FINAL TRANSCRIPT

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RAX - Q3 2009 Rackspace Hosting, Inc. Earnings Conference Call

Event Date/Time: Nov. 09. 2009 / 9:30PM GMT

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to Rackspace Hosting's Third Quarter earnings call. As a reminder this call is being recorded. At this time, all lines are in a listen only mode to prevent background noise. After the prepared remarks, there will be a question and answer session.

(Operator Instructions)

It is now my pleasure to introduce Jason Luce, Vice President of Finance for Rackspace. Mr. Luce, you may begin.

Jason Luce - *Rackspace Hosting, Inc. - IR*

Good afternoon. Thank you for joining Rackspace's third quarter earnings conference call. I'm here today with Lanham Napier, our CEO and Bruce Knooihuizen our CFO. We issued a press release after the close of the market today with our unaudited financial results for the third quarter of 2009. If you do not have a copy, please visit the Investor's section of our website at rackspace.com where this call is also being webcast.

The primary purpose of today's call is to discuss the third quarter results. However, some of our comments today are forward-looking statements that involve risks, uncertainties and assumptions. If the risk or uncertainties materialize or assumptions prove incorrect, our results could differ materially from those expressed or implied by the forward-looking statements and assumptions.

All statements other than historical fact are statements that could be deemed forward-looking statements including any statements concerning expected operational and financial results, long-term investment strategies, growth plans, the performance or market share relating to products and services, any statements of expectation or belief and any statements of assumptions underlying any of the foregoing.

These risks, uncertainties and assumptions include infrastructure failures, the potential continuation or further deterioration of current difficult economic conditions and other risks that are described in our second quarter Form 10-Q filed with the SEC on August 13, 2009 and our Form 10-Q for the third quarter that will be filed later this week.

These forward-looking statements speak as of today. Except as required by law, we assume no obligation to update these forward-looking statements publicly or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements even if new information becomes available in the future.

During today's discussion we will be using GAAP as well as non-GAAP financial measures such as adjusted EBITDA. Our GAAP results and GAAP to non-GAAP reconciliations can be found in the earnings release we issued earlier today. Following our prepared remarks, we'll open the call for your questions. Okay, let's get started; Lanham?

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Thank you for joining us today. We are excited to be here to share our strong third quarter results with you. Before Bruce dives in the numbers, I would like to add some commentary about what these results mean for our longer-term strategy.

During the third quarter, we continue to execute on our business plan and improve significantly against our 2009 operational plan. At the beginning of the year, we told you that we would grow our managed hosting business and would make the investments to roll our cloud business at a very rapid rate. We committed to scale of a cost side of our business to become leaner and more profitable and said that if we burned any cash in 2009 that it would be minimal.

Given the uncertainty in the economy in early February, these were lofty goals. However, they were necessary for us to cease the significantly larger opportunities that lie ahead. We're proud to say that we have honored our promises in the third quarter and throughout this year and have created real value for our customers, Rackers and stockholders.

There's been a lot of separation going on among competitors this past year given the recession. With our strong performance this past quarter, we have further separated ourselves from the competition by taking market share and are now positioned as a leaner and tougher competitor.

Today Rackspace is the world's leader in hosting and cloud computing. A massive, emerging marketplace is largely untapped. Let's look briefly at that market and our leading role in it. One part of the market will be won by the low cost provider. That segment of the market will not require the need for human support.

Another part of the market involves the hosting of varied and complex IT operations that span in-house computing, dedicated hosting and cloud computing. That part of the market cannot be automated. It requires extraordinary levels of support by a special kind of IT expert. A geek with great bedside manner, and that's where Rackspace excels through our unique culture of customer service, which we call fanatical support.

This culture is something we have built and honed for more than a decade. It's the result of a complex business process that involves special systems for testing and hiring and assigning employees. It involves multiple metrics to track customer retention and referrals and system uptime. It involves compensation systems that reward and celebrate excellence. This culture of customer service has made us the leader of our industry. It is the reason we've been able to grow revenues and profits faster than our rivals and take market share from them. It is a sustainable advantage, one that our rivals do not and cannot match.

Another sustainable advantage for Rackspace is our portfolio approach of finding the right fit for our customers across in-house computing, dedicated hosting and cloud computing. Most customers are moving away from in-house computing and we're helping them do that. We're helping them find low-risk ways to achieve the significant cost savings available through hosting and cloud computing.

Both our culture of service and our portfolio approach have been built through the efforts of our employees, who call themselves Rackers. Before I hand the call over to Bruce, I want to thank the Rackers for their continued hard work and creativity and I want to thank the loyal customers who continue to place their trust in us. Bruce?

Bruce Knooihuizen - *Rackspace Hosting, Inc. - SVP, CFO, Treasurer*

Thank you, Lanham. Given the strong results of third quarter, we can safely say that our business model is working and we've delivered on our 2009 operational roadmap. We have a stronger business today with strong fundamentals. Third quarter represents the 43rd straight quarter that we've grown our business. Looking ahead, we're steadfast in our commitment to becoming an even stronger company as we continue to improve our operational discipline through the end of this year and beyond.

Now let me get into some of the detail around our third quarter. First, as it relates to growth, total net revenue for the third quarter was $162.4 million, up 6.8% from the second quarter and up 17.4% from the third quarter of 2008. For the third quarter, currency fluctuations between the US dollar and the pound served as a tailwind on a quarter-over-quarter basis and benefited net revenue by $2.4 million. However, on a year-over-year basis, currency was a headwind and negatively impacted net revenue for the third quarter by $6.5 million.

Also, as a reminder, in Q2 of this year, we issued $2.4 million of service credits associated with service interruptions at our DFW facility. Cloud revenue for the quarter was $15.3 million, up 17.5% from $13.1 million in the second quarter and up 137.9% from $6.5 million in the third quarter of 2008. This represents the fourth straight quarter that our cloud business has grown in excess of 100% year-over-year. Our cloud business now represents approximately 10% of total net revenue, up from only 5% in the third quarter of last year.

Manage hosting revenue increased to $147.1 million, up 5.8% from the second quarter and up 11.5% from the third quarter of 2008. In terms of the macro economy, we continue to see signs of stability and optimism. We also believe the applications we host for our customers are critical and in down markets are the last to go and in up markets are the first place customers will spend their IT dollars. In terms of the macro environment and demand, we continue to see improving signs of stability and predictability. However, most companies are still operating based on an IT budget that was set earlier this year and IT spend is still conservative. So we are still growing at a rate that is less than half the rate in 2008 and roughly one-third as fast compared to our annual growth rates between 2003 and 2007.

Average monthly churn for the quarter went from 1.0% in Q2 to 1.1% for the third quarter. This compares to our monthly churn rate in 2006 and 2007 which averaged around 0.9% per month. In the third quarter of 2008, average monthly churn was 1.2% and as high in the fourth quarter of 2008 at 1.3%. Despite the challenging environment, we're able to improve monthly churn in the first three quarters of this year to 1.1% or better. Keeping churn rates in check demonstrates the value of fanatical support and our commitment to providing our customers with a world class customer outcome.

