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<<Colby Synesael, Analyst, Cowen & Co. LLC>>

Okay, we're getting started. Good morning, and welcome to day two of the Cowen TMT conference. My name is Colby Synesael. I'm the Communications, Infrastructure and Telecom Services analyst here. For this presentation, we have Rackspace. And from Rackspace we have the company's CEO, Taylor Rhodes. This is structured as a 40-minute fireside chat. I prepared a list of questions, which I'll go through, and then towards the end, I'll open it up to the audience. So, Taylor, thanks for being here.

<<Taylor Rhodes, President and Chief Executive Officer>>

Pleasure. Thanks for having me, Colby.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

So I want to just jump right into it and talk about your managed cloud product, and more specifically, that for AWS. So, since last October's launch through April, you guys have said that you signed up 187 customers across every size, geography and vertical. I guess first off, are you surprised by the diversity and the demand to which you've been seeing?

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes. Probably it helps maybe to kind of click up a couple of levels there and talk about the category we play in and then I'll get into that specifically. But the category that we play in is called managed cloud and it's a new category relatively. Prior to the cloud era at Rackspace was what we would call managed hosting.

And in the early days of no Internet, the Internet – no website to website, no eCommerce to eCommerce, we made our bones in becoming the leader in providing managed services on top of dedicated hosting infrastructure for companies who were trying to scale web apps. And what's happened over time is you see this $300 billion of spend that's sitting in corporate and government data centers. That spend is flattening out on workloads running in that data center. And where is it going?

It's going into public clouds and private clouds at an accelerating rate. And what happens in these inflection points in time is that scarcity becomes expertise – people who know how to operate, architect, scale, secure these types of applications. And we're sitting on the verge of this new inflection that's bigger than any we've seen before where the mainstream market has now proven the model – they said it works economically; it provides productivity; it provides speed and competitive gains – now I want to get there. And so as the herd starts to move in these inflection points, the scarcity becomes who can help them do it? Who can manage that for them?

So, the category is managed cloud. The forces in the market that are driving it are the exit of the corporate data center over time and into cloud models. So, when we think about our opportunity managing AWS or managing Azure or managing an OpenStack private cloud, the framework over the top is managed cloud services that make all of those things work. The infrastructure platforms underneath are important, but they are also just one of the options in the model.

AWS happens to be, and will be for a long time, the largest public cloud platform. It's $10.7 billion growing at 70%, if you do the math, in three or four years, that means it will be a $30 billion company. What we see is that there is a large part of the mainstream market that prefers AWS but doesn't have the skills, expertise, capabilities, et cetera, to migrate their applications to that platform and then operate them on an ongoing basis.

So we're not surprised by the size of the demand. This is following a very predictable inflection in the market. The fact that it's small, medium and large, and striking across all the demographics is not surprising either, because we see that this is an overall secular trend that is impacting every business out there. But it's a very big opportunity. And the scarcity in the market plays well to our core historical strengths.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

Just to – and let me go a little bit off script here – but just in terms of how you just explained and presented yourself in terms of growing, it seems like you guys are getting more confident that this is absolutely where the market is going as opposed to maybe six months or nine months ago, when you kind of first rolled out with it, less certainty that this was clearly the way the market was going to go?

<<Taylor Rhodes, President and Chief Executive Officer>>

Well, I think we wouldn't have done all the product work we did in 2015 if we didn't believe this was a big opportunity. But when you first launch something, you are in the early product market fit stage and you've got to go learn and see what the uptake is, and how does the pricing work, and what does the offer have to have in it. And so I'd say we're in learning mode, but our conviction has been high that this is where the market is going. You don't have to be a genius to come to the conclusion that companies want workloads out of their data centers moving into clouds. You simply have to believe that there is a healthy segment of that market that wants to buy managed services to make that work rather than a pure DIY model.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

Okay. And I guess when I speak with investors – I'm going to talk about the competition for this spend – so when I speak with investors most referenced Datapipe and 2nd Watch as your two primary competitors within managed cloud. I guess first off, do you agree with that? I mean, if someone asks you the question, who is your competition, who do you say?

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes. So the good news for us is that, yes, those are the referenced competitors that we're seeing today. And why is that good news? It's good news because if you think about a company like Datapipe, there are a couple of advantages that we feel very strongly about. One, there's only four companies in the world that had to build their own at scale public cloud. That's AWS, Azure, Google, and Rackspace. The heritage we bring in having built our own OpenStack public cloud from a software expertise, dev ops – you name it – is very differentiated when you're talking to a customer who is using large-scale cloud applications on AWS or Azure and making those things work.

