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<<Jim D. Breen, Analyst, William Blair & Co. LLC>>

Thanks for coming this morning. My name is Jim Breen. I'm Comm Services and Internet Infrastructure Analyst here at William Blair. For all our disclosures and conflicts you can go to our website, williamblair.com. With me today I have Karl Pichler, the CFO at Rackspace. Karl has chosen to do a fireside chat format. So, just sort of general questions from me. If there is questions from the audience, feel free to raise your hand. It won't be a canned presentation. I think Karl will start off with some basic comments about what their business is and the segment they operate in, maybe the competitive landscape, and then got some more specific questions. But again, anytime feel free to chime in and ask from a Q&A perspective. Karl, go ahead.

<<Karl Pichler, Chief Financial Officer, Treasurer & Senior VP>>

Thank you for having me. So, Rackspace was founded in 1998. We originally started off as an infrastructure service provider and very quickly turned the business into really more of a service company. So there are two main aspects to our business today. One is the provision of infrastructure as a service, very similar to other hosting and cloud computing companies. And then the most differentiating factor of our business is the service layer that we ramp on top of it. Our mission and purpose is to make technology usable for our business customers, and we've always done that.

So we build the business around the complexity of technology and providing that in a useful manner to businesses so that you they can make the best use of technologies. It has a heavy infrastructure as a service component to it. So traditionally, and to this date all the workloads that we are managing for our customers are deployed on our infrastructure. So we have data centers in the U.S., several facilities with data centers in London, and then in Hong Kong and in Sydney. And we deploy compute, storage, networking infrastructure in those data centers.

And then provide that – those platforms to our customers so that they can run their workloads that we help them manage. We have been public since 2008. We've grown every single quarter in our existence. We are now very, very close to being a $2 billion run rate company. And so that's kind of the generic background.

<<Jim D. Breen, Analyst, William Blair & Co. LLC>>

Great, so just to start off, thinking top line down, can you just talk about the drivers for the business for the past 12 months? Have those drivers changed? The drivers of growth? How are they monetized?

<<Karl Pichler, Chief Financial Officer, Treasurer & Senior VP>>

Right. So, over the last two years there was a lot of talk and conversations and internal deliberations as well in terms of how do we differentiate ourselves very specifically from our largest infrastructure competitor, which is AWS? And we really sell something else. We are a more service-oriented solution. There is an infrastructure component as well, but we've always catered to the companies that have infrastructure needs and required technology expertise that they didn't have in-house. If you deploy an application on AWS, you have to have a lot of expertise yourself, usually in-house.

The younger companies that are born on the Internet, they tend to be run by Stanford PhDs. They usually have the expertise to deploy applications and scale them on AWS. But for the vast majority of IT, there is a need for expertise as well. And that's where we come into play. So, over the last 12 months, we really kind of went back to our roots to establish what we call the managed cloud strategy, which is really the next evolution of our strategy.

And again, combining cloud form factors and cloudy infrastructure solutions with a heavy service aspect; fully managed, fully operated by us rather than in-house resources that are not really required anymore. So, as we go through that differentiation, we moved away from pure infrastructure as a service play, because that's where the biggest competitive angle of attack is. And so, we are what are we calling moving up the stack, which simply means we are taking on more of the application management services that are required to run bigger applications of these days.

So, we're talking about data source as a service, where you have a highly integrated package of infrastructure, software and services on top of each other so that we are the best place to run, let's say Mungo app. And that – those database solutions, data store solutions are being expanded to include SQL and non-SQL databases. And so the customers can simply run their application consumer database as a service rather than thinking about how they scale it out, how they start it, how they patch it, how they back it up. And so, that transformation is ongoing.

So, people that have been observing us closely have seen that we've made quite a shift in terms of how we present ourselves on the website, whereas before we were selling infrastructure elements, compute elements, whether it's public cloud or dedicated. And it's now more of a solution focus, and that change is ongoing and we are happy with the progress. But in Q1 we had a fairly slow start out of the year, which is I guess on people's minds, or at least the ones that observe us closely. And so we need to accelerate out of that slow start.

