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# EDITED TRANSCRIPT

RAX - Rackspace Names Taylor Rhodes as CEO and a Member of the Board of Directors

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## CORPORATE PARTICIPANTS

**Jason Luce** *Rackspace Hosting - VP, Finance*

**Graham Weston** *Rackspace Hosting - Co-Founder, Chairman*

**Taylor Rhodes** *Rackspace Hosting - President and CEO*

## CONFERENCE CALL PARTICIPANTS

**James Breen** *William Blair & Company - Analyst*

**Pat Walravens** *JMP Securities - Analyst*

**Jonathan Schildkraut** *Evercore Partners - Analyst*

## PRESENTATION

### Operator

(Audio in progress) September 16th. (Operator Instructions)

As a reminder, this conference is being recorded Tuesday, September 16, 2014.

I will now hand the conference over to Mr. Jason Luce, Vice President of Finance with Rackspace. Please go ahead, sir.

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### Jason Luce - *Rackspace Hosting - VP, Finance*

Hello, everyone. Welcome to Rackspace's conference call to discuss this afternoon's announcement. We hope you had a chance to read our press release, which we issued earlier. If you don't have a copy of the press release, please visit our Investor Relations page of our website at [www.ir.rackspace.com](http://www.ir.rackspace.com).

This call is being webcast online, and can be accessed through our Investor Relations site. For Rackspace on the call today, will be Graham Weston, Chairman of Board; and Taylor Rhodes, President and our newly appointed CEO.

I need to remind you that some of the comments we may make today are forward-looking statements, including statements regarding expected operations and business results, our growth plans and expectations, the impact of new platforms, products or services, and our expected level of capital expenditures.

Those statements involve a number of risks and uncertainties that could cause actual results to differ materially. Please note that these forward-looking statements reflect our opinions only as of the date of this call, and we undertake no obligation to revise or publicly release the results of any revisions to these forward-looking statements in light of new information or future events.

After our short prepared remarks this afternoon, we'll be happy to take a few questions. I will now turn the call over to Graham. Graham?

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### Graham Weston - *Rackspace Hosting - Co-Founder, Chairman*

Good afternoon, and thank you for joining us today. As you saw from our press releases issued a short while ago, we made two announcements about the future of Rackspace.

First, we announced we have ended our formal evaluation of the M&A transactions, a review process that we announced to the market on May 15th. In doing so, we have confirmed our commitment to and belief in the inherent value of our business, and our strategy to capitalize on the



growing market opportunity for managed-cloud services. We also announced that Taylor Rhodes has been chosen Rackspace's Chief Executive Officer, and added to the Board effective immediately.

Before we talk about where we go from here, let me start with some background. Over the past several years, the cloud market has gone through massive disruption. Different business models have emerged, along with new technologies that have changed the customers' experience and expectations. As a result, every tech company has evaluated its position and its strategy.

At the same time, over the years, we've built up a lot of strategic value based upon the stellar reputation of our managed services and Fanatical Support, a unique and differentiated asset in the market. This created interest from other companies in Rackspace.

As a testament to our differentiated positioning, as we announced on May 15th, Rackspace had been approached by multiple parties who expressed interest in a strategic relationship with us, ranging from partnership to acquisition. The Board's Strategic Transaction Committee evaluated these inquiries, and retained Morgan Stanley to facilitate a comprehensive review, to maximize value for shareholders, customers and Rackers.

In this review, we talked to a diverse group of interested parties, and entertained different proposals. None of these proposals were deemed to have as much value as the potential value of our standalone plan. Based on Rackspace's reaccelerated revenue growth and its expected trajectory for the coming year, the Board concluded the Company is best positioned to maximize shareholder value by executing its strategy as an independent company.

Ultimately, the Board has a great deal of confidence in the Company's growth and cash flow operating plans, and believes that Rackspace is best-positioned to maximize shareholder value by continuing to execute its strategy.

That's the background and where we stand today. It's certainly not the end of the story. And importantly, we are confident that we have the right team in place to help us on the next phase of our growth and development. As many of you already know, Taylor has served in a variety of roles since 2007, and has been deeply involved in delivering Fanatical Support to customers globally.

Recently, he was instrumental in leading the development and execution of our managed-cloud strategy. We are already seeing the benefits of this approach on our strong results. And it is a key factor in our confident outlook.

Throughout this time at Rackspace, Taylor has proven himself to be an inspiring leader, a strategic thinker, and committed Racker. In Taylor, we are excited to have found a dedicated, long-term leader. And I look forward to continuing to work closely with him as we embark on our next chapter together.

I will now hand it over to Taylor to talk a bit about why we're so confident about the road ahead. Taylor?

