

FINAL TRANSCRIPT

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RAX - Rackspace Hosting, Inc. at Barclays Technology Conference

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CORPORATE PARTICIPANTS

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Rackspace Hosting, Inc. - CTO

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Rackspace Hosting, Inc. - VP of Finance

PRESENTATION

Unidentified Participant

Pleased to have our next presenters. From Rackspace, we have John Engates, Chief Technology Officer, and Jason Luce, VP of Finance. Rackspace is a late addition to the agenda, so we're happy to have them.

John Engates - Rackspace Hosting, Inc. - CTO

Thank you. Good morning, everybody. My name is John Engates. I am CTO at Rackspace. I've been at Rackspace for about 10 years. And I'm going to give you a little overview of the Company this morning, and get you familiar with who we are and what we do, and then we'll hopefully have some time to answer a few questions. And I think there's a breakout session, so we can go do that afterwards.

So, Rackspace. The Company -- we're publicly traded. We were founded back in 1998. We went public in 2008 on the New York Stock Exchange. Headquarters, San Antonio Texas. That's where we started and grew most of our original businesses but then over time, we've expanded into some other cities from a sales and marketing perspective. We're in Austin, Texas. We've got a big presence in London; sales office in Amsterdam and a sales office in Hong Kong.

And in terms of data centers, the footprint looks like San Antonio, Dallas is our Texas locations. We have a new data center in Chicago that's coming online very shortly. We have a couple of data centers in Virginia; a couple in London; and then one in Hong Kong.

And these data centers are where we house all the servers that we manage for companies all over the world. We're a hosting company and the core business is a managed service that includes the data center, the network, hardware, operating systems, and the management of certain applications on top. Primarily, customers are bringing custom applications and hosting them on top of our infrastructure, and then we're sort of co-managing from assistant administration, and storage and engineering perspective.

Today, we have about 2,700 employees. We call them Rackers. Rackers is our name for them. But they're supporting over 80,000 customers on over 50,000 servers -- 55,000 almost, across the globe.

The Company's strategy has very much been around being a specialist in our space. We have been the guy that has always focused on hosting first and not try to get into too many other businesses. We're not a telco; we're not a telco background, so we don't do the backbone stuff.

We're really focused on hosting. We don't do colocation, so that really differentiates us from a lot of people in our space. Sometimes people try to find somebody that looks like Rackspace out there, and it's hard to pin down because a lot of guys are in the colo business. We don't do colocation. We're really about hosted computing and cloud computing, and we are the leader and the specialist in that space.



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We also provide something we call Fanatical Support. Fanatical Support is our brand name for our level of customer service, our focus on customer service. And it's, again, something we've really based the Company on. It's in our DNA, in her genes, so to speak.

We believe that while, I guess, technology is -- could be thought of as a commodity, what you do with that technology is not a commodity. Most of the companies that come to Rackspace are really putting something that is mission-critical, something that's very important to them, something that they're sort of betting their business on. And they look to us as a specialist to manage that.

Fanatical Support describes sort of the experience that customers get when they talk to Rackspace. They expect a high level of service. We really respond to customer need very -- to a -- sort of a high-touch, in a high-touch way. And we do support mostly businesses -- very little, if any, consumer. It's almost all business-focused service.

And then the last piece here, this last element is a hybrid hosting suite. One of the things that's really emerged over the last couple of years is cloud computing. And while cloud computing gets a lot of attention, for most companies, it's not an all or nothing thing; they can't take everything they're doing today and just magically drop it onto a cloud computing platform.

What they're doing is taking strategic applications, things that could go to the cloud first, and they're sort of trying to pick and choose those applications and move them in a sort of a strategic manner.

The trouble is -- again, back to the all or nothing -- you really can't -- some applications can't go to the cloud without sort of relying on some of the other applications that are still maybe in the data center. So we believe this hybrid suite, where people can pick and choose capabilities and components, put them together in the same data center, tie them together with high-speed networking, is a real differentiator in the cloud space.