<<Jim D. Breen, Analyst, William Blair & Co. LLC>>

And I guess just staying on that point then, what do you feel led to that? Was it the general business environment? Was it how you allocated sales resources internally?

Taylor talked on the call about the lengthening of the sales cycle as you are going after a larger enterprise customer base, which is traditionally an outbound sales versus inbound.

<<Karl Pichler, Chief Financial Officer, Treasurer & Senior VP>>

Yes, that's absolutely correct. So we talked about this extensively, Taylor did on the call, and we did on subsequent conferences, but basically, as we add additional layers of growth opportunities, as we get bigger enterprises being an earnest asset for us over the last, I would say, really 3 to 4 years in earnest, and really last year was probably the first year where we had several quarters in a row where we had a very nice pipeline and a continuous flow of deals that do take longer. But once the pipe is primed then the deals can come in quicker as well.

And we've always had seasonality over the year-end. Sales guys always said we had it; we never believed it until a couple of years ago when it became very visible. And it's really driven by two very distinct things. On the cloud side, it's the utility nature of compute that plays a factor, where you have a very high build up into the holidays and then a fairly low degree of activities over the New Year. And so, companies actually do slim down and reduce their workloads.

And then on the enterprise side, you more have kind of as an organizational kind of time, where activities just get slowed. Budgets are not done yet, or they do take vacation and there's a holiday break, et cetera. And so there's just slower activity out of the gate. And we've seen that, too. So what exaggerated the problem a little bit is that we now have a higher degree of reliance on larger deals.

So, whereas in the past, we had a very small contribution on the marginal growth dollars from enterprise customers, that contribution now makes up about a third of the entire bookings number on a monthly basis. And so, the slower activities in the year and then the kind of timing uncertainty that's associated with those deals has created that volatility that we are seeing right now.

<<Jim D. Breen, Analyst, William Blair & Co. LLC>>

And it sounds as though the pipeline has improved. So you are seeing customers there that want to use the service, but it's just a matter of getting the paperwork done, signing the contracts. Is that the case? And so, do you feel like there is some point where, like you said, you build a pipeline, you start to close on these contracts, and then you sort of get back on track with more consistent growth?

<<Karl Pichler, Chief Financial Officer, Treasurer & Senior VP>>

Yeah, we certainly don't see a huge falloff in terms of demand or interest or lead flow or anything like that. But we do have to improve; I mean there's no question about that. We're not closing deals at the rate that we need right now to get back into the 4% or 5% growth rates that we've seen last year. So, our sales have to definitely improve. But the

lead gen metrics are – they are working – there is nothing that is discontinuous in terms of volumes.

<<Jim D. Breen, Analyst, William Blair & Co. LLC>>

Do you feel like you need to add sales resources in order to get to where you want to go in terms of growth either on the large enterprise or the small-medium businesses?

<<Karl Pichler, Chief Financial Officer, Treasurer & Senior VP>>

Yes, there is always – I guess there is always the – if you are building a continuous growth engine, which we are aspiring to build, your sales force always has to get bigger. So that's just a general requirement because you just have to add more dollars on the top at all times, and that number has to grow. And so, it's always a combination between sales productivity and then the volume of your sales force.

So, heads and units and productivity per head. So we're definitely adding. In all areas we're adding an international – in our international business; that's mainly driven out of the U.K. We are certainly adding in the U.S., and we basically have the sales force structured into midmarket SMB and enterprise, and we're adding in all areas.

<<Jim D. Breen, Analyst, William Blair & Co. LLC>>

As you see a little bit more of a shift in the sales platform and you see some larger enterprise deals coming through as a larger part of your base, is there a difference in terms of the profit or the EBITDA margins or capital efficiency around these larger customers versus some of the small-medium customers?