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#### **Taylor Rhodes** - *Rackspace Hosting - President and CEO*

Thank you, Graham. First off, I'd like to say what an honor and a privilege it is to be leading this great Company. We've passed numerous milestones, and have grown tremendously since I joined Rackspace in 2007. And with the most talented team in the business, we've distinguished ourselves as leaders in managed hosting and now managed cloud.

We have become famous for our customer support, having introduced the world to Fanatical Support, creating an experience that customers not only need, but that they've become devoted to. We've established a leading position in hybrid cloud technologies anchored by OpenStack. All of these strengths differentiate us.

Our strategy to increase share in the growing managed-cloud market will further separate us from our competitors. In short, we're focused on helping businesses and developers design, manage, and scale their cloud applications and operations.



Rackspace is focused on serving businesses that want to stay fast and lean, by leveraging Rackspace's managed-cloud services and Fanatical Support. These customers prefer to have Rackspace manage not only their cloud infrastructure, but also the many tools and applications that run on top of that infrastructure, including the latest databases and ecommerce platforms. By taking on these highly specialized areas, Rackspace enables customers to focus on their core businesses.

We have been hard at work executing this plan, and the renewed traction our managed-cloud positioning has gained with customers and industry experts gives us confidence in our future. Looking ahead, we are more focused than ever on expanding our leadership of the managed-cloud market. And we think the best way to do that is by remaining independent.

As Graham mentioned, the underlying strength of our business provides us with a runway for growth and confidence in our prospects. Revenue growth accelerated in the second quarter of 2014, and demand has remained strong in the third quarter. With roughly two weeks left to go in the quarter, we are on track to have strong results, and we are comfortable with the guidance range we gave you on our Q2 earnings call in August.

We also believe that this trajectory will continue as we go into the end of the year. We look forward to reporting our results to you on our call in November. Looking into 2015, we aim and plan to drive consistent revenue growth, and we are also committed to leverage the investments we made in 2013, which should lead to increasing margins as well.

It is too early to give you detailed specifics here, but we have plenty of opportunities to drive both revenue growth, and margin improvement. I have been at Rackspace for seven years. I know the Company and our business model well. And our leadership team is committed to execute on both levers. We will give you more details on our plans on our upcoming calls.

One more topic that I'd like to discuss is a share buyback. While we gave extensive consideration to authorizing a buyback program, at this time, we have decided to preserve our financial flexibility to pursue our best growth opportunities to the maximum extent possible. However, we are evaluating all options, and that includes a possible buyback program in the future, if that proves to be the best use of our balance sheet.

Rackspace is an amazing company. I am deeply proud of our business, and I'm honored to have the opportunity to lead Rackspace forward. We will continue to focus on what we do best, delivering Fanatical Support, and our specialist expertise to the hundreds of thousands of businesses that depend on us every day.

And as always, we are committed to maximizing value for our shareholders. With that, I'll turn the call back over to the Operator for questions. Operator?

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) James Breen, William Blair

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### James Breen - William Blair & Company - Analyst

Thanks for taking the question. I guess just first off, can we assume that you rejected an offer that was at a premium to where your stock is today, based on the decisions you've made?

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### Taylor Rhodes - Rackspace Hosting - President and CEO

Hey Jim, this is Taylor. I'm sure you realize that we have confidentiality agreements. We can't discuss any details. But as we stated in our prepared comments and the press release, we considered multiple opportunities with multiple parties. But that's all that I can say in terms of detail there.



**James Breen** - *William Blair & Company - Analyst*

All right. Well I guess then, assuming you did reject an offer because you think you can create more value by hitting the targets you've set forth for your guys; number one, what gives you confidence in that plan? What are you seeing the business there?

And then two, if there was a premium offer that was not suitable for you guys, why aren't you buying back stock here with the trading at 6.5 times EBITDA? Thanks.

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**Taylor Rhodes** - *Rackspace Hosting - President and CEO*

Okay, Jim. Fair questions. Let me take the first one first, in terms of confidence. Well you guys remember back to our Q2 call, just a month or so ago. And in the second quarter we set quite a few records in terms of net revenue added to the Company. The growth trajectory for the Company approached 18% to 20% on an annualized basis.

We had another record revenue per server, lots of different milestones that show us that our managed-cloud strategy is gaining traction in the market. And the backdrop against that, you'll remember, was that this was the same time that the historical price cuts from the unmanaged cloud providers were hitting the market. And so during that time, the ability for us to have a very, very strong quarter in terms of revenue was testimony to the fact that we believe we're playing in a different market, we have different target customers, and that this a big, big market in early stage.