I can't emphasize this enough; the ability to keep churn rates in check is one of the best indicators of how Rackspace will benefit as the economy continues to stabilize. As long as the economy remains stable, we believe that churn will also remain stable.

Average monthly net upgrades remain constant quarter-over-quarter at a positive 1.2%. Our installed base growth is highly levered to an economic rebound and although we have not benefited from the installed base growth engine over the past year, we do expect this to boost our growth assuming the economy returns to a more normalized level. So as IT spending returns, we are confident that our installed base will help fuel growth early on in a recovery cycle. The average monthly install base growth for the quarter came in slightly lower at positive 1% compared with positive 0.2% in the second quarter due to the 0.1% change in churn.

Total server count increased by 2,386 units, a 54,655, up from 52,269 servers at the end of the second quarter and total customers increased by 10,141 to 80,944 customers, up from 70,803 at the end of the second quarter.

Moving on to profitability and the cost side of the business; adjusted EBITDA for the third quarter grew to $51.4 million represented a sequential increase of 6.9% and a year-over-year increase of 39.1%. Adjusted EBITDA margins, adjusted only for non-cash share-based compensation, were 31.7%. So no change compared with the second quarter and an improvement of 500 basis points from 26.7% compared to the third quarter of 2008.

As you may recall, we signed leases for our latest data centers in Chicago and Virginia earlier this year. The actual cash payments wrap to match our expected demand. However, the lease accounting rules under GAAP require us to straight-line the full amount for the rent expense. In the third quarter, we recognized approximately $1.9 million more in non-cash rent expense. Non-cash data center rent expense for the fourth quarter will be approximately $2.5 million and approximately $6 million to $8 million for 2010.

In Virginia we are in Phase IV of X that we are making cash rent payments, but still less than the full amount of the expense required by GAAP. In Chicago, we began paying cash rent in November of this year and expect to open operations in the first quarter of 2010.

Excluding the $1.9 million non-cash rent expense in the third quarter, adjusted EBITDA and adjusted EBITDA margins would have been higher. Net income for the quarter was $7.6 million, up 45.3% from last year and up 8.8% from Q2. Return on capital was 8.6% annualized in the third quarter compared with 9% in the second quarter. However, that number would have improved sequentially if not for the non-cash rent expense.

Total CapEx for the third quarter was $46.7 million, including $28.7 million for purchase of customer gear, $4 million for data center build-outs, $5 million for office build-outs and $8.5 million for capitalized software and other expenditures. Adjusted free cash flow for the quarter was $10.4 million; this includes an income tax refund of $7.5 million related to the 2008 tax period. In August, we provide a CapEx range of $165 million to $185 million. For the full year of 2009 we now expect total capital expenditures to come in closer to the full $185 million range including approximately $110 million for customer gear, $35 million for data centers, $15 million for office space and $25 million for capitalized software and other.

We will share our CapEx view for 2010 when we report the fourth quarter and full year 2009 results sometime next February. As of September 30th, we had $103 million of cash and cash equivalents on our balance sheet and access to an additional $194 million under our revolving credit facility. Recall that we repaid $50 million of our revolving credit facility this past July.

At the end of the third quarter total debt outstanding including our capital lease obligations was $168 million and net debt was $65 million. Net leverage at the end of the quarter was 0.35 times. We continue to be fully funded and have no plans to raise additional primary equity capital.

To wrap up, we are proud of the progress we made in the third quarter and our success year-to-date. We continue to differentiate in the marketplace given our commitment to servicing our customers and focusing on delivering a world class customer outcome. This competitive advantage is the reason we have been able to improve our results throughout the year. With that, I'd like to hand the call back over to Lanham.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Thank you, Bruce. The improvements made during the third quarter better position Rackspace as companies search for a trusted partner for their IT needs. The strategy behind our portfolio of services is straightforward; we utilize our suite of services to identify and provide the right solution for our customers. We serve businesses that want a trusted partner to provide them a world class technology service experience and these customers are willing to pay a premium relative to commodity providers.

We want to serve our customers so well that they remain with us for years and trust us to solve their critical IT needs. The portfolio consists of our traditional managed hosting offering at a dedicated environment, our private cloud offering and our complete cloud suite, cloud sites, cloud files, cloud servers and hosted apps. This services portfolio positions us as the hybrid hosting leader in the market and these technologies are being more widely adopted on a global basis.

The addressable market for our services continues to grow and presents us with opportunities. We are moving up market with our traditional managed hosting services to solve complex IT needs for our enterprise customers and we are using our cloud services to better serve simpler, more dynamic IT workloads. We are making good progress in the enterprise space today and now serve 40 of the Fortune 100 companies, up from 32 in October of last year.

Earlier this year we formed our enterprise segment that we call Rackspace Enterprise Services. We recently launched an additional target market initiative to create market power for our enterprise offering in a category where we already have an established presence. This initiative is now in its first selling phase so it's getting the market test.

The enterprise space is a big opportunity for us and our fanatical support message is resonating with large companies that have struggled to make IT work for them. Equally important to the better service experience we offer versus the traditional outsourcers is the value proposition based on the potential cost savings for the customer when they select us over IBM or HP. We don't always have the [brand] strength when going head to head against these large outsourcers. However, we do have a business model advantage that can deliver real value for these enterprise customers.

Quite simply, we beat the big outsourcers by delivering fast, flexible and reliable solutions delivered as services at a compelling cost. Because our business model is optimized around hosted computing, these larger deals are more profitable for us. And finally, our position as a leader in the emerging cloud space positions as a future proved partner that can help them take advantage of new computing models as they become ready for the enterprise. As we like to say, the cloud is for everyone, but not for everything. And our enterprise customers value our ability to lead them into areas they can begin to take advantage of today while planning for how they will use it in the future.

During the last 18 months we have made a strong push to become a leader in the cloud. Amazon is the pioneer and they deserve a lot of credit. Today we are the clear number two in the infrastructure as a service cloud market behind Amazon. Our challenge over the next year is to close the gap and shape our points of differentiation in the market place.

Adoption of our cloud business is growing at a high rate. We are making the right investments in this business. In the third quarter, we launched our cloud tools ecosystem portal, further illustrating our commitment to the development of an open cloud. Cloud tools is an online service for sharing tools, applications, and services built by Rackspace's strategic partners and independent developers on the Rackspace cloud.

We also made six key hires that bring significant product development experience for Microsoft and Yahoo and we are advancing our thought leadership through a new marketing campaign called, No More Servers. This campaign shows how companies of all sizes are embracing our vision that they should never again buy another server. They are instead buying computing as a service through the hosting and cloud computing market in which Rackspace is the world leader. We still have a lot to do to accelerate adoption and we are working on those initiatives now and will communicate them with you when they are ready.