<<Karl Pichler, Chief Financial Officer, Treasurer & Senior VP>>

Yes, I mean, larger deals – we have stayed away for a long time deliberately from larger deals because we had the – first of all, we didn't have capabilities in the early days when we were starting the business to really serve those complex solutions, and the complex organizations actually that stand behind this as customers. And so, we had to develop that over time those capabilities. Customers were pulling us in that direction. This is how we tend to evolve our business is when we feel customer pull. And even when we didn't have an enterprise strategy or an enterprise sales force, we ended up having sometimes very large customers or customers that grew very large.

Not necessarily the company is big or enterprise customers, but the deployments became very big. And so, over time we obviously developed those capabilities and continue to develop them. And originally, what I meant before, or what we stayed away from was our – we feared that these heavy deals or these large deals are heavily negotiated and the pricing pressure is enormous. And we actually don't see that. Because on the competitive landscape, if you get into larger deals, you are dealing with competitors like IBM and

AT&T, and they are not necessarily cheap at all. They may have big, deeper pockets but they tend to be more expensive than we are.

Their own benchmark is usually in-house IT, which tends to be less efficient than a specialized service provider than we are, so their internal cost base when evaluated properly is usually higher, so we go there. And then we have significant scale advantages, too. Our largest customers have dedicated teams. And so, yes, the deals are maybe more aggressively negotiated because they have a high volume, but they are much more cost-effective as well for us to serve.

And so, I think when we look at obviously every customer basis and distribution in terms of deal profitability, but the average and the distribution is roughly the same. I guess it's heavier negotiated. It has more, higher volume price discount components to it, but they are justified because they are more cost-effective, so very similar. Long answer, but very similar.

<<Jim D. Breen, Analyst, William Blair & Co. LLC>>

So, can you talk about the overall capital efficiency of the business? You spent – deployed a lot of capital, spent a lot of OpEx in sort of 2013 and 2014, I think to start to serve some of these larger customers. You've announced some wins within that space of companies that you probably couldn't have served in 2013. How does that play out? What kind of factor you've built-in now? Can you grow to a $2.5 billion company without a significant amount of capital being added?

<<Karl Pichler, Chief Financial Officer, Treasurer & Senior VP>>

Yes and no. So, there is certainly capacity in the system. When you look – we talk about capacity very specifically in terms of our data center capacity. Our data center capacity is somewhere in the 60% to 65% range, depending on the kind of timing, and but we still have a – the generic business approach is still that we have production facilities, which is where the new growth is going into. And then everything else is full. And so, given that we are operating now in multiple regions, we have several production facilities, not just one, as we had in the old days.

And so that adds a little bit to excess capacity, but in general we have good runway in terms of data center space, already secured, already ready to be deployed. We have growth space in all of the areas that we are, and we have contractual arrangements with data center providers to provide additional space when and when we need it. So from a – so that's that side. And we actually changed our strategy, our capital strategy on the data center front. We are now exclusively building new facilities with partners, most notably Digital Realty, who just built our London data center that we just opened for our customers last week, actually.

And so, they do everything from raising the capital, designing it in collaboration with us to our specific needs, and then building and operating it to a certain extent as well. From

the equipment side, the equipment side has a growth element to it and a replacement element to it. We usually proxy replacement capital at about 10% of prior year's revenue. That's a good proxy that has held over many, many years and holds to this date. So there will always be some capital elements to our business because it is an infrastructure business after all. And then the growth CapEx, we proxy with $0.50 on the marginal dollar of revenue, so if we add $100 million of revenue year-over-year, we would add $50 million in growth CapEx.

Now to your point, that varies a little bit. So in a year like 2013, where we had significant expansions going on, where we launch new products and launch them in multiple geographies, you have multiple capacity pools that you have to deploy in advance of revenue. Cloud generally is pre-deployed. We have managed hosting. Our traditional business is deployed upon request, so the revenue proximity is much closer whereas in cloud you pre-deploy capacity pools, 40 different products in different regions, and [indiscernible] revenues. Now we're working on minimizing the steps you have to take, but there's always pre-deployed capital necessary for that.