This is -- these couple of pie charts represent our revenue over the last, I guess, last year. In the third quarter of 2008, cloud represented about 5% of our business; managed hosting represented about 95%. The difference, when we say cloud versus managed hosting, managed hosting is single tenant. It's all dedicated equipment. Cloud is all multi-tenant, which means we're using a platform of equipment or a cloud, and then sort of carving that up for lots of customers.

So the cloud was 5% last year. This year, same time, it's 10%. It's growing very fast, but it still represents a relatively small portion of our overall business.

Computing-as-a-service as a market opportunity -- I think that this is, again, something that gets a lot of attention. But we do believe it's real. Computing as a service -- you see companies like salesforce.com, lots of people use it nowadays. It's not at all uncommon to put salesforce at the top of the list. Well, that's computing-as-a-service.

If you think about outsourcing your email, we do that as well for companies. Years ago, nobody thought of doing that, but today, it's very commonplace to go buy -- you know, outsourced email, email-as-a-service, sharepoint-as-a-service -- those kinds of things are becoming pretty commonplace.

Well, that computing-as-a-service trend we think is very large today but it's also growing. The cloud computing, especially during this downturn, got a lot of attention because the CFO frankly said, how can we do it cheaper? How can we go faster but do it cheaper?

And cloud computing was oftentimes the technology sort of brought up. And really cloud is a placeholder for on-demand computing of one flavor or another. We believe a lot of the things we do -- in fact, all of the things we do are in this category of on-demand computing or computing-as-a-service is question marked around how do you define cloud? And everybody defines it a little differently, so I won't use that term on this slide.



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But a paradigm shift that's going on, I think companies are starting to think more about how they can consume IT over the Web. Some service providers, it shifts all of their expenses from sort of the CapEx to an OpEx expense. And I think that helps them and it also lowers expense over time, because we can do it at scale; we can do it cheaper than companies can do it themselves. And again, we can go a lot faster than they can do it themselves.

We talked a bit about cloud computing; but again, back to this full suite of services. I think it's very critical to think about cloud as just a piece of a larger technology strategy. It is not a technology strategy all on its own. It's a piece of one. And it's not an all or nothing decision, so that full suite really does matter.

Let's see. So here's another way to think about it. These are the guys that sometimes Aconex and IBM -- sometimes they come up when people compare us to those guys. They ask, how do you guys compete? Well, we don't really necessarily think we're a direct competitor; we think we're a substitute for some of these services. But if you think historically about how people did IT, it was either do-it-yourself or the full-on IBM, big-bang, outsourcing approach. Those were sort of the ends of the spectrum.

Colocation -- we use Aconex because everybody knows them, but a colocation was really an extension of do-it-yourself. It's data center outsource, but all the work that you do inside the data center is still a do-it-yourself approach.

We think that a Rackspace/computing-as-a-service model is a better alternative for a lot of reasons. The total cost of ownership, for example -- if your decision is based or driven by total cost of ownership, we're a better story. We can do it -- a much better story than doing it yourself, because we've got the scale; we've got the time to market advantage; and we've got the expertise on staff that you don't have to go to and hire.

In terms of speed and flexibility, comparing us to IBM, a lot of times a customer tells us it takes six weeks to get their infrastructure online at IBM. If they do it themselves, it takes about that time because they've got to order their machines; they've got to provision it. I mean, we can deploy cloud computing in as little as a minute or two. We can deploy traditional hosting in just a couple of days; so it's a much different story in terms of speed and flexibility.

And the other thing that's, I guess, a very important factor if you think about this time of year, a lot of companies have this very bursty seasonal trends, where they've got a lot of black Friday demand and then it sort of tapers off. And then it maybe goes up right before Christmas; and then after the New Year, it's gone.