The overall size of the market opportunity for Rackspace is hard to precisely calculate. However, we know that it is massive and growing larger at a fast pace. Computing is shifting to service providers like Rackspace and away from internal corporate computing models because it is cheaper, faster, and more reliable. We believe the future shift in the computing landscape will be bigger than the shift from mainframes to client server computing simply because there's much more computing in the world today.

Cloud computing speeds this paradigm shift in the way businesses plan, revision and consume computing resources. Rackspace sits in the middle of this structural shift and we believe that our point of difference in the marketplace will allow us to compete effectively. Rackspace's best position to win when one or more of three criteria are most important to the customer. First, when support and reliability are critical to the customer, Rackspace is in a good position to win. Most technology vendors take advantage of customers by not owning up to customer outcomes. So that's why we've been able to build our leadership position around fanatical support. Delivering world class support and customer outcomes is our competitive advantage. It is robust, hard to replicate and sustainable.

Second, Rackspace's ability to deliver the benefits of a dedicated configuration. Together with the scalability and cost efficiency offered by cloud computing or hybrid hosting is a key competitive advantage. Many customers will need a leverage of blend of managed hosting and cloud hosting solutions to power their applications and Rackspace is the only leading at-scale provider of the full hybrid hosting suite.

Third, customers choose Rackspace for a product high set of tools and streamline technical capabilities. We offer productized solutions. We are not a custom shop and we do not strive to be all things to all people. That means that we are able to be flexible in scale with our customer's needs so when time to market is critical, Rackspace is also well positioned to win.

Before we take your questions, we would like to share a few good wins with you. Fila, a leading manufacturer of sport and leisure footwear and apparel recently selected us for our industry-leading reputation. We host Fila's ecommerce website. Fila has been extremely happy with our customer service culture and our flexibility in executing on their changing IT needs.

On the international front, the UK Administrative Defense recently selected Rackspace to host its website and it's partner's websites. We currently host about 70% of the Administrative Defense websites. The MOD chose Rackspace based on our robust support offering of 100% network uptime guarantee backed by around the clock access to certified engineers and constant monitoring of potential threats and technical capability and the ability to solve complex IT needs, and beating out 18 other providers. Rackspace will consolidate the MOD and its partner's websites onto a single virtualized infrastructure to enable easier management, greater efficiencies and scalability.

In the Rackspace cloud the NBA's Boston Celtics franchise is using us to host social media applications for promoting interaction with fans. They selected Rackspace because our reputation for being easy to do business with and the fact that we are located in San Antonia, Texas, home of the world champion San Antonio Spurs.

Freshbooks with over 1 million end users today is the leader in online invoicing and bookkeeping for professionals. Freshbooks is a hybrid hosting customer, hosting applications on a dedicated managed environment. Using Rackspace's mail application and the Rackspace cloud for its need to rapidly scale its infrastructure, Freshbooks selected us based on Rackspace's emphasis on fanatical support. Freshbooks is continuing in its trend to offload non-strategic tasks and chose the Rackspace cloud to scale infinitely while focusing on their core business function; delivering high quality hosted bookkeeping services to business professionals.

To wrap up, we had a great quarter. We have a lot of work to do to become better and to create more value for our customers, Rackers and stockholders. We realize the unique opportunity ahead and we're working hard to innovate and become a stronger company to best position us to lead. With that, we're now ready to take your questions. Operator? Hello, Operator?

QUESTIONS AND ANSWERS

Operator

Yes.

(Operator Instructions)

We'll go first to Jonathan Schildkraut with Jefferies.

Jonathan Schildkraut - *Jefferies & Co. - Analyst*

Great. Thank you for taking the questions, congratulations on the quarter. I was wondering, Lanham, if you could dive a little deeper into the competitive environment. There's been a number of recent announcements about the launch of cloud hosting or a movement into the managed hosting field and from our perspective a lot of those announcements seem like new companies moving in the space. From your perspective you kind of see the business on a day-to-day basis. Are some of these announcements people that you've previously competed with that we're just starting to hear about, or just starting to highlight a different element to their business?

Also I was wondering if you could give us a little bit more color on the enterprise business. Previously you kind of broken out the percent of revenues enterprise versus SMA and I'd like to hear that again. And then finally, sorry to do this, it looks like you lost a couple of managed hosting customers and I was wondering if that was pure loss or whether you saw a shift into the cloud. Thank you.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Let's start with the competitive environment first. In our prepared remarks, we talked about the three conditions where we compete the best. The first being that when we talk to -- we serve businesses and when businesses care about having a world class service experience, when support matters in terms of how the technology is delivered, we are very competitive.

Second, the combination of our service suite, the combination between our singleton architecture of managed hosting, our multi-tenant architecture and cloud hosting; the combination of those suites creates hybrid hosting and when that is important to customers in the marketplace, we win and compete well.

And then lastly, we are a productized shop. For us, enterprise does not equal custom and so we work on building out the right tools and service sets for customers. And so today with all the announcement and the interest in cloud specifically, we feel like that interest validates the category, it draws more attention to the category and what's happening. As a leader in the category today, any attention given to the category we believe [inures] to our benefit. With the services we provide, we allow an extremely fast time to market for our customers and we are a productize shop. So the announcements and the discussion around cloud we believe is good for us and the marketplace. It also highlights our need to create a differentiated position.

The cloud's going to come in a lot of flavors; there's going to be a lot of choice out there. The point of different that we want to reinforce and carve for ourselves is the one for businesses that want a world class service experience, that want a partner who's going to own the technology outcomes; that's when we want the marketplace to think about us. Right? We do not compete on price. We are not a commodity provider. There's going to be selection of the market that chooses that commodity outcome and for people that are most concerned about that; we're not the one for them.

We have a disciplined approach where we are trying to create a lot of value and so for those customers that are willing to pay a premium that are businesses that want a world class service experience, this is where we will thrive. So that's the answer to your first question.

The second question in terms of enterprise percentage of revenue, just to acquaint everyone on the call with our history; we started out primarily as an SMB company. By customer count today, we still remain an SMB company. When you look at revenue, however, we are much closer to 50-50. So that the high end of our business, those customers paying us about a couple hundred thousand dollars a year; that's just a little south of 50%. When you look at the lower end of our business, those customers paying us around $20,000 a year; that's a little over 50% of the business. That is changing, Jonathan.

We are currently today experiencing a higher growth rate in our enterprise business than we are in our SMB business. We talked about a couple of the wins here on the call today. We continue to see a ton of opportunity out there in the enterprise space, specifically when we look at customers that come in interested in subscribing to a service and solutions set that is millions of dollars a year. We commented on this development in some of our earlier calls and that during this recession it's created a tipping point and a new consideration set for CIOs. That trend continues. We continue to be part of many interesting conversations that a couple years ago our company was not in the consideration set. So we believe that trend will continue. We mentioned some of the investments we've made on this call to keep working there and so we will continue to do it.

