FINAL TRANSCRIPT

Thomson StreetEvents℠

RAX - Rackspace Investor Conference Call with Merriman Curhan Ford Equity Research Analyst

Event Date/Time: Jan. 29. 2010 / 4:00PM GMT

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

CORPORATE PARTICIPANTS

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

CONFERENCE CALL PARTICIPANTS

Alex Kurtz
Merriman Curhan Ford - Analyst

Vince Benedetti
- Analyst

PRESENTATION

Operator

Hello, and welcome to the Rackspace and Merriman Curhan Ford cloud computing conference call. As a reminder, all lines will be on listen-only mode, and we will conduct a Q&A session throughout the call. (Operator Instructions). At this time I would like to turn the call over to Senior Vice President, Technology Equity Research at Merriman [& Company], Mr. Alex Kurtz.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Thanks Ross. And really thanks everyone for joining today's call on cloud computing and how Rackspace plays into the market.

My name is Alex Kurtz, I'm the data center systems and now managed hosting and cloud service provider analyst at Merriman & Company now covering companies like Rackspace, Terremark, Savvis and NaviSite.

Today joining us on the call is Lanham Napier, CEO of Rackspace. I'm going to lead off with several questions for Lanham. Then we will open it up to Q&A.

So Lanham, let's start big picture for a minute. I believe I am one of the only data center hardware analysts follow you guys right now. Traditionally I cover names like EMC, NetApp, but we believe the cloud is a very disruptive approach to how IT is being delivered to the data center. And we want to cover this space now. Am I thinking about this the right way? Is this really going to be disruptive to how IT is being delivered to the data center?

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

Yes. We believe it is. Our perspective is that there is a service revolution taking place in technology today. In the old days companies and CIOs had to go buy gear, deploy it in their facilities, and run that all themselves.

What the cloud represents is an accelerator in the service trend. We are going forward. Companies won't go do that themselves and buy that gear, they're going to buy it as a service from a partner, they're going to buy what they want, when they want, and scale it smoothly going forward from a service provider like Rackspace.

So the old day, you did all that stuff yourself. Today and going forward you're going to buy those technology outcomes as a service, and buy it perfectly in terms of what you want.

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Got you. Later in the call we will go into some of the downstream impact of what a Rackspace has on someone like a system reseller in the market, right, that obviously was servicing a data center, and now you guys are competing for that business. So let's just start off high-level with a view of Rackspace's history for everyone on the call, and then talk about your strategy around serving businesses with your portfolio strategy of managed hosting and cloud computing.

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

Yes. We've started the business 11 years ago. I've been here for about 10 of them, so I didn't quite get here at day zero, but almost. Our perspective started around managed hosting from -- and what we mean by that is, we were running dedicated infrastructure for customers. We have always served businesses, we have a focus on serving businesses. The early adopters were really SMB companies. The first technology we centered on what white box on Linux.

What's happened over time is that we have migrated into enterprises, they've pulled us there, we've rolled out new technology sets, and we've developed a portfolio approach, so that our original iteration was running applications for customers on dedicated infrastructure. It now is a portfolio approach where we are combining that dedicated infrastructure with a shared pool infrastructure in our cloud.

So the principle here is that what we want to do is have the right IT infrastructure matched to the right IT workload for the customer. So for some things, customers want to have a clustered environment that is dedicated to them -- talk about their -- a specific database running a critical application for their business. On the other hand, they may have a promotional site that's going to experience rapid scaling and growth that they may want to put out on a cloud.

So our take on this is that we are a technology company, but more importantly, we are a technology service company. Our point of difference in the marketplace is around the service we provide that we call Fanatical Support, right, so that it's not enough just to run this technology for people. Businesses want to consume it in a service fashion with a world-class partner. A partner that they can trust, a partner that's going to be there for them, and so we bring a deep expertise to this.

Today we serve 80,000 customers on a global basis. We have a significant footprint in North America and Europe, and we just launched Asia last year. Our cloud is growing in excess of 100% per year. So we are operating at web scale.