Well, that's another way that Rackspace helps a lot of companies, especially e-commerce and retails. We can scale them up and we can scale them back down, and that's very difficult to do if you're doing it yourself; and even to some extent, inside of an IBM-type of approach.

The technical capability -- this is, again, back to Fanatical Support. We really built our business on being the experts and the specialists in this space. We have -- probably in terms of Linux technicians or certified technicians, we're probably second only to Red Hat in terms of number of experts. We call them The Geeks; you know, basically the guys that are supporting our customers.

A lot of people look at cloud computing and they say, well, why do you need people if you're doing it in the cloud? Well, you still need somebody to fix the stuff when it breaks. Technology breaks. We all know it's not perfect. People have problems, outages, application breaks -- all kinds of stuff goes wrong. And you really can't replace the human aspect, in my mind; not any time soon, at least.

And then in terms of customization -- this is the one place where if you need infinite customization, you might choose your own do-it-yourself. But I think most applications today don't need anything special in terms of hardware infrastructure. We support Linux; we support Windows; we have a broad range of technology in the stack that supports most applications.

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It's sort of that 80/20 rule -- most applications today are really moving toward that commodity stack of services, and not really -- nobody's choosing to go down the very highly-customized Sun platform or something like that. It doesn't matter as much any more. And I think that -- again, if that decision is around customization, then you might go somewhere else.

In terms of our leadership, Rackspace is leading -- in the hosting space, we're a clear leader. We've taken an early lead in cloud computing. And I think one of the things we want to demonstrate is why people are choosing us. I think support and reliability; I think our culture of customer service; our focus on a great customer outcome has driven that. And companies like Aeon and ARAMARK, and even the Boston Celtics have chosen us for that purpose. They want somebody who can manage their infrastructure and support it.

That hybrid hosting suite we talked about -- we do have quite a few companies already starting to utilize that. FreshBooks is a software-as-a-service company that sort of competes with QuickBooks. It's an online QuickBooks-type service. They're already mixing the physical infrastructure with the cloud infrastructure.

GitHub is a very popular developer platform for storing your code. They've recently moved to Rackspace. And they thought they were going to go straight to cloud, but they actually ended up in sort of a hybrid mode because some of their infrastructure ran better on physical equipment.

And then in terms of our capabilities -- Rackspace has built a model that I would describe sort of like a factory. And I also sometimes describe it as a menu. So, customers can come in and choose from a wide array of technology, but we're not custom IT. We are a repeatable set of services and on a very standards-based technology stack. And I think those are important characteristics.

And back to my 80/20 comment, most applications fit fine on that type of infrastructure. You don't necessarily need to have a particular brand or platform. We tend to support only a couple of hardware platforms from the server perspective. We use Dell to a large extent; we use our own lightbox platform for a lot of our cloud and even some of our managed -- we're not going to go out and buy some really, really custom hardware. But that brings the cost down and it allows us to, again, do the rapid time to market and very flexible infrastructure.

Our strategy, I guess, in terms of our portfolio of products -- we want to -- I've talked about this a couple of times -- but this is really how it breaks down. If you think about our core business, it's dedicated and what we call private cloud.

Private cloud is really the same concept that you might hear VMware describe as internal cloud. The only difference is it's not on premises in Rackspace's data center; but it's all dedicated to you. So in that category, people know the specs from the servers they buy. Based on specs, they have a very clear understanding of all of the hardware in that mix. And, again, that's our core business for the last 10 years.

The new businesses that we've gone into are really the cloud businesses or the stack businesses. Those have really emerged over the last two to 2.5 years.

In all of these businesses, we have a different sort of set of competitors. Cloud servers -- we compete pretty much head-to-head with Amazon EC2 on that. We are a clear number two to Amazon in that space. In platform-as-a-service, a different set of competitors. We've got Google running Google App Engine. We've got salesforce running force.com. We think we're the largest in that category running [130,000] applications. Google reported 80,000 the last time they reported and we were well ahead of them.