And our main point of difference here when we look at our traditional competitors, the IBM and EDSes there is we have a business model advantage over them. We are cheaper and faster than they are. We provide a lot of flexibility that those traditional outsourcers cannot provide. The reason for this is pretty straightforward; we were purpose built to provide these services and those companies were not. So that's the answer to the second question.

The next question was about the managed hosting customer count. And you almost got the whole answer there in your question. Okay, so specifically we have a portfolio approach. One of the things we've talked about in previous calls is within our managed hosting business, we are moving up market to solve more complex IT needs, which is reflected in the enterprise comments I made just a minute ago.

The second part is that we are using our cloud to serve simpler, more dynamic IT workloads. We have had an active campaign in the Company to migrate single server customers off of single tenant architecture onto our cloud architecture. The reason we are doing this is because it's a better way to serve those customers.

During the third quarter, we migrated approximately 350 single server customers out of our managed hosting number on the key metrics page and into the cloud customer number on the key metrics page. So we will continue to follow this strategy because it's a better way to serve them. The important thing -- a couple things to draw out for you here; number one, if you look at our server count, our server count went up in the quarter about 5%.

So that in terms of building models and doing the analytics and running regression analysis, the correlation between our server count and revenue growth is extremely high. In fact it is higher than the correlation between customer count and revenue growth. So that when we look at the number of IT workloads we're running and how the business is performing, we focus to some degree on server count over customer count. This is also reflected in the average revenue per customer and the average revenue per server in the business. So that when we run the metrics and do the analysis around those trends what we see is that in our managed hosting business the average value per customer is climbing, the average value per server is climbing.

This reflects the fact that we are moving up market in solving more complex IT workloads and so that the customer count number that you're referencing reflects this portfolio approach; that we are moving up market in managed hosting, that we are using our cloud technology for one factor to serve the single server customer in our managed hosting business. The single server customers in our managed hosting business constitute about 5% of our company's revenue today.

Operator

And we'll take our next question from James Breen with Thomas Weisel Partners.

James Breen - *Thomas Weisel Partners - Analyst*

Thanks. Just with respect to the financials, it looks like when you add back in the 1.9 for the non-cash expense, margins went up sequentially in the face of a slowdown somewhat in the revenue because of the economy. Could you just talk about the relationship between the revenue growth going forward if we do see a recovery here? How can we think about margins moving up in to the current levels? Thanks.

Bruce Knooihuizen - *Rackspace Hosting, Inc. - SVP, CFO, Treasurer*

This is Bruce. From a margin standpoint, in our managed hosting business we still have many opportunities to continue to scale as we continue to grow the business. Now I think you've pointed out a good relationship to think about, particularly in the shorter run that as the revenue grows faster, that could put downward pressure on our margins. As revenue slows down, that relieves some of the pressure on the margins.

I would like to take note though that in the third quarter really it was no small feat for us to keep our margins constant with what we saw in the second quarter despite having that large non-cash rent expense. Keep in mind what effectively we're doing from an accounting standpoint, even though this is not from a cash standpoint. From accounting standpoint, we're paying for the full effect of those new data centers, even though we haven't really begun operating the Chicago data center and have just started over the last quarter-and-a-half to operate the Virginia data center.

And then obviously one of our key metrics, the return on capital would have improved sequentially had we not had to recognize this expense as well. So when you think about our cost structure, the number one key on our margins will be our rate of growth; the higher the growth rate in the short run it could put pressure on our margins. We still have opportunity for scaling in our managed hosting cost of revenue side and in our G&A side those are primarily fixed type costs as well. So as the business continues to grow, we'd expect scaling in there as well.

James Breen - *Thomas Weisel Partners - Analyst*

Great, just one quick follow up to that; you had guided toward the high end of your CapEx range for the year. That's always been a bullish indicator I guess about what you see going forward. Can you just talk about sort of the overall trend in the environment right now?

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Well I think in terms of outlook, a couple things that we would highlight for you; number one, the conversations we have today with customers relative to a year ago, relative to earlier this year are a whole lot better. So from our perspective, in the macro economy things have certainly stabilized. As we talk to customers today no one is proclaiming they are cutting IT budgets.

A year ago I felt like most customers we were talking to were saying my IT budget's under pressure, and they were in a mode of reducing IT spend. Today when we talk to customers what we hear back is they're not cutting IT spend anymore, so from that we draw a conclusion that things have stabilized. Our customers are still in their planning cycle, so we will see to what degree they come out in terms of either keeping their budgets flat or even some of them increasing their budgets.

So from an outlook point of view, the way we feel today we feel like this year we have accomplished what we set forth to do so far. We wanted to grow the business, we wanted to increase our margin and we weren't going to have any burn. We have done all those things. When we think about next year, we are thinking about how to better position ourselves competitively. We believe the growth opportunities ahead of us are substantial. We think we are well positioned to a rebound in the economy.

As the economy rebounds and IT budgets start to grow again, we believe we will get an uplift in our growth from our installed base growth, which historically has provided 30% to 40% of our growth as a company. So in normal expansionary times we believe our installed base growth will increase again. So we are feeling that we are in a much better spot than we were a year ago. The body language when we talk to customers is a whole lot stronger. We've worked hard this year to achieve our objectives and position ourselves competitively to win in the marketplace. So we are going to continue running this play.

Operator

Okay we'll go next to Chris Larsen with Piper Jaffray.

Chris Larsen - *Piper Jaffray & Co. - Analyst*

Yes, so I wondered if you would talk a little bit about incremental revenue and the mix between new customers and existing customers and how that played out. It looks like most of the incremental revenue came from new customers but I understand FX may have played into that as well. Talk a little bit about that and when you might think that one of the big drivers of your revenue growth to top line growth in '08 and '07 was existing customer growth and how -- where you feel that you're existing customers are in terms of getting ready to spend more. Thanks.

Bruce Knooihuizen - *Rackspace Hosting, Inc. - SVP, CFO, Treasurer*

Yes, Chris, this is Bruce. Just in terms of the business from new customers versus existing customers. When you look at our existing customer base, customers that are still with us actually grew. The net installed base grew by 0.1% this quarter, but the customer that stayed with us are actually up 1.2%. The net being the churn of 1.1% that gets reduced. And so from that standpoint, we are seeing growth from some of our existing customers.

If you look back in history 30% to 40% of our growth rate has come from our existing subscriber base. As we look at the economy and we look at the things we hear from our customers, things they tell us about, when they're either reducing their services or leaving our company, much of it sounds as though it's related to the economy and we're seeing close relationships between the economy and the growth of the installed base.

We talked a lot about the growth opportunities going forward. We talked a lot about the economy and certainly our expectations are when the economy turns around that the installed base will be a catalyst in our growth.