Now what this scale means is we are running north of 50,000 servers on a global basis. With that type of activity level, we have a deep expertise at the operating system level, at the network level, in security, in databases, and so we can bring engineering resources to bear to really help our customers run these apps.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

So just to follow up on that, because I think there is a view in the market that you have guys like Amazon at the low-end, offering just really very scalable compute resources but really not a lot of support behind it. Then you have very sophisticated vendors like IBM, AT&T, Synaptic Hosting, and Synaptic Storage, Terremark and Savvis doing very sophisticated tier 1 SAN environments.

But I think the question is, where do you guys fit? And I think the one thing you said to me before -- and I find interesting and I just want you to sort of expand on it a bit -- is that you guys can go and help an IT organization look at a very complex query on a database, either in your managed hosting or your cloud business, and really get into the weeds and try to figure out why is that database table hanging and how do you do performance tuning.

So I think it would be helpful for people on the call to understand. Go a little bit into the weeds on exactly where the expertise lies and what kind of problems you're solving, either on the managed hosting side or on the cloud side.

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

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

Okay. Yes. Let's start with how these markets segment, because the segmentation reflects the expertise that we bring.

If you look in the low-end of the market, for example, Amazon Web Services -- and Amazon gets a gold star for pioneering this. They have what we foresee to be a commodity compute offering, compute and storage offering. What that means is you're going to interact with the Amazon interface. You're going to have access to that compute resource, and you're going to do all the work. So this is tailored toward a geek that wants to interact with a command prompt.

Our take on the marketplace is that we are serving businesses that want a partner who is going to hold their hand and help them when things break. We are in the -- our business is delivering this customer outcome.

So if you look at the service that we have, whether it's on our cloud business, which is a -- cloud, for us, is an accelerator to this service revolution, whether it's in our dedicated infrastructure business, we are -- the problems we try to solve for customers tend to come in a few flavors.

Number one, it's about uptime. These are mission-critical apps where customers have millions of dollars of revenue flowing across them. It's about their mission-critical back-office systems upon which their business relies. And so when we are dealing with this, we have to be a trusted partner. We have to bring expertise, whether it's in an Oracle database, a SEQUEL database, we have to know more about this stuff than our customers when there is a problem.

What enables us to have this kind of definite expertise is that we are literally operating at web scale. Running north of 50,000 servers, we see more networking issues than our customers will ever see; right? So we have in-house knowledge bases, we have best practice learning around this, and we can bring this expertise to bear on our customers.

The trick for us is that we have to do it in a productized fashion. We cannot become a job shop, or we will screw up our economic model. So what we have are teams that are dedicated to serving sets of customers. When we get beyond the expertise in that team, we have certain talent pools within the company that those teams can go tap to fix the database query that's hanging -- or whatever the particular problem is.

So when the market segments, if you want a pure commodity with no help, you should pick Amazon. They will always be cheaper than us. The customer who desires that is not our customer. The customers that we want to serve are those that are looking for a partner, that are willing to pay a premium for this ease of mind, they're willing to pay a premium for the trust they have in that partner who's going to take care of that performance level, and we're going to bring a portfolio and an SLA approach so that across these different sets of services we covenant to our customers what they're going to receive.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

So all these -- so this expertise that you're mentioning, is that being -- are you really scaling that across both the private cloud and the public cloud offerings that you guys have today? Or is it really about the private cloud plus managed hosting, and that's where a lot of that activity is?

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

Right now we have more of that expertise in the private cloud and managed, simply because we've been on that path a whole lot longer. The cloud -- the public cloud development here, we've been on that path for a couple of years. What will happen, though, is we are going to bring the service levels that we have on our dedicated infrastructure into the cloud. We are working on that now.

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Alex Kurtz - *Merriman Curhan Ford - Analyst*

So the one area that I think I look at this a little bit differently is that having covered hardware names and understand the sort of the political nature of IT organizations, it seems to me that migrating very complex, customized Oracle databases that are running on a tier 1 storage array or on a complex server environment and having all of those elements managed off-premise, it seemed like there's a lot of internal -- on issues around letting people let go of that and having you guys manage more of that.

So as far as adoption curve that you've seen when you go talk to say the larger enterprises, how do you overcome that? Because that would be a very strong case against cloud computing, saying that you've got a lot of folks internally at a large enterprise who just don't want to give up certain tasks.

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

Right. Yes. There are certainly the people we affectionately know as server huggers, right, that want to hold onto all that gear. What's happening though is the use case for the initial adoption tends to be for a web app that's customer-facing, and we -- and the enterprise tries us there.