Cloud Files is our storage cloud plus delivery on top. That competes probably most closely with Amazon F3. And then our email and apps business, our primary email -- or our primary product in this division is email. Microsoft has their BPOS, their exchange business. Google sells email but most of it under Gmail is given away for free.



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We think we're number one or number two. We're not quite sure because we don't know -- the exact numbers, they don't report. But we think we're number one or number two in the paid email-as-a-service business.

We also have a brand that's called Jungle Disk. And Jungle Disk is basically an online backup service. If you have a laptop or a PC, you want to back it up to the cloud, Jungle Disk is an acquisition we made, and it's part of our email and apps strategy.

So today, companies can use Jungle Disk to back up their desktops, their servers. They can even use it as an online file share -- file sharing for the small workgroup. So, it's sort of like a collaboration tool -- instead of having a file server down the hall, you just use the cloud -- we call it cloud drive. You use the cloud drive to store your files and collaborate with your co-workers.

There was a company -- or an online blog that did a survey of the top 500,000 websites by cloud provider. And this is sort of where we get the idea that Amazon is number one. We're a clear number two, and then you sort of got this long tail of folks that are in the cloud space competing for that business; but it's really -- it's sort of a bunch of smaller guys.

There hasn't really emerged another serious cloud player in terms of a public cloud. I think a lot of hosting companies today are getting into cloud in some form or fashion. They're waiting on VMware to help them with that. We didn't wait for VMware; we jumped ahead by a couple of years and really invested our own resources, built our own IP around the Zen Platform. We used Zen as the hypervisor underneath our cloud servers business, and that's really given us advantage in terms of price and in terms of customization.

We have ability to really create and set our own direction, rather than sort of having to follow the road map of someone else. It also allows us to differentiate from all the other guys, who are really going to just take the out-of-the-box package and use it as-is.

Let's see. This is another interesting stat over here. Of the Fortune 100 companies out there, a year ago, we had 32 of them. Today, we have 40 of them using Rackspace in some form or fashion. And 20 of those are using our cloud -- is that -- that's the right way to describe it, right? 20 of them are using --? Okay.

So, it's interesting to see that the big companies are starting to take us up on this. We built the business historically on small to medium businesses; but we're doing a lot more with the enterprise today, both in the hosting business and on the cloud. And that interest seems to have ramped up a bit since the economy went haywire a year ago. The move to cloud computing has opened a lot of people's eyes up to the other possibility around hosting, email-as-a-service, and our newer business as a cloud.

Let's see. Rackspace's business model -- today, our hosting business -- no, we don't have these giant whale customers; really, no customer is really bigger than 2% of our revenue. We're hosting companies all over the world. Our two sort of bases of operation have been, historically, Texas and London. London represents a very large chunk -- I think, Jason, what's the number today?

Jason Luce - Rackspace Hosting, Inc. - VP of Finance

Roughly 25%.

John Engates - Rackspace Hosting, Inc. - CTO

25% of the overall business. And so we've got a strong base in the UK. We compete really well over there. And this differentiation that we talked about in terms of Fanatical Support -- we think it really does drive a very loyal customer base, which is a customer base that -- it grows over time. You have to really fight churn every day, and churn has historically been very low at Rackspace.

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One of the reasons, I think, is because of our high degree of customer service and focus on the customer. It's a subscription-based business with a recurring revenue model. I think that has been a good place to be over the years.

Almost all of our growth has been organic. The only few acquisitions that we've made have really been technology acquisitions rather than trying to grow revenue in some way. We acquired three companies -- the mail company, it was called Webmail.US -- I forget, because we've changed the name once or twice. Webmail.US was the company that helped us build our mail business.

Jungle Disk was the backup-as-a-service. And then a company called Slicehost, which helped us sort of get the foundations of our cloud computing platform underway. And I think all of those, again, were technology acquisitions. And otherwise, it's all been organic growth.