So, in short, it's a function of growth. We are very comfortable with the fact that we deploy capital because we monitor the monetization and adequate return generation of this capital very quickly. And we disclose that through our key metrics like capital turnover so people can follow that. But it's largely a function of growth. So there is some capacity build up, capacity burn off, that creates a little bit of volatility, but other than that it's largely a function of growth.

<<Jim D. Breen, Analyst, William Blair & Co. LLC>>

As the strategy has changed and becoming a bit more technology agnostic, and talking about supporting Google apps and Azure and AWS, maybe just talk about sort of the – how you're going down that road. How difficult – or easy, maybe, depending on those providers – and then how that potentially affects the capital you deploy and the margin of the business.

<<Karl Pichler, Chief Financial Officer, Treasurer & Senior VP>>

Yes. So, maybe again, a little bit of more context and background on this. We have been very, very technology-agnostic. As a matter of fact, we've always been technology-agnostic in the simple sense that we've never really built or developed any technology up until probably 2011; at 2010, 2011. And we've always, as I mentioned in the introduction, we've always been a company that takes technologies that have market traction that our customers want to utilize for their web applications; build expertise around them, in terms of how to deploy them best, how to operate them best, how to scale them best; and then provide that as a package to the customer so that they can just simply deploy their applications. Don't worry about all the stuff that's underneath.

So that's always been our business. We had a deviation from that strategy, and it's not really a different strategy but an add-on, a necessity, where we started to build

OpenStack, and that was really a response from the fact that most or all cloud platforms back to those days were big, proprietary systems that nobody could deploy on their own premise. Our customers couldn't deploy an AWS stack. We couldn't deploy an AWS stack or a Google stack or a Microsoft stack. Any cloud platform was basically proprietary and locked into the facilities of that specific vendor. And we felt very strongly, and others in the industry that an open source cloud solution had to emerge so that companies have an ability to deploy it themselves, or other service providers have an ability to deploy them themselves, and there was a general need and desire for an open source solution to be developed.

And we started off contributing that in collaboration with NASA and formed OpenStack. We then felt very strongly that we had to put as much ways that we can put behind this to make OpenStack a success. And I guess there were a couple of contenders out there in the beginning, but to this date I think it has been established as the open source standard for cloud deployments.

And so, that was a little bit of a deviation in the sense that this was something that we felt was really necessary for us as a company but also for the cloud evolution in general, so we felt good about that. But in general, we are still – our main strategy is to provide expertise and monetize other people's technology through service.

And so, okay. Now, the other question now becomes with respect to other cloud providers. So, we've also, similar to our enterprise deals, we've also stayed away from providing services on other people's technology in the past because it's a nontrivial task. If you – the less of the stack you control, the more you are vulnerable in terms of what the other elements of your input are doing, how well they work. If you rent somebody's data center and the data center is sound, the customer usually doesn't care. They deal with us and they want us to provide uptime guarantees and uptime reliability in general. And so that's our function to do.

And so, we've always had a tendency or a preference to control the entire stack, to deploy the entire stack, and quite frankly to monetize the entire stack as well. But there is no question, and I guess the numbers have demonstrated it that they've closed out, that AW S is a very dominant platform. And going back to our basic business strategy, we are supporting and helping customers use technologies in the sense that the dominant platforms that are being utilized by our business customers, our customers and our noncustomers.

They deserve to be served, and there is really not many service providers at scale that have demonstrated how to build a repeatable business around technology services. We are not a consulting shop. We're not a professional services firm. We do productized services, and we see a big opportunity in doing that around technology stacks that are – that include capital from other companies like Azure, Google, AWS.

<<Jim D. Breen, Analyst, William Blair & Co. LLC>>

Early indications, like what's the feeling in terms of them supporting you, supporting their platform? They tend to not have a support infrastructure around it with very strict SLAs and so forth.