So if it's a consumer products company, right, it will be a set of their brands that they are using to interact with customers, to build those relationships with customers. We will start with that use case. Once we win that use case and they're a customer for a while, the adoption curve and migration path tends to be pretty straightforward.

It's all about building that initial trust, because then they start to think, all right, well, I have a trusted partner in Rackspace, what other architectures can I send to them, important with them, that are consistent. And we start working our way from that customer-facing website, that particular web app, into their back-office systems.

So for some of our customers that our media customers, it will start with those consumer brands upfront, and then before you know it, we are into their publishing in the back-office. So this is a typical use case. It's a little bit where enterprise will try us on something, figure out how that system works, assess the fit in how we serve them. If we serve them well and earn their trust, they will buy more from us later.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

So just a follow-up on that, I think the perception is for Rackspace that a lot of your sales activity is incoming leads and that you guys obviously provide a lot of great support, but the proactive selling nature of what you guys do is somewhat limited. What you just outlined for us, that you get someone hooked on some of the more web site hosting kind of applications, then you migrate it to the tier 2 and the tier 1 apps. Explain to us how you guys can accomplish that without an enterprise sales force that can go down the street and sort of be there when the choices are being made and you need to have someone in front of the customer making those bigger decisions.

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

Yes. I'll tell you the secret sauce. The secret sauce here is that we serve the customer so well, we turn them into an internal promoter on our behalf, so that what happens is that initial team that selects us becomes an inside sales force for us inside that company; right?

It's -- the loyalty economics that we generate from our customers is really compelling. If we serve them well, that IT director, that VP of IT, the CIO will advocate on our behalf with new projects.

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

A typical adoption will be, we will do work for one division inside a Fortune 100 company. We will do such a good job that that divisional CIO will take us to his peers across the company. Now, as soon as they start to take us, we will absolutely show up with Rackers and sales folks and engineers as part of a joint effort to see if we are a good fit for that business.

But what this provides us is, number one, we don't have an expensive enterprise sales force running around all over the place in the street. We do have a few hands and feet in the street. It's a highly leveraged model, but instead of making cold calls, we are making warm calls, because we've already got an introduction into that company, we are already running an app or something for them, and then it's about developing that account and developing that business.

So our approach is very different. The traditional approach is to have an expensive sales force that's taking all these folks out to play golf. It turns out that we are a service company, we serve IT folks, and they are not really good golfers anyway. And so what happens here is, by serving them well, they take us around to the rest of their company and their peers.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

I just want to close out on this topic because I think it's really important to understand, because as you guys try to move through into the enterprise more going forward, I just want to understand how you compete against the IBM's of the world, who obviously have some very entrenched positions within these larger companies, these Fortune 100 that you speak of, at multiple levels, both at the C-level, but also at the IT administrator level.

How does a Rackspace overcome that in a deal bake-off? And -- because it's not just having a couple of internal promoters that like talking to folks, the Fanatical Support, it's much larger than that. So how do you guys deal with that over the next couple of years?

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

Well, the basic proposition is the following. We cannot do everything that IBM can do, but for the places that we overlap, we will save you half. Okay? So IBM is a job shop, and they will do any IT task you want.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Right.

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

We will not. We are a service factory. So for those services that we provide, we make sure they are replicable, that they are of high quality, that we can covenant an SLA around those, and if you look at the contracts we write and the SLA agreements that we put in place with customers, man, they are industry-leading. We are a specialist in this service set. IBM is a generalist. So when IBM gets on our turf, we can deliver a higher quality at a cheaper price because we are purpose built to do it.

Now IBM has an account coverage advantage on us. The data you set forth around the historical relationships they have, etc., man -- and that is a historical relationship that they have had in place.

What we have on them is we have a better service, and we have a growing army of promoters, so that as a specialist, as we build this out, we will sprinkle in at the right time investments around a sales force to visit with these customers.

The proposition that we have is, man, we can save you half -- which from a customer perspective, when we walk in the door and stop start talking to the customer about -- for these IT workloads we can give you higher quality and save you half -- that

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

puts a lot of pressure into the situation. Particularly during recessionary times and the choppy times that we are experiencing now, people are interested in that value proposition. And as we win one of these accounts, one begets another.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Okay, that's helpful. So let's just pull it back to the broader topic of cloud computing.