Chris Larsen - *Piper Jaffray & Co. - Analyst*

For the statement do you have a sense for capacity utilization amongst existing customers? I know you were on the campaign in the fourth and first quarter of a year ago to sort of help customers maximize. Is there a sense that you can give us in terms of how much of their -- how much wiggle room they have left in their existing services?

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Sure. As we talk to customers about running their IT workloads and solving their needs, a few things come up. We have certainly helped customers right-size their configurations and solutions with us during this recession. This has helped customers save money. It's made their deployments more efficient and effective. We believe we've done a good job on this in terms of taking care of our customers. We also see it as an investment in them. So at this point in time across a broad base of our customers, we've already done that' work. So now the question becomes at what point does their IT budget expand? Because there isn't a whole lot of slack in the system, they will therefore add more solutions with us.

Okay, so our feeling on this, we aren't in the forecasting business, but I suspect IT budgets start to expand when businesses feel like there is a sustained recovery underway. As that feeling becomes more present, we will have a lift up in our install base growth again. We saw this before in our business after 9-11 and the recession associated with that. We believe we will see it again this time. We think we've done a good job taking care of our customers and right-sizing a fit. Our average share of IT spend for our customers is pretty low. So that as their IT budgets start to expand, not only should we get a lift from that but we still have more opportunities just to do a better job and get a bigger share of their IT spend today?

Bruce Knooihuizen - *Rackspace Hosting, Inc. - SVP, CFO, Treasurer*

The other thing to keep in mind on that installed base is that when you think about the installed base versus new customers, there's a lot higher flow-through in terms of their revenue. We don't pay nearly as much in terms of our sales and marketing efforts to grow our installed base as we do on our new customers. If they've been a customer for a period of time, the longer customer -- longer the period of time someone's a customer with us, the more profitable they are with us. And so there's tremendous flow-through from our existing base as well.

Operator

(Operator Instructions)

We'll go next to Simon Flannery with Morgan Stanley.

Simon Flannery - *Morgan Stanley - Analyst*

Thanks a lot, good afternoon. Another impressive growth in the cloud platform this quarter. As you get more scale in cloud, how are you thinking about the economics of that product as compared to the managed hosting? What's going to be the impact on the overall margin as this scales and on the return on capital; overall company as well? Thanks.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

We think about cloud and economics a couple of different ways. In terms of understanding in the long run what type of returns will the cloud generate for us. If you look at return on capital, the calculation is return equals margin times capital terms. There are many attributes of the cloud that tell us we should get a higher capital turns on cloud than we do in our traditional single tenant managed hosting business. This is driven by the ability to receive a higher -- utilize a higher level of the base compute itself. So we like our chances on improving the economics of the business from a capital terms perspective.

The second component of that return calculation is margin. It's still early in the game for us for margin on cloud. Some parts of our cloud we are doing real well on margin and other parts we aren't. Now this is a reflection of fact that is drawn real fast. We're still making high investments in the cloud so that we can scale it and we're only a little over a year-and-a-half or so down the path here.

So that we want to scale cloud, it's just right from a margin point of view, but right now our number one priority in cloud is not margin. Our number one priority in cloud is to carve out a differentiated position so that we can compete in that marketplace. We believe the growth opportunity in cloud is massive. So right now our priority is making sure that we are one of the leaders, that we reinforce our fanatical support point of difference and in the long run create business and service set here that is really valuable to our customers and stockholders.

Operator

And we'll go next to Bryan McGrath with Credit Suisse.

Bryan McGrath - *Credit Suisse - Analyst*

Yes, good afternoon. Couple questions on the metrics; Lanham, when you're talking about the migration of the single server managed hosting customers to the cloud, does that have any effect on the installed base growth metric? And then on the churn, is there any way you can see better estimates what percent of the churn would have stemmed from some of the outages of Q2? Thank you.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Sure, okay so the first part of the question is what percentage -- sorry the second part of the question is what percentage of the churn comes from outages? All right, and then the first part of the question was within our metrics, specifically the managed hosting metric, customer metric going from managed hosting to cloud and how does that manifest itself in this page we've sent you. Is that correct?

Bryan McGrath - *Credit Suisse - Analyst*

Right. I mean does that provide somewhat of a headwind to the growth in the metric, if you will? I just wanted to clarify that.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Okay, well I think that with churn -- let's deal with the outage issue. I mean obviously any outage we have is entirely unacceptable. Okay and this is something that our customers expect more out of us and we expect more out of ourselves. So an outage absolutely harms customer relationships and therefore makes customers more susceptible to churn. When we look at the data today and we see the churn moving up -- I mean it's basically flat, but it moved up a little bit, the outages absolutely had an impact in shaping customer perception. Okay, and so I think that when you look at the numbers, the outages have an impact we would say yes.

We would also say that we have an extremely loyal customer base because we have spent so much time and investment serving them well. It's during an outage that fanatical support makes all the difference. That we can tap into that relationship asset with our customers and so as a result we can have an outage but the churn numbers really don't move that much. So churn absolutely shapes how customers feel, sorry an outage absolutely shapes how customers feel about us but it didn't show up here in terms of driving big churn.

Bruce Knooihuizen - *Rackspace Hosting, Inc. - SVP, CFO, Treasurer*

In terms of the numbers and the shifting from managed to cloud, certainly when you look at our metrics page and you look at the gross side, the customer side the cloud numbers grew quarter over quarter by about 10,000 new customers. When you think about the 300-and some customers that transferred from managed hosting over to cloud, did it have an impact? Certainly it had an impact but as you can see it's 300 out of the 10,000 difference. So what we're really seeing in the cloud business is a growth in cloud service and it's not really being fuelled by folks leaving managed and going over to cloud.

Bryan McGrath - *Credit Suisse - Analyst*

Got it. Thank you very much.

Operator

We'll go next to Winston Len with Goldman Sachs.

Winston Len - *Goldman Sachs - Analyst*

Thanks for taking the question. So maybe just a touch on the recent [cloud] computing hires. You've talked about some of the high profile guys you got from the industry. If you could just give a bit more detail around the initiative; these employees who are working on. And given the rapid development in the cloud, how quickly do you think the [monthly] cloud hosting will shift the [other] customers at single server deployments? And maybe just a touch on the Dallas data center issues again. Can you talk about any longer term initiative you have to mitigate operational risks there? Thanks.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Okay, let me just recap that. First question is talk a little bit about cloud computing, the new hires we've made and the initiatives they're working on?

Winston Len - *Goldman Sachs - Analyst*

Yes.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Second is as cloud continues to develop how will it shift our customer base? Third, what are we doing in DFW to mitigate the problems we've had there?

Winston Len - *Goldman Sachs - Analyst*

Yes.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Is that all of it?

