higher performance storage, and we're looking at a lot of options there. I can't really tell you that there is one or more companies well positioned to service it, but I think that all of them are very aware of it and all of them are investing in it.

And I think that the big question for all of them is do they want to have a service provider-oriented strategy or an enterprise-oriented strategy? And I think that that's a big decision.

It is very difficult to sell equipment into large service providers because we have a strange set of requirements in terms of billing -- there's billing requirements, there is multi-tenancy requirements, there's all sorts of authentication requirements we have because we are serving so many different users. This is not the kind of requirements you get when you go into sell into an enterprise.

So I think that -- and that, I think, is a little bit of what's held back some of the traditional providers from servicing enterprises -- or serving service providers really effectively is that it's a real commitment to really serve that group and make it work.

So it is disruptive. I don't know if that answers your question, but sort of some high-level thoughts on it.

Unidentified Audience Member

That's helpful. And just a related question, you mentioned about authentication. It seems to me one of the roadblocks to really taking this cloud compute to the next level, Fortune 500 kind of stuff, is concerns about security or compliance. I guess at this point, how do you get people comfortable with that?

Lew Moorman - Rackspace Hosting - President Cloud Operations, Chief Strategy Officer

You know, I think there is a couple of things. One is just time. It really does just take time for people to get comfortable with it, to see others doing it.

There's always those brave folks that go out there and try things before it's been proven, and so I think some of it is just -- the only thing that will solve it is time.

It's sort of like e-commerce in the early days. There were many people who said they would never put their credit card online, and that just sort of -- as every one of your neighbors does it, you kind of say, okay, well, I'll do it, too. It must be safe.

I think that some of it is just that piece. And the education that goes with it. I think also -- I do think that some of the compliance rules aren't evolving as fast as the technology is, so I think things like [PCI] and other things, there are still a lot of roadblocks to doing it in the cloud that are just -- I don't know that they are necessarily good, that there is any rationality behind them.

Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

But I think it's sort of because they have those requirements, it will continue to sort of make things a little bit more difficult. But I think the compliance pieces will evolve because I think that all these tools are going to have to become available to folks to run these kinds of things.

So I think you see those kinds of things. I think there's also going to be a number of tools and services that emerge to give people comfort that I think will be value-added services that happen. But again, I think that the biggest security risk that most companies face -- they deal with policies and procedures and their own code. Those are where the vast majority of security issues are.

And I think that people have started to realize that. So I think in the long run, security is not going to be the bottleneck. I think it is a short-run bottleneck, not a long-term one.

Unidentified Audience Member

Great. Thank you.

Erik Suppiger - *Signal Hill Group LLC - Analyst*

Somewhat related to that, Lew, can you comment a little bit about how the different services, cloud services, are differentiated? And obviously, Rackspace has had a strength in this customer support arena. How does that play out in the cloud? Because cloud has traditionally been more self-service oriented.

Lew Moorman - *Rackspace Hosting - President Cloud Operations, Chief Strategy Officer*

Yes, and -- so look, I would say we have three main tenets to how we want to talk about our difference. One is clearly fanatical support. We really believe in creating great service experiences and being available and transparent and helpful to customers. And go above and beyond. So that's a big piece.

I think also this notion of customer fit, and having a suite of services and helping customers to take advantage of all the products and services, we think is going to be an advantage.

And I think the last one is we really believe in a standards-based approach. So I think one of the reasons, for example, our platform as a service has been so effective is that we built it on a standard.net and LAMP stack, which is -- these are dominant web development stacks, whereas Google has been sort of building around some of their proprietary technologies and very custom additions of Python and Java.

I think that the lack of standards really will keep people from adopting these things.

Now I do think service really does matter. We find this in our experience. It doesn't matter to everybody, and I think that we've seen this in the dedicated hosting space.

There's lots of providers out there that can sell a no-frills, no-service, cheaper server than we can. They always have, they always will be able to. And there's going to be use cases and customers and IT departments where that's a better fit. And that's just not going to be our market.

Our market is going to be those customers that want to be able to call and talk to somebody, want to be able to know what's going on, want help solving problems, and all of this technology still is incredibly complicated and lots of issues emerge. And so, having that ability to get great service, we find that companies really, really value it.



Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

So, again, it won't be everybody, but we have seen already to date that it is extremely valuable in this space.

Erik Suppiger - *Signal Hill Group LLC - Analyst*

Jessica, any other questions?

Operator

We do have a follow-up question from David. Your line is open.

Unidentified Audience Member

On the authentication and security, do you design your own or do you partner? Do you do a combination, and if you partner, who do you do it with?