There's been outages across the market, obviously a lot of security concerns. I think an interesting aspect is, a company that has Sarbanes-Oxley requirements, how does that work in a cloud computing environment where you have to be able to get to certain records; right?

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

Yes.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

So looking at all those things, the barricades on cloud computing right now would be, it's going to be great at the low end where Rackspace plays, because the SMB market doesn't have a lot of those sensitivities that a Fortune 100 company would have. So how do you sort of see that playing out as far as the hurdles to broader adoption of cloud computing?

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

First of all, I would just tell you today, a lot of enterprises are testing the cloud. So there may not be a discussion about it at the headline level, but the reality is, many, many enterprises are testing the cloud today. The cloud may not be for everything, but it is for everyone. So based on the IT workload, the cloud is a perfect fit today.

I also think the cloud is in its infancy; right? These are the early innings of the cloud game. So the technology will continue to mature, and as it matures things like security concerns will start to fade away. So today if you are concerned about HIPAA or Sarbox or particular industry regs, the best way to do that, the gold standard way to do that is to run those apps in a hardened environment on dedicated infrastructure.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Right.

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

Right? So we offer that for our customers. Over time, the cloud technology will mature, we will combine that maturing technology with Fanatical Support, and the enterprise adoption in the cloud will accelerate.

So enterprises are absolutely testing the cloud for certain IT workloads. We see that option growing actually, it's not slowing down. I think over time you will see the more -- the other concerns about security and shared infrastructure, etc., start to fade away as the technology matures.

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Just to follow up on that, and then we are going to go to questions, if you look at a couple of other vendors in the market like a Terremark or a Savvis, who have been developing I think pretty sophisticated approaches to managing tier 1 storage area networks over a cloud, and given all of your application capabilities that you spoke about earlier in the call, is that a place that Rackspace wants to go to overtime, when you (multiple speakers)

Go ahead.

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

Yes. Great question. As we look at the service that we provide and how we add value to customers, we don't think there is a lot of long-term, durable advantage to be gained by differentiating on hardware. We think what's part of this service revolution disintermediates the hardware manufacturer from their ultimate user; right? We are that company that disintermediates the specific hardware manufacturer from the people that actually end up using that device.

People want to buy this as a service so that ultimately the way, we believe, to differentiate in our market is around Fanatical Support, it's around the service outcomes we provide. And how behind the scenes that service outcomes gets delivered? Customers are going to care less and less about that.

When we started the business 10 years ago, there was value in really customizing a server. How many drives, how many sticks of memory, etc. Today customers don't care about that. And the hardware server brands are losing relevancy with our customers. They look at it and say, Rackspace, we understand you're going to run the environment, you are promising what that performance is going to be, we trust you to do that, let's move on and talk about the app.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

All right. Now you got my hair standing back on the back of my neck here, because I do cover all those companies. So (laughter) so obviously companies like a NetApp, an EMC, Dell, IBM, Super Micro Computer -- how do you envision -- obviously they understand their end customers shifting; right?

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

Yes.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

And that's why I want to cover you guys and the space. What has been the conversations with those companies like -- I would imagine it's changed over the last couple of years, because they are starting to understand the implication now. They would make the argument that private cloud will lead the way on vSphere from VMware, or something like that, and that that will be managed still on-premise on their hardware. But give us a flavor of those conversations, because I am sure they've been calling.

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

Yes. Well, I don't want to comment on any company in particular. Just generally speaking, I would say years ago the traditional hardware companies, the traditional technology industrial complex didn't think the service provider model had legs. I'd say now, 10 years later, they understand that there is a revolution underway.

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

I also think for those companies there will be a seg -- markets have lots of flavors. There will be a segment of the market that is going to be the super-duper high end, the customers that absolutely want to own all their gear and do it all on-premise, and they just have that sort of religious mindset. So I think that's going to absolutely exist.

Our belief is that most of the market is going to go the route of a service provider model because it's cheaper, faster, easier to use, and it's a better fit.

So that for those companies that want to have lots of excess capacity in their IT infrastructure and feel that that's important to them and want to control and be able to touch all that stuff every day, hey, that market is still going to exist. I just think that that market relative to the size and mass of the rest of the market is shifting significantly and that going, man, if you're a company with sales of less than $500 million, why would you invest in IT infrastructure? A few years from now we'll be able to say the same thing about a company with $1 billion in sales. Why would you invest in IT infrastructure?