Winston Len - *Goldman Sachs - Analyst*

Perfect.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Okay, thanks. Well, cloud computing -- our business is changing with cloud computing. Cloud computing fundamentally increases our effectiveness as a company and requires some different skills in new -- it requires us to build new muscles relative to how we've built the business in the past. So the cloud business provides us an opportunity to create a set of intellectual property that we haven't had in the past. When we think about the cloud, we're going to differentiate around serving businesses who are willing to pay a premium for a world class technology service experience. We call this fanatical support.

In order to do that on the cloud, there are some technology sets that we need to create. There's some technology sets that we need to integrate with others and so we are working to build an open cloud. We had talked about our ecosystem in this call that we're working on with cloud. So some of the new hires here that we've mentioned in this call, these Rackers are working on the development of this ecosystem. They're working on this intellectual property within our cloud. They're working to make this world class service experience a reality in this new technology set because this is about the software we have to create to do it. It's about the customer experience and the user understanding we have to have to provide this service. So that's what these folks are working on. It is very exciting stuff.

The second part of your question; how is cloud going to shift our customer base over time? We believe that we are part of a revolution in technology. That instead of customers having to do it themselves, and instead of customers buying technology from vendors who do not take responsibility for the customers technology outcome, we want to provide computing as a service and take responsibility for the services we provide to our customers. This revolution fundamentally changes how companies are going to buy IT.

So that over time our ability to describe for you who's running on singleton architecture and who's running on multi-tenant architecture is going to blur pretty quickly because the reality is we're going to have the same customer by name, the same customer's logo in both parts of the service set. It's more driven by the IT workload the customer wants us to run than it is the attribute or any generic factor of the customer themselves. So when we talk about having an active campaign to look at our single server business and migrate those customers to the cloud.

The reason we're doing that is it's a better way for us to serve them, it helps us elevate our output for them, it helps us take responsibility for what they're doing. So we will continue to do those things and what's going to happen here is some of your IT workloads are going to stay on a single tenant architecture, other of your IQ workloads are going to be better served through a multi-tenant architecture and the combination of these we call hybrid hosting, we believe we are a leader in this practice in the marketplace. So we expect this integration of the services to continue.

In terms of DFW and mitigating the problems we've had there; this is a number one priority for our company. We've actually made quite a bit of progress since last summer. We are in the middle of a multi-million dollar investment campaign there. We have talked to our customers about it. We have already improved the reliability of the facility and several parts of the facility significantly. What happened to us most recently was we had a failed maintenance. That failed maintenance caused an infrastructure problem for a small portion of the data center for about five minutes. This five minute interruption caused some significant problems for our customers. This is one of those things that we take full responsibility for and we own it.

So we had some customers that we were able to recover in a matter of minutes. Other customers, though, had an impact that lasted hours. This is one of those things that we feel awful about. So in terms of mitigating this and doing everything we can to make sure it doesn't happen again, we have already made investments in monitoring. We've already made investments in talent and in our team. We've already made investments in processes. Those investments will continue and we won't make the mistake we made a week ago in that failed maintenance again.

Winston Len - *Goldman Sachs - Analyst*

Great, thank you.

Operator

We'll go next to Jonathan Atkin with RBC.

Jonathan Atkin - *RBC Capital Markets - Analyst*

Yes, so a couple questions. One is you just spoke to the hybrid managing cloud. How early are we? Very early innings or is the adoption already fairly routine among your customers? And then for Bruce, the managed hosting revenue grew more than usual and I think you said -- you sort of implied that the minority of that -- well, maybe if you could just say how much of that was up selling existing customers versus new sales? And then on the cloud side, it sounds like the small part of that growth is migrations but if you had to confirm most of that was new sales versus migrations over from managed? Thanks.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Okay, let's start with the short one first. Yes, the cloud growth is primarily new customers. In terms of the adoption rate of hybrid hosting, the interaction between our single tenant and multi-tenant architectures, it is in the early adoption phases. In some ways we believe that our single tenant architecture, even though we're a company that's over 10 years in its development is still in its early adoption. So that as we think about the market adoption of our services, hybrid is certainly very early in the game. Cloud is very early in the game, managed is later in the game but we do not believe it is mature. So that therefore hybrid is something on everyone's mind. All of our customers want to talk to us about the promise and capability of hybrid hosting. So hybrid in its adoption cycle is still early in the game. We believe the promise of hybrid is significant. We think we're very well positioned to capitalize on it.

Jonathan Atkin - *RBC Capital Markets - Analyst*

Again, on the -- go ahead.

Bruce Knooihuizen - *Rackspace Hosting, Inc. - SVP, CFO, Treasurer*

Do you want to rephrase your question?

Jonathan Atkin - *RBC Capital Markets - Analyst*

Yes, on managed hosting, what drove the significant growth sequentially in the hosting revenues? Was that up selling existing customers or taking on maybe a greater mix of enterprise?

THOMSON REUTERS

Bruce Knooihuizen - *Rackspace Hosting, Inc. - SVP, CFO, Treasurer*

Well, it's really a combination of both but when you look at the existing customer base net of churn; that part of the business grew 0.1% over what it was the previous time. So it's really effect of new customers coming on with new services, but having said that we have a number of customers that have increased their business with us. It's just that their business is offset by some customers that downsized their business and it was offset by customers who left the business. So on the net basis, our installed base growth grew by 0.1%.

Jonathan Atkin - *RBC Capital Markets - Analyst*

Thank you very much.

Operator

And we'll go next to Steve Salberta with Boenning and Scattergood.

Steve Salberta - *Boenning & Scattergood Inc. - Analyst*

Hi, guys. When you're seeing customers migrate from the managed hosting, are you getting the same amount of revenue out of those customers when they move over to cloud?

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

No, we are not. Today we are not. I'll tell you the reason why. Our service levels on our single tenant architecture in terms of how we structure our teams, the problems we solve today are higher in most instances than what we do on a cloud. So that the cloud today is a service level that is a bit below our traditional architecture when you get into our cloud server's offering.

If you look at our cloud sites offering, here we have a fully bundled stack and we are providing a support experience on that stack. So that with most of the customers that we are migrating today out of our managed hosting business, the single server customers, as we migrate them to cloud are paying us less. In the future, as we add additional service levels on the cloud, that math will change and tighten. What we would point you to is that the most important metric to evaluate here on the value of our managed hosting business is back to the servers and the revenue per customer.

Okay, so that what we are trying to do is we are trying to have our managed hosting business, our single tenant architecture solve more complex IT needs. And so that the revenue per server is growing, the revenue per customer is growing. We believe this reflects the value that we are adding to those customers in solving those needs.

Steve Salberta - *Boenning & Scattergood Inc. - Analyst*

As you see customers migrate to the cloud and the large interest in the cloud, should we see the growth in managed hosting customer count plateau over the next few quarters?

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

I think this gets a little bit back to -- we'll see how it all plays out. What we've experienced today is we migrate these managed hosting customers to the cloud, you're seeing the revenue per server in the cloud go up. And so to say that managed hosting customer acquisition rates and the aggregate number of additions in a managed hosting business is going to change, yes I'm not sure I'm ready to opine on that or forecast on that at the moment.