We have a strong plan. And we have high conviction in that plan, and that conviction is based on the momentum that we're already experiencing, our visibility into the demand remaining strong into Q3 and end of year, and trajectory that gives us confidence that you'll be pleased with our results.

So that's why we have confidence on the standalone path for Rackspace. I think your second question was around the share buyback and why aren't we buying shares.

Look, I want to first make sure that everyone is clear that we spent a lot of time and thought on this option. We heard clearly from our investors that this is something they wanted us to do if we could not provide higher growth opportunities for our cash. We just felt in the end that preserving flexibility in this market that is so large and so early stage is paramount.

We think it's improper for a growth company, a company that is growing on an annualized basis in the high-teens to take on debt in order to buy back shares. And so this about preserving our options. It's also me being a new CEO, wanting to study our options and determine the best use of our capital. And as I said in my prepared remarks, we will keep this option on the board for the future.

And if it turns out to be the best way to provide value for our shareholders, we certainly will exercise it down the road. So it's on the table. It will not be executed at this time.

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**James Breen** - *William Blair & Company - Analyst*

Great. Thanks.

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**Operator**

Pat Walravens, JMP

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**Pat Walravens** - *JMP Securities - Analyst*

Okay. Thank you. So two questions, and I think Taylor, you may have just helped with one of them. But who made the decision not to buy the stock back now?

And then the second question? I'll get the second one out and then let you guys go. The second question is just in terms of your margins, what timeframe are we talking about in terms of getting back to your historical margins? Thank you.

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**Taylor Rhodes** - *Rackspace Hosting - President and CEO*

Hey Pat, this is Taylor. I'll take the second question first, and then I'll ask Graham to comment on the first question.

So in terms of margins, look, I think that we have the opportunities starting in the near-term future in Q4 and certainly into 2015 to begin to march our margins forward back up to historical norms. And it is a very high priority for us. We are mobilized against it, and we feel like we have many levers to pull.

Our first priority in 2014 was to reposition the Company, get our story out there and begin to execute on the growth model again. And we are now turning to also growing the margin as we grow the top line. And we don't believe this requires any Draconian measures. It requires us to go pull some efficiency levers.

Remember we built out a lot of capacity in 2013, which we get to harvest going forward. So we will start to show margin improvement in the very near-term future.

Graham, did you want to comment on the decision around share buybacks?

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**Graham Weston** - *Rackspace Hosting - Co-Founder, Chairman*

Yes. Actually, the buyback, it was a heavily debated issue at the Board. And along with Taylor, the decision was made to not buy back stock at this time. There are acquisitions out there that I think we would prefer to do with cash than stock, currently. And I think that we just think given our growth trajectory that we felt that we wanted to conserve our cash and not incur debt at this time.

But we certainly are open to it. We continue to study it. But we decided not to announce a buyback at this time.

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**Pat Walravens** - *JMP Securities - Analyst*

Okay. Thank you. And if I may, you know, one more. Why did this process take so long? Is there anything you can tell us new on that front?

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**Taylor Rhodes** - *Rackspace Hosting - President and CEO*

Hey Pat, I think as you know how these things go, right? When there's multiple parties involved these things take time to go do the diligence on, and to really get into the opportunities and the parties involved. And that's what we've been doing. We would have ended it earlier if we thought we didn't have good prospects.

We took our time to do the diligence on them, and we ended it as soon as we could do it. So multiple parties, lots of work, and we worked it as fast as we could.



**Pat Walravens** - *JMP Securities - Analyst*

Okay. Thank you.

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**Operator**

Jonathan Schildkraut, Evercore

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**Jonathan Schildkraut** - *Evercore Partners - Analyst*

Great. Thank you for taking the questions. The first is I'm sure that you guys thought about a lot more than price as you evaluated some of the strategic options. And it would be interesting to know what other considerations you took into place as you evaluated those other options.

And then secondly, you were looking at both strategic deals and M&A. And I'm wondering if there are any sort of strategic partnerships that could emerge out of the conversation that you had.

And then finally, you guys probably were a little bit hamstrung as you went through this process in terms of ability to maybe execute on some new initiatives. And so are there things that are in the pipeline that maybe we should be looking for as you start to execute on a go-forward plan on a standalone basis? Thank you.

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**Taylor Rhodes** - *Rackspace Hosting - President and CEO*

Thanks, Jonathan. Look, our goal throughout this whole evaluation was maximizing shareholder value. That's always going to be the goal of the Board and the management team. And so as we considered options, they really were around comparing our standalone path to other options that were on the table. And again, the decision came down to a high conviction that we have a much greater opportunity to create shareholder value in standalone mode.