Alex Kurtz - *Merriman Curhan Ford - Analyst*

That's an important point. And I want to pick up on that after going to Q&A. I would say, before we jump to Q&A, the company has asked me to say that (technical difficulty) [any] questions cannot be about the last quarter, anything around what happened in December. So obviously any questions, please just keep it to sort of the macro trends in cloud computing that we are talking about today.

Ross are you there? Do you want to poll for questions?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions).

Alex Kurtz - *Merriman Curhan Ford - Analyst*

All right. So while we wait for some of that to take place, I'll just ask one follow-up question, and then we will go back to Ross to see if there's any questions here.

Customer segment, we view as one of the most important things to understand in the market; right? So you have the SMB, who have a certain set of IT requirements, you have midmarket that has another set, and then you have that enterprise group, maybe the top 5,000 companies in the world that have some of the most sophisticated data center architectures. How do you think about your go-to-market strategy today? And do you believe that the SMB and midmarket is really the easy target for this and that's really where you're going to be, the focus is? Because you've also talked about enterprise being ready for some cloud adoption as well.

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

Yes. The first thing is, based on all those segments you just identified, man, is that a huge market. Depending on which analyst you talk to, some analysts believe this is a $100 billion opportunity over time. And so there is a whole lot of IT thinking and spending at stake.

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

As we contemplate these segments, our mission and purpose is to build the service leader across these segments and to carve out a defensible market position around it. The early adopters were the SMBs you talked about.

Why did they -- why were they the early adopters in this? They didn't have the legion of IT people internally. They were more capital focused than their enterprise brethren. So they were willing to look at this new, emerging model around buying IT as a service.

Well, then what's happened is enterprises have started to wade into the pool as well. And touching a little bit on the point we made earlier in that it's about the -- what IT workload do they test us with, and then when we win their trust on that, they pull us across their company.

So our go-to-market strategy from a segmentation point of view, based on customers, is very similar to what you just set forth. We feel like the opportunity -- we've always had a massive opportunity in SMB -- the millions of SMB businesses here in the States as well as around the world. What's happened, though, as buying computing as a service has matured, now enterprises are weighing in. And as enterprises weigh in, the market opportunity goes up by a multiple.

So the next part of your question, how do we attack this? What we have today is a brand reputation as a service leader, and those customers pull us. We have a sales and marketing machine that is primarily an inside sales force today that is very cost effective. So if we look at our ratios around our cost to acquire a customer versus our competitors, we are a whole lot more effective at that. This is how we know we have a service business that works. Our cost of acquisition is significantly lower.

When we look at enterprise, we have a value proposition that says, we can't do everything that other guy can do, but what we can do, it's better and we save you 50%. So we have a penetration strategy there where we are looking account by account, which ones do we want to win? And how do we want to create power around those customers?

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Got you. All right. Well, Ross, do we have any questions yet?

Operator

[Vince Benedetti].

Vince Benedetti - - *Analyst*

Just a quick question relating to competition. When I look at IBM or Microsoft -- and I understand that you guys have like probably, one, a first-mover advantage, and then more importantly, you have like this complete suite or toolkit. How much more -- how significant is that for you? And how do you see some of your bigger competitors gravitating towards that type of model?

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

I think what's happening, our crown jewel here (technical difficulty) Fanatical Support. The portfolio approach and the services we provide gives us a real advantage, which you've identified. That advantage we believe is durable because when we say Microsoft -- Microsoft is a great technology company. They are not known as a service company. And we have all experienced this in our lives.

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

So I think that -- I suspect that traditional tech companies will approach this in a similar fashion to how they have approached other markets, and it will be a technology solution. They have significant understanding and assets there.

What we are going to bring to it is we're going to bring a service understanding, a "trust with customers" understanding, and differentiate based on the service levels we provide. So we've always thought about technology as integrating the best-of-breed components, and our -- and the technology intellectual property we create around here is around how these components work together, because let's face it, when these tech vendors create that technology, they do not think about their competitors and making their devices and software interact with each other well; right? These guys all tried to create silos and profit pools that way.