What we are sure that we want to look you in the eye and tell you is that we are focused in our single tenant managed business of moving up market. This is demonstrated by those revenue per server and revenue per customer metrics we just talked about because we are more concerned about aggregate value creation than we are about managed versus cloud customer count. It's also one of those things that as we have cross selling taking place between our managed and cloud businesses some of these metrics are going to start to blur together.

Steve Salberta - *Boenning & Scattergood Inc. - Analyst*

Great, thank you.

Operator

We'll go next to Chad Bartley with Pacific Crest.

Chad Bartley - *Pacific Crest Securities - Analyst*

Hi, thanks for taking the question. Back on the topic of competition. Can you talk about the general pricing trends and dynamics on the cloud side and then potential pricing pressure? I'm specifically just curious about recent news in Amazon if it's going to lower it's pricing on EC2 and curious how that may affect you in the market.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Sure, okay. We believe that the way the cloud market's going to develop one part of it is going to be commodity, one part of it is going to be service oriented. Amazon plays squarely in the commodity space. So that as they compete there they want to drive down price. When we talk about why we win, the first reason we win is when support matters. When businesses care about having a service experience and they're willing to pay a premium for us, for that experience. So that if you look at Amazon cutting their price versus where we are in the cloud, we think this reinforces that point of difference; that we are not a commodity, we're a service provider. We're a service company and you're going to pay a premium to have that service experience.

The second part gets back to this full suite. We have a combination of a multi-tenant cloud and a single tenant architecture. This hybrid hosting is something that sets us apart with those square-on cloud competitors. They don't have that. The third is that we have a productized tool set. We can mix and match these services together and the cloud competitors don't have that either. So that as we look at our company today, we are standards based, we're productized. We win when support matters and businesses are willing to pay a premium. We win when having a full suite and being a future proof partner matters; we call this hybrid hosting. And we win when the productized tool set matters. So the cloud's going to evolve into lots of flavors, we aren't worried about the commodity part of that market. Somebody else is going to win that. Okay? And I'd put good money on Amazon winning it.

Chad Bartley - *Pacific Crest Securities - Analyst*

All right, helpful. Thank you.

Operator

We'll go next to Rajesh Ghai with ThinkEquity.

Rajesh Ghai - *ThinkEquity LLC - Analyst*

Yes, good afternoon. I just wanted to get your sense on the impact on margin and ROC of [due dynamics], number one the potential user for a larger enterprise that ex salesforce going forward as you compete with the likes of HP and IBM and go after the large enterprise market. And number two, your recent announcement about the user brand equipment specifically from [ENZ] and Netapp for [Sandanez] as opposed to the use of I think commodity cheaper, [by product] that you used in the past.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

We had a bad connection. Could you repeat the question? I'm sorry.

Rajesh Ghai - *ThinkEquity LLC - Analyst*

Sure. Yes, I just wanted to understand the potential impact on margin ROC of due dynamics, number one. The potential user for larger enterprise that has excess force as you compete against HP and IBM, as you said during the call. And then number two, the use of branded equipment from EMC and that as basically as you mentioned in recent press release; what was the use of cheaper white box equipment in the past?

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Okay, okay, got it. So the first part of the question is the impact on margin and returns as we win more enterprise customers. We eluded to this a little bit in our prepared remarks today that based on our productized set of services, as we move up market these enterprise opportunities drive significant value for us. That value shows up in terms of margin in the returns. Basically what's happening here is for us enterprise does not equal custom. We have developed a general purpose set of services. These services we can sell to SNBs, we can sell them to enterprise and what happens is because we're serving so many customers relative to other competitors in the marketplace, we have an economies of scale advantage over them.

We have a purpose built machine to serve thousands and thousands of customers. So that as we increase our addressable market and move into enterprise, this drives the value for customer up. It drives the value per serve up, which reflects that we are adding additional value to those customers. So the net result of that is that the aggregate profit that we can yield on an enterprise customer is typically many times larger than what we can yield on an SNB customer. This is simply reflected in that we are doing more work for them. We have a productized disciplined approach and so we are able to replicate these activities for enterprises on a larger scale.

Rajesh Ghai - *ThinkEquity LLC - Analyst*

Would you need to hire more sales people in order to go after that more opportunity?

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Certainly as we grow, we will hire more sales resources and capability. Even during this downturn in the broader economy we've been hiring sales people as we've gone along. So we will continue to do that. Certainly the sales model to sell enterprise customers, it's going to be a little different than how we've done it for SNBs. So we are experimenting and working on that model today. We've had some early success and we've had some things that make ourselves ask questions.

Okay. So we're still working to figure that out, but today within our managed hosting business, our enterprise business is the fastest growing group. Okay, so we are having a real traction there. Your next question was the use of branded equipment and its potential impact on margins and returns. You talked about specifically EMC and Netapp and I can't remember if you named another brand --

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Rajesh Ghai - *ThinkEquity LLC - Analyst*

No, that's it.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Okay, so the first point is that when we are pricing our services, we follow a disciplined pricing tool based on EBA. Every opportunity that we win we price in our cost-to-serve as well as our cost-to-capital. So that we want to make sure we are adding value with each customer that we win into our portfolio. We are constantly looking at what we can do to better serve our customers, what we can do to increase our economics, how much of that economic outcome we can pass along to customers to better serve them to create a virtuous flywheel for our customers and our stockholders.

All right, so internally when we look at the type of equipment we are using, we take a disciplined approach so if there are ways for us to get the performance we want out of a viable alternatives to the way we're doing it today, we will consider that, look at it, study it and if it's the right thing to do for our customers and Rackers and stockholders, we'll do it.

Rajesh Ghai - *ThinkEquity LLC - Analyst*

All right, thank you.

Operator

And we'll go next to Erik Suppiger with Signal Hill.

Erik Suppiger - *Signal Hill Group - Analyst*

Good afternoon, congratulations.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Thank you, Erik.

Erik Suppiger - *Signal Hill Group - Analyst*

First off, in terms of the hybrid customer; how many of those customers are -- have applications that leverage both the cloud and the dedicated platforms or is it mostly just they have applications that are running in one and in the other?

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

We haven't gotten into that kind of detail, Erik. Certainly every customer in hybrid, and by definition it's hybrid, they're in one or the other at least. And some of those apps will have web heads, want to have web heads on single tenant architecture as well as burst into multi-tenant architecture. So the answer is it's going to be a little bit of combination and at this point in time, we aren't breaking out all the details around that.

Erik Suppiger - *Signal Hill Group - Analyst*

Okay, but is that a growing segment? I mean you talk about that being a key advantage doing both but --

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Yes.

Erik Suppiger - *Signal Hill Group - Analyst*

Is it that they actually leverage both simultaneously?