And then last, this loyalty model -- I think, historically, we have grown -- if you look back in history, I think the annual growth -- I remember 50% to 60% growth every year for the first few years. I think in the last couple of years, it's been a little slower, mostly because of the economy; but I think that model has grown our business very steadily.

This culture of customer service. One thing I think I really have to point out, and this doesn't really come through, just looking at Rackspace from the outside, but we are a very different kind of company on the inside. We've built a company that is one of Fortune's 100 Best Places to Work last two years in a row. We have won the same award from the Financial Times in the UK.

This leads to a great employee base; a very engaged employee base who loves their job, who loves their work. These are people who love the technology that they support. And what we think that leads to is low churn, high customer promoters, which means people that recommend us to their friends and colleagues. And that leads to, again, a loyal customer base that, over time, upgrades and adds more.

I'm going to let Jason just, I guess, take the last bit of the presentation to do any financial stuff that he's interested in talking about, so.

Jason Luce - Rackspace Hosting, Inc. - VP of Finance

Yes, or we can open it up for Q&A.

John Engates - Rackspace Hosting, Inc. - CTO

Yes.

Jason Luce - Rackspace Hosting, Inc. - VP of Finance

It's just kind of granular model here.

John Engates - Rackspace Hosting, Inc. - CTO

Yes, that is kind of granular. We won't do the eye chart. So -- anybody have any questions or thoughts?

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QUESTIONS AND ANSWERS

Unidentified Audience Member

For the cloud business, can you just give us a general view of what applications are? What's the general use case? Is it for internal --?

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

Yes.

Unidentified Audience Member

-- testing data? External facing and what the trend is there?

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

Yes. So the applications that are running today in this public cloud -- in effect, all of these clouds -- those are externally facing Websites, Web applications; Internet, Extranets, test and [dev]. We see a lot of very scalable Websites that need that unpredictable infrastructure workload kind of capability; people that run promotions or short-term events of all sorts.

I think we've yet to see a huge move into these public cloud type of services for the real core applications. You don't see Oracle financials running there; you see -- again, back to the Websites, Web applications and those types of things.

Software-as-a-Service companies are building their businesses there on that cloud, but you don't really see, again, a shift of all of your core applications. We do see those running in the private cloud. So over here with VMware on top of dedicated infrastructure, you meet all the compliance requirements; you meet all the security requirements that companies have and you really take a lot of the risk out of it. And that's where you see Oracle financials or the back office CRM-type stuff today.

Unidentified Audience Member

And just a quick follow-up. On the mail product and other sort of services you sell or, just in general, the cloud products, how do you differentiate and sell against, like, the Google Ask-for-your-Domain or the Amazon's -- what's your (multiple speakers) --?

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

I think in terms of email, the service matters. Otherwise, people wouldn't pay for it; they would just go get it for free. So, service matters to some extent for these people. Our service is clearly better on all of our products than most of the guys that you've listed.

You can call Rackspace 24 hours a day and always get a human. Right now you could call -- you won't get a dedicated -- or a automated attendant; you always get a person on your team. So, service does matter.

But even price -- we've been very good about competing, being efficient about how we build our infrastructure, how we design our software. Our non-exchange business -- we have two flavors of email -- that exchange and our own brand. The non-branded exchange costs about \$1 per mailbox per month, and that's cheaper than Google mail; it's cheaper than Microsoft mail. And I think the experience is better with Rackspace.

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We will help you -- a lot -- much more hand-holding in terms of getting your domains moved over. We will help you with your Blackberries and your mobile devices. All of that stuff matters. When you can't get your mail, you want somebody to call, and we have those people.

Let's see, what else? Okay. So I think we have a breakout session. We use -- I think that's perfect timing, so we'll go to the breakout room. I don't know where the --

Unidentified Participant

The Pavilion Room.

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

Pavilion Room. Okay. Thank you, guys.

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