What we do is we cut across that pool. We invest in intellectual property to make those technologies work well together. We combine that into a productized service and deliver it with an industry-leading SLA to the customer. So that will continue to be our approach as we chip away at these markets. The traditional competitors, I bet they bring a technology flavored approach to it.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Thanks Lanham. Ross, any follow-up questions there?

Operator

There are no further questions at this time.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Okay. So I'll just -- we'll go on for a couple more minutes here.

I think the other question around Rackspace to a certain degree is, is there really a connection point between the managed hosting business and this cloud computing business that you have that's about 10% of your revenue, because as you laid it out here, one sounds very complex, much higher revenue profile versus an SMB that is doing something very different.

So I think a lot of questions that investors might have is, well, is there -- are there really a lot of synergies around these two practices together going forward? And -- or are we going to end up in a situation where two years from now you're going to have this one set of customers that are really just focused on SMB focused cloud computing, companies hosting or working with 200 gigabytes of storage on one of your servers, and then a different profile of customers on the managed hosting side? Or do you think there's going to be some crossover over time? And sort of explain how you get there.

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

Yes. Sure. The crossover has already started. And what happens is it's really IT workload driven, so for any customer, SMB or enterprise, they may have a clustered app that they run on a big metal environment that's dedicated to them. Then they will want to burst from that at the web head level into the cloud -- from a scaling point of view. They will want to have their blogs and wiki's out on the cloud, while they run their e-commerce web front on dedicated infrastructure.

So this has already happened. It's already started here. The metrics we provide you with our financials break the business out in terms of terms of customer accounts with managed customers and cloud customers. And those things are rapidly merging. So the risk of the portfolio not being a real portfolio, at this point I would say is nominal. I mean, it's already happened. And we

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

have customers ask us for each of these different service sets all the time, and it's the same customer asking; right? So I think that as cloud matures and we make the integration more seamless than it is today, you will see the crossover accelerate.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Well, I just have a couple more questions, then we will poll for any additional questions from our clients, and then we will wrap it up.

It seemed to me that one of the biggest opportunities for you guys is in clustered, large-scale NAT environments, network attached environments, that are very file-focused and really could be specific to verticals like oil and gas, media, and health care, areas where if you look at a company like a NetApp, have really made hay over the last five, seven years. And that's a vertical that would seem would really fit your model today. Do you guys think about it in those terms? Do you guys think about pursuing specific enterprise verticals over the next couple of years around (technical difficulty) [different] kind of environments?

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

Yes. The short answer to your question is, yes, we are starting to think about things that way. Historically we have viewed ourselves as a general-purpose technology, and so as adopters moved into the market around our service set, we weren't particularly obsessed and focused on whether it was a brick-and-mortar manufacturer versus a law firm versus an oil and gas company. And there's a lot of our basic appeal in the services we provide that we cut across the economy. Every company today requires IT to some degree, so therefore, broadly speaking, our addressable market fits most companies out there.

What we are discovering in enterprise is that we do have an ability to really target a use case within an enterprise, be it the examples you talked about or other examples within our customer base, and tailor the offering to that use case. And what we have discovered here is as we win a couple of those, we start to create reference around those wins, and other, like-minded customers, either in that industry or with similar use cases, will start to adopt our services.

And so what we see with the enterprise is, part of penetrating that market in our go-to-market strategy is really understanding one of their core customer needs and problems that we can go solve for them.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Got you. Okay. So Ross, why don't we poll for some more questions, and then I'll just lead off with a couple more here, then we'll see if there's anything left to discuss.

Operator

(Operator Instructions).

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Comparing the cloud business to the core managed hosting business, can you talk about economics and sort of the revenue profile and sort of the margins that you guys are thinking about as far as how that revenue mix shifts over time and sort of what the impact is to the business?

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

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

Yes. Sure. Right now our cloud business is relatively new here. We've only been down the path a little while relative to our managed, so we understand the metrics and the data around our managed business more clearly than we do the cloud.

What we have today with the cloud is a rapid growth business that is an emerging business model. There are elements of the cloud around capital turns and such that are very compelling for us as we look at it relative to our managed business.