<<Karl Pichler, Chief Financial Officer, Treasurer & Senior VP>>

Yes, so I think they are – this is – Taylor calls this a horizon three initiative. That's a terminology that's been established in a lot of those business books. But it basically means that we are in the process of really defining what the business is all about, what the business model looks like, what the offer looks like, what product markets it is, how we charge for it, how we bill for it, etc. So we are really in the process of forming the service layers that our customers really want from those, and also the ones that we can effectively serve. So, for example, we don't want to be a big billing inquiry house for customers who don't know how to read their Amazon bill. That is a big pain point.

We know that for a lot of customers, but our business cannot evolve into being a billing call center. But capacity management is something that is associated with billing. Billing is simply the economic outcome of that, but customers usually consume so many resources unknowingly that they are upset with the bill at the end. So capacity management in terms of consuming those third-party resources is a very high-value task, and so that's one example of where we can provide significant value to our customers on other people's platforms. So we are doing that, and you know, the – Microsoft is probably a perfect example.

We have been Microsoft's Hosting Partner of the Year for probably 14 out of 15 years of our existence. They have built a business where they rely on companies like us to provide the service layer. Microsoft support, if it exists, has a fairly bad reputation. And we have built businesses in direct competition with them where we have a hosted exchange offer that they have too, and we charge $5 more per seat than they do, and we still sell a lot. So it's not like that they are squarely competing. And then Google and Amazon are slightly different but kind of similar in the sense that they do have a very, very, very strong technology focus. They are a technology companies, as we know.

And they don't really – I mean I can't really – intelligently comment on what they may be doing in the future or what their plans are, but they don't really want to be a service company. They probably see the necessity to build an ecosystem. They probably see the necessity to build an ecosystem. They probably see the necessity to provide product services around their very, very large customer. And we have indication that they are building service capabilities, in-house service capabilities, for a very small segment of their market that they are serving, but in general they want to have an ecosystem that is developing around their product set. And that has been the case for many technologies in the past and we see a similar path for the large cloud providers as well.

<<Jim D. Breen, Analyst, William Blair & Co. LLC>>

As you approach a midsize-large enterprise that's hosting all their IT internally, doing it all on their own, can you just convince them that the outsourcing portion – or letting you manage that then is better, and you do start to bring in things like AWS where it's appropriate, or Google apps, whatever. Does that change the competitive environment? I think there is a huge perception two years ago, three years ago, that it was you versus Google versus AWS head-to-head all the time, that certainly was reflected in the stock movements as those guys were cutting pricing. And then that sort of went away. How does that change? Is it more of a symbiotic relationship going forward? And AWS is saying, listen, we're not doing the support portion. If you know what you are doing, come use us, but for the 85% of enterprises that don't, you have to use a business like Rackspace to do it.

<<Karl Pichler, Chief Financial Officer, Treasurer & Senior VP>>

Well, we'll see how it evolves. The reality is we have to continuously evolve our business and have points of differentiation. In the past, what has happened in the first, call it 12 years of existence of our Company, there was no differentiation on the technology side. Everything was x86, either Linux stack or a .NET stack, and every website was running on exactly the same thing. It was just completely non-differentiated.

We built a company – we were quite literally, as far as I know, the only one who actually said, okay, we're not going to compete on the technology side because there's no real point of differentiation, because everybody uses the same stuff. But we want to build a service business around that, and that has helped us tremendously well.

And I think it's just a matter of – for us going forward, there is a lot of – we believe and we have every reason to believe in our customers telling us that there is a huge market for private cloud. And I use private cloud not really as a product category but as the next evolution of dedicated, single-tenancy hosting. Which is like, yes, a lot of workloads will go to public cloud multi-tenancy solutions and yes, Amazon demonstrates a lot of traction, but we are talking about a market that is enormous in size.

And so, mainstream IT is still very much our main competitor, so to speak, which is in-house do-it-yourself. And the cost of deploying capital in-house or do-it-yourself is just – this is the beauty about the price/cost in terms of our industry, which is like it becomes prohibitively expensive for any company to deploy their own capital going forward. It just doesn't make any sense anymore.