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Yes, what's happening is -- the answer to your question is yes. Every customer has this on their mind because it offers the promise of the best of both worlds. Some of the control of the single tenant, some of the economies of scale of multi-tenant. So the vast majority of our customers that we're visiting with and helping them do their IT plans for next year and figuring out their scaling requirements, etc. hybrid is something that is something that is absolutely on their mind that is a consideration set and that customers want.

Erik Suppiger - *Signal Hill Group - Analyst*

Okay. And then you talked about taking up, ideally taking up the service contribution for some of the cloud customers. Do you -- when do you see your average revenue per cloud customer going up, or is that a direction that you think that the service (technical difficulty) would take you?

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Well, if you look at it quarter-over-quarter I think it is actually up a little bit. It's up slightly. So I think right now -- it's a good question. It is further down our priorities in terms of our thinking today. We are most concerned with traction, establishing a differentiated leadership position and making sure that we build a valuable long-term model over there for customers, Rackers, and stockholders. Part of building that valuable long-term model will be to address the revenue per server or the revenue per customer metrics in cloud. I'm just not in a position today where I can give you a forecast on the adoption of those metrics and what the trend will look like.

Erik Suppiger - *Signal Hill Group - Analyst*

Okay and on the enterprise segment of your business, what have you done with the sales force? Can you comment a little bit about just how much that's grown in the last couple quarters or how much you think that grows going forward in terms of the sales force?

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Yes, we don't want to get into specific headcount thoughts and stuff, just from a competitive point of view but basically we do have some contextual data that we can share with our stockholders. Okay? The first is that it is the fastest growing piece of our managed hosting business today. What's driving that is the business model advantage that we talked about in our prepared remarks earlier on this call.

We have additionally made investments in that business by creating an enterprise segment, which we call [REZ]. We are serving those customers better and working to tailor our services in a productized fashion for them. We've increased our sales coverage for those customers because the sales process is just a little bit different than the way we've historically gone to market and we mention this a little bit earlier on today's call. So we believe that our share of IT spending in this customer base is relatively low.

We believe we are serving them well. We can't do everything that IBM can do for them, but when we are in the mix we'll typically be 30% to 50% cheaper than IBM. So if CIO's are considering how to run their infrastructure today and are looking for a partner, we are a very compelling proposition for them. We believe this trend will continue.

We believe there's more we can do for these customers in terms of rolling out additional productized services for them as we pull those services up from our SNB base. We think this gives us economies of scale because we are purpose built to run this type of infrastructure where our competitive set there the IBM's and traditional outsourcers are not purpose built to run this type of infrastructure. So we believe we have a business model advantage and we will continue to tweak and make investments around our sales capability to there to figure out the optimal way to do it.

Erik Suppiger - *Signal Hill Group - Analyst*

Okay, very good. And then lastly, just on the currency exchange rates, Bruce, did the -- can we assume the revenue upside from the currency exchange rates relative to Q2 were offset by higher expense for commiserate with the revenue upside?

Bruce Knooihuizen - *Rackspace Hosting, Inc. - SVP, CFO, Treasurer*

Yes, that's right. Our -- as our revenue flows so do our expenses because we've got full operations over in the UK where we pay people on the pound, we have a data center over there. We pay all those expenses on the pound. So the net impact to us when you get to the bottom line is really just the marginal impact of that change.

Erik Suppiger - *Signal Hill Group - Analyst*

Very good. Thank you.

Operator

And we'll take our final question from Colby Synesael.

Colby Synesael - *Kaufman Brothers - Analyst*

Great, thanks for fitting me in. I just wanted to talk about EDS and IBM a little bit. You talked about competing against them, I'm just curious if you're just talking about them in the traditional sense; are you seeing them more as they focus more perhaps on offering a managed hosting and cloud-based solution? And the second part of that question; what's to prevent them from simply throwing more money and resources towards managed hosting and cloud computing? If in fact that becomes a very large component of growth for IT services, I would think that they would be able to offer a fairly competitive product once they choose to actually dedicate the effort to do so. Thanks.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

Sure. The first part of the question in terms of how we compete with IBM and EDS, what we are seeing out there; I think it's more about managed hosting and Rackspace, about our services becoming relevant for the traditional outsourcing customer than it is any other factor. In traditionally outsourcing, IBM and EDS and others who pioneered that industry showed up and took over one's IT department. They took over everything. So this is a little bit like being a department store and you have all these different sections inside the department store.

What our company does is we are not the whole department store, but we are absolutely the specialist in one section called web infrastructure. And today more and more computing is migrating to the web. As it migrates to the web, we are a purpose built service machine to take care of these computing needs for these customers. For IBM or EDS to really compete in this marketplace I think is difficult. The reality is we're over ten years down the experience curve; everything we do is about providing fanatical support. We have fanatical support creating a world class service experience in our DNA around here. Those companies don't.

The other thing I'd say, it is really hard for somebody's who used to serving the Fortune 50 to go down market and slug it out with us in SNB-land. We have built an expertise in this and understand how that marketplace works. For years I feel like those companies have been trying to figure out how to sell to an SNB. We believe it is far easier for us to build on our SNB base and cheat up and encroach upon midsized enterprise and enterprise customers than it is for somebody who's used to selling Fortune 50 customers to go down market and compete with us. So far our experience in our enterprise market is that we are well positioned to compete with those companies.

Colby Synesael - *Kaufman Brothers - Analyst*

Okay, and, Lan, if I could just get -- I'm sorry if I interrupted you. I just wanted to get a follow-up in there. You mentioned I think in your prepared remarks potential partner opportunities with some of those companies, was that correct? And if so, can you just expand on that a little.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

No, sir, that is not correct.

Colby Synesael - *Kaufman Brothers - Analyst*

Okay.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

We believe that we are specialist. We are following a cause to be recognized as one of the world's greatest service companies. We think we have found the right vein in the marketplace and so we're going to continue to execute and build our model. Now look these are -- when you talk about a company like IBM, they are a heck of a brand, they're an American institution and juggernaut, right. So for us to compete with them, we have to be something very different. We have to be something that is compelling and differentiated. This is what fanatical support provides for us.

Colby Synesael - *Kaufman Brothers - Analyst*

Okay, great. Thank you.

Operator

And as there are no more questions, I'd like to turn the conference back over to Mr. Napier for any closing remarks.

Lanham Napier - *Rackspace Hosting, Inc. - CEO, President, Director*

I want to thank all of our customers that place their trust in us every day. I want to thank Rackers that volunteer their best to make fanatical support real. And I want to thank our stockholders for sticking by us. We are focused and working hard to build a company that is recognized as one of the world's greatest service companies. We believe we are entering a magic moment in our company's development. We believe we're part of a revolution, that we are a leader in this revolution of computing as service. We think this is a game changing event that is going to transform how companies on a global basis consume computing that is a structural shift in the economy, and we want to do our part to make it real and easy. So thanks to all the Rackers for making it happen. Take care.

Operator

That does conclude today's conference. We thank you for your participation.