So what the cloud business ought to be able to bring, it ought to bring a very capital efficient service offer from our perspective. We should be able to get very high utilization rates across the infrastructure in our cloud. With the automation and technology sets there, we ought to be able to deliver a high-quality service level to the customer at a manageable margin building cost to serve, so that what we are hoping as we construct our cloud service set is that we get capital turns that are better than our managed business, and then figure out how in the cost to serve to manage those service sets through the use of automation and Fanatical Support to really hit the right margin as well.

Now, this is a work in progress today. We see promise in this, but we haven't cracked this code yet.

The code that we understand much better is that code and those characteristics within our managed business. So in the managed business as it sits today, every year we work on this business and try to continuously improve it. So we feel like the numbers in our managed business are best in our industry, but we don't think they're as good as they can get here yet.

There are lots of investments we want to make to improve the financial performance of the company, so we look at our company as a good company today, we do not consider ourselves great yet, we look at our business model and we think it's a good one, but there are lots of changes and improvements we can make to that to make it a great one.

And when we think about our investors potentially investing in us, what we want to be known for is that we are a good steward of capital, that we are going to invest their money wisely, and that we are going to make this business model continue to improve over time.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Just on that one point, (technical difficulty) on that one point just about investments that you've made in the cloud business, can you just talk us through some of the technology choices you've made, and why you did it, and sort of why, if any, you think there might be some advantages there?

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

Sure. I think one of the issues of the cloud -- and sorry I am coughing so much, I'm just battling a cold here -- is scaling. So the early iterations of cloud around VMware was VMware really didn't scale that far. And so as we think about this service revolution in computing, we believe it's going to be about open standards, big, web scale systems that people can tap into and out of at will, and we are going to differentiate based on the service levels we provide. We are the service focused company here.

So technology choices we make in the cloud -- you look at our cloud today, it's based on Zen. Okay? A common platform, scales and scales and scales, we've created open APIs so that people can tap into our systems. We are not trying to create a closed cloud. We are trying to create a public cloud to where people can tap and utilize those resources, and then we want to retain those customers based on the service levels we provide.

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

So the technology choices we are making are really based on a future that we are trying to invent around here. It's about things that are based on standards, that are easy to use, that are open, and that we wrap and integrate Fanatical Support around them. So all of the technology choices we make are about enabling our customers a higher technology service outcome.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Thanks for that. And Ross, do we have any other follow-up questions there?

Operator

There are no questions at this time, Alex.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

All right. I think the one area I want to sort of finish up with here is, thinking about the cloud business, that is a small portion, but where it could go to over the next couple of years, and the kind of environments that you want to get into, the kind of applications you want to support. Are there any really specific workloads that you're not supporting today across that SMB space and as you move to midmarket enterprise that you think you have a really good shot on goal on landing? Maybe it's an OLTP database, maybe it's some kind of ERP system, over the cloud infrastructure -- or are those areas and workloads you don't think will ever really migrate to the cloud?

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

No, I think that the broad macro trend here of IT moving from the back office to the web, I believe continues. Then it's a question of, when you look at particular apps, how are those apps best served? Should they remain on-premise? Should they be in a service provider like us? Who is the right partner for them? -- etc.

So from a long-term trend point of view, I think every new app that gets written today is going to be written for the cloud. The innovation will take place on the cloud and the web in those architectures. Legacy apps that were written on a mainframe architecture are going to stay there. They are never going to be part of our sweet spot. But the innovation and technology will continue to be in our sweet spot. So over time, as technology matures and advances, our addressable market will continue to expand. So there is absolutely opportunity to get to specific apps.

Right now what's happening is we are riding this general innovation wave in adoption into web computing. And it's still early. For a lot of companies, they still have a mindset of doing it themselves, while as this technology matures, as our company advances, as our service levels improve, companies will adopt our service set more and more often.

So I think that we have a general macro thrust here that is absolutely in our favor and provides a tailwind over time. Then the ability to target specific apps and tailor an offering around that just enhances the value prop for the customer.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Got you. Well, this has been great, thank you very much for doing the call today, and I want to thank everyone for joining. Thanks everyone, and have a great weekend. Thanks again Lanham.

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS

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

All right. Thank you. Take care.

Alex Kurtz - *Merriman Curhan Ford - Analyst*

Bye-bye.

Operator

Thank you ladies and gentlemen, that concludes this conference.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2010, Thomson Reuters. All Rights Reserved.

©2010 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

THOMSON REUTERS