<<Jim D. Breen, Analyst, William Blair & Co. LLC>>

Because of the efficiencies you see as a larger company?

<<Karl Pichler, Chief Financial Officer, Treasurer & Senior VP>>

Yes, and it's just crazy to do it. It's too complicated. It's too costly. You need – you have constraints everywhere, from expertise to capital to scale. Everything is just getting – it's

just a bad equation. And so we've always benefited from that secular trend that do-it-yourself is going away, but it just adds one more argument to it, which is that the cost is just – the cost comparison is just too compelling. But still, if you talk to any CIO of any decent-sized company, they would – they are the first ones to claim that the multi-tenancy public cloud economics or the attractiveness of their economics go away very quickly as a fairly decent-sized private cloud.

And so they don't really believe that they have a cost disadvantage because they feel they have scale enough to get into those scale economies. And so, we have an obligation and a duty as a business to constantly evolve and to provide platforms that are differentiated and it makes sense, but we also have a duty to start complementing our own form factors with something like an AWS or a Google Cloud Engine if our customers want to deploy on those platforms.

And so I think we have a business opportunity and then we have probably the broadest type of form factors that any provider supports, where customers can really choose any landing pad for their application that they want, and that is a very compelling proposition.

<<Jim D. Breen, Analyst, William Blair & Co. LLC>>

Great, I think – did you have a question?

Q&A

<Q>: [Question Inaudible]

<A – Karl Pichler>: Yes. So on the AWS side, on the third-party clouds, that is still in the process of being developed. We don't really have any offers launched or anything like that. So on the traditional business, we are basically – the very simplest way to think about this, we are a professionalized army that does what you're in-house IT guy does, right. So anything from deployment to scaling to patching to backing up to any – really anything other than actually managing the content or the business process of the application that runs on top of it.

<Q>: [Question Inaudible]

<A – Karl Pichler>: Yes that's…

<Q>: [Question Inaudible]

<A – Karl Pichler>: Yes. The idea of the hybrid cloud is really around the recognition that you have. One way to think about cloud or public cloud specifically is that it is the most elegant solution to do shared hosting, or multi-tenancy at as it is called these days. But 15 years ago it was called shared hosting, and shared hosting didn't work because you had the noisy neighbor problem. And if I happen to be on the same server as a bandwidth-hungry other content provider, then I lucked out.

And so, cloud has many, many more advantages, but from that point of view it's another version of shared hosting, which is that it has a high degree of asset utilization because you can really max out the compute or the revenue generation per unit of compute, but it does have certain of those problems. And that's why most companies that want to deploy production-grade workloads, where the performance requirements are somewhat stable, not very variable, where they get out of testing and deployment and scaling, but into kind of stable production.

A lot of companies actually built their stuff on public clouds and then got move into private as soon as its production-ready. Because then you don't really have the – a lot of the value props are around non-committed infrastructure purchases, right, where you don't actually know how fast you want to grow. You actually don't know – you want to grow quickly to basically test your applications at scale, but then you don't want to – you want to go down again. But that is very, very different in what you need from a technology platform once your stuff is in production.

And so, the idea of the hybrid cloud is to combine those two things and say, okay, there are elements like a database that performs better and is actually better deployed on dedicated single-tenancy solutions. And then you have your [indiscernible], which serve up the website that you want to be highly dynamic. So, if you have a lot of demand on your website you want to be in a – on a platform that is elastic, and that ideally manages the traffic itself, which is the typical cloud stuff.

<Q>: [Question Inaudible]

<A – Karl Pichler>: Yes, we have a product called RackConnect, which is a link between dedicated and our public cloud solutions where companies can do exactly that. Yes.

<<Jim D. Breen, Analyst, William Blair & Co. LLC>>

Great, so I think we are out of time. We have the breakout session is in Allium back near the restaurant. Thank you.

<<Karl Pichler, Chief Financial Officer, Treasurer & Senior VP>>

Thank you.