I think also your final question is a good one about what haven't we been doing while we've been going through this. First, I'd like to just say we have been extremely busy. We have our next Solve Conference in New York on Thursday of this week, the 18th, and we've been hitting the road. We've been doing a lot of marketing. We've been doing a lot of work with our large customers to bring them our portfolio.

But certainly management time and distraction and Racker distraction went into this. So going forward, you will see us continue to push very, very hard on marketing, getting our message out there, building partnerships, go-to-market partnerships with key players, considering as Graham put on the table, if there are any acquisitions that can accelerate our capabilities and/or our revenue.

And so really it is about full steam ahead, now that this distraction is lifted from us, and executing the managed-cloud strategy.

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**Jonathan Schildkraut** - *Evercore Partners - Analyst*

Thanks, Taylor. And congratulations.

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**Taylor Rhodes** - *Rackspace Hosting - President and CEO*

Thanks, Jonathan.

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**Operator**

Simon Flannery, Morgan Stanley

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**Unidentified Participant**

Hey, thanks for taking the question. This is [Lisa] for Simon. Just kind of following up on the initiatives that you guys are considering internally; has kind of the process impacted your discussions with customers over the past four or five months, and how do you expect that to change kind of going forward, now that you are remaining independent?

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**Taylor Rhodes - Rackspace Hosting - President and CEO**

Lisa, I am so excited to not have to have this conversation with prospects and customers anymore. It has been a distraction, no doubt. It has caused extra time in our sales cycles. It has caused lots of lots of sort of?let's go back and double-check if I'm a prospect. If I'm a customer, I need to know what your future is.

And so while we've managed it, I think, very, very well, because recall even when this distraction was out there in Q2, we had one of our best quarters ever. I am so excited to get that time back. I'm excited to let our prospects and customers know we're standalone, and that they can safely choose us. And we've got lots of proof points for them to feel comfortable. And remember the Gartner magic quadrant that was recently out that placed us in the leadership corner versus our peers.

And lots of the offers we've been building hit the sweet spot of these companies who are just very, very early in moving from corporate datacenters into managed-cloud models. And we're going to be very, very well-positioned versus others in our magic quadrant there, because of Fanatical Support, because of our expertise in hybrid portfolio. So we are pumped to get this behind us.

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**Unidentified Participant**

Great. Thank you.

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**Operator**

Frank Louthan, Raymond James

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**Unidentified Participant**

Hi, great. This is Alex here for Frank. Can you go into a little bit more detail on the investments opportunities that you're seeing? Any capabilities that you feel like you need to acquire? And then maybe any early color on the results of your renewed marketing efforts after this first Solve Summit. How was the feedback? Was it what you were expecting to get? Thanks.

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**Taylor Rhodes - Rackspace Hosting - President and CEO**

Thank you. Look, Solve--our marketing first, out of our first San Francisco Solve, again we had 600-plus, standing room only attendance. We had lots of what we call A-leads from that, and sales cycles are going well out of that. We are sort of sold out again for the New York Solve. And I think that our goal is, whenever our customers are on stage talking about why they choose Rackspace and why us versus somebody else; that is the most powerful marketing we can do, and it has very high return. First of all, it's very low cost. And second of all, it has super high return.

I also think that the investments going forward will follow the practice areas we've talked about throughout the year. We are, for instance, by far the leader in what we call digital, which is ecommerce solutions and web-content management, coupled with the big data stores that those run off of. We are the leader in the Internet 1000 Ecommerce sites. We continue to see amazing traction in opportunities like that.

And you can imagine that is almost an infinite market. Which business out there is not pushing more of their business online, spending more money on big data and content and making content work with ecommerce?

And so those are areas that we would be continuing. We also think that private cloud in the context of running VMware, Microsoft and OpenStack private clouds is an enormous market opportunity. You all know we have a very large VMware and Microsoft-based business today. And we made an announcement with VMware at VMworld a couple of weeks ago about a tighter partnership with them in terms of their vCloud Air ecosystem.

We're working to revitalize our Microsoft offer so that we can run and manage Microsoft stack private clouds. And we are about to release version 9.0 of Rackspace Private Cloud built on OpenStack. So those are areas that you could expect any investment to follow as part of our core thesis around where the market is moving and how we will win with customers who are managed-cloud customers.

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**Unidentified Participant**

All right great. And then I know this is new, but any plans to fill your previous role as COO or President, or too early?

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**Taylor Rhodes** - *Rackspace Hosting - President and CEO*

At this time I'm going to retain the President title and we will evaluate that in the future.

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**Unidentified Participant**

All right, great. Thank you.

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**Operator**

Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines.

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