Lew Moorman - *Rackspace Hosting - President Cloud Operations, Chief Strategy Officer*

So we have built all -- on our cloud services, we built our internal authentication systems. I am not a security expert, so, Eric, maybe we can set up something to talk through that specifically.

So there is a whole bunch of stuff we do to audit and test and all these kinds of things, but generally because of our multi-tenancy requirements in that we are dealing with so many companies, we are in a position where we need to build those systems.

Erik Suppiger - *Signal Hill Group LLC - Analyst*

With that, I think I'll just throw out the last question here. I think that's all the questions we have. So just in terms of differentiation again, do you envision that the infrastructure that you are using, either the hardware or the software, is that a key differentiator from what the likes of Google or Amazon are using? Or are you using a lot of the same foundation for offering the cloud services?

Lew Moorman - *Rackspace Hosting - President Cloud Operations, Chief Strategy Officer*

Well, I would say -- there is no question there is an IP element to this. Much more so than the dedicated hosting business, which was us sort of aggregating and integrating standard components.

We do -- this is a development -- this is a development-driven business, and we are building intellectual property to both provision things, to create new services. I think in the long run, what that's going to help us do is just tailor the customer experience the way we want it to be.

We ultimately -- our hope is to sort of create world-class services that are cost effective, and I think the intellectual property will matter in that regard and I think that that will give us some advantage.

I do think that sort of the big [F] scale folks -- I think that the intellectual property in the long run won't be -- end up being the differentiator. I think it's going to be the things you build on top of it. How great of an experience is it? How do you deal with customers? How do you integrate all these pieces?

Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

Look, it's an important piece of what we're doing, but I wouldn't say that our strategy or differentiation is moving from a service experience to an IP-based differentiation. No question, there is more IP, but again, I think that it's -- I don't think that that's going to determine the winner.

Erik Suppiger - *Signal Hill Group LLC - Analyst*

Very good. I think that's it. Jessica, we don't have any other questions, do we?

Operator

We do have one last question on the phone lines. The question comes from Thomas.

Unidentified Audience Member

Lew, a quick comment, if you would, on the competing virtualization software vendors. What is your perspective on Microsoft versus Xen versus VMware?

Lew Moorman - *Rackspace Hosting - President Cloud Operations, Chief Strategy Officer*

Yes, so, we are good partners with Microsoft and VMware, and we use Xen. So, we do -- are engaged in exploring all those technologies.

VMware is an offer that we deploy in our managed hosting space, sort of what we call our private cloud. It's fully managed and we use VMware for you to carve up your own servers and to get more effectiveness out of your own infrastructure. And I think it's very effective for that.

In our core cloud initiatives, we have decided to go with Xen to date and I think -- for a number of reasons. One is it's economically very attractive. Open source is very economically attractive. It's got a great community. It's got a proven track record.

It also allows us to customize in ways that you can't do with packaged vendors. In the things we are trying to do and at the scale we are trying to do it as a service provider, the ability to do that customization has really made a difference.

I do think that both VMware and Microsoft are getting more attuned to the service provider market, and we are going to continue to have dialogue with them about it and where they might fit, but we feel good about our strategy with Xen in the core space.

As we've looked to deploy Windows, which right now we are Linux-only in our cloud servers offer -- as we've looked to deploy Windows, we are really talking actively with Microsoft about the best way to do that, and certainly Hyper-V is on the list because we want to deploy it in a fully supported way, which Amazon has not been able to do on open-source Xen.

So that is one area where I think it creates some opportunities for some other technologies. You know, I can't really disclose where we are headed on that right now.

But we are constantly looking at the different hypervisors, but I think that it is interesting that most of the service providers to date have not standardized on VMware. And -- despite them having great technology and having great presence in the enterprise space. I think a lot of that has to do with how the economics work and the ability to scale and customize things.

And we'll see how they evolve and how they adjust to that. They are really getting aggressive on it, which I think is great to see. And we are engaged with them actively.

Jun. 23. 2009 / 4:00PM, RAX - Investor Conference Call with Signal Hill

Erik Suppiger - *Signal Hill Group LLC - Analyst*

Very good. Thank you all for joining us. Lew, I would like to thank you very much for your time. That was tremendously helpful for me. So with that, I think we will wrap it up and, once again, thank you all for joining.

Lew Moorman - *Rackspace Hosting - President Cloud Operations, Chief Strategy Officer*

Okay. Thank you.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the conference and you may now disconnect. Everyone, have a wonderful day.

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