A company like Datapipe has never had to do that, so they come at it from a very traditional almost dedicated hosting system administrator perspective. So our differentiation on skill, the tools we build, the capabilities, we've built this one very big point when you think about Datapipe or 2nd Watch.

The second is scale. Right? Those are subscale companies. They largely operate in the U.S. only. They largely have limited footprint outside of the U.S. And so when you're talking to a medium or large size enterprise, you are also able to differentiate yourself on the scale of expertise you have, where your data center footprints are, your experience set, et cetera. So we feel very good about those new era of managed cloud competitors versus Rackspace.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

And I think we sometimes oversimplify what it means to provide these managed services, and we simply think everything is put on AWS and it stays on AWS but they have other systems that are not on AWS that are talking with their AWS solution. Those can be built on VMware. Those can be built on Accenture's open system. You have historically focused on them. You've also historically focused on Windows. How does your expertise with VMware, with Windows, with other non-AWS solutions actually help you with AWS or with Azure?

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes. I think that you raise a great point and it creates an lot of complexity for a CIO or a CTO to manage – which is I have this heterogeneous set of applications and tools strung out over time on different platforms, so how do I manage all of that while I'm also making the decision for the long run to move more and more of these applications onto AWS or Azure or what have you?

So the complexity in offering what we call a multi-cloud portfolio is part of our opportunity. If you're today running a large fleet of VMware workloads in your corporate data center, you no doubt have said, in five years, I'm going to look very different. Applications Tiers 1, 2 and 3 will be on AWS; applications 4 and 5 will be on Azure. These will go into private clouds. And so as you're making that transition over time and having to integrate all of that and make it work together, that's historically our managed services core.

Those are the types of complexities that we solve for our customers. And frankly, the shift that's going on now makes it even more complex. If you think about AWS as an example – it is not a single product. It's actually almost 100 products. And in 2015, they released over 700 product feature changes, and that was up from 500 in 2014. So the pace of change in these product stacks is incredibly complex for a mainstream company to keep up with.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

So, based on all of this, it seems like there is clearly a market – there is clearly demand for what it is you provide. So really it's about executing. Talk about the Company's go-to-market strategy, what you're trying to do to insert yourself into these conversations.

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes. Thank you. So we hired a Global Sales and Marketing leader in January named Alex Pinchev. Alex – his heritage most famously is Red Hat. He joined Red Hat sub-100 million; he exited Red Hat at about 1.2 billion, and he really did build their entire go-to-market and professional services and partner channel ecosystem out. Alex will tell you it was really fun in the early days trying to figure out how to make money selling free software. But he was one of the guys who helped invent the Red Hat model, so he's got extensive global experience. He is leading our go-to-market.

Now clearly, he's five months in and so he's still early-stage, but our go-to-market has to be about, first of all establishing the managed cloud category, remember it is a new category. The first $10 billion on AWS was all DIY – it was all greenfield application development led by technology early adopters who could do it and wanted to do it themselves. We're entering that phase of the market of mainstream adoption where you have to help people understand that the offer exists, that the category is real, and then you have to associate Rackspace as the leader in that category.

So there's a lot of branding, there's a lot of partnering up to go do. And then we also need to make some shifts in our skill set around salespeople and train people – sales and technical salespeople, et cetera, around these new technologies. You heard us talk in Q1 about shifting resource and hiring new resource to be able to be trained and enabled in the new offers. And so there's a lot of that work going on behind the scenes, and that's a big piece of work that we've been at now for roughly six months. And we're excited about the future on it but that's a lot of heavy lift.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

And I mean, to that point, you did, I think, on your first-quarter call, provide guidance for 2016 – I think it was a little bit lower than what some were expecting, including ourselves. But you mentioned and you just brought it up again that you reallocated some resources more towards the managed cloud product at the expense, if you will, of the primary services-oriented business you've always had. Once that transition has been completed and Alex has gotten everybody in line, and more of the heavy lifting you just described has been completed, should we or can we potentially see the re-acceleration then in the growth relative to what the expectation level is, at least now for 2016?

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes. Well, certainly our aspiration is that these new businesses are hypergrowth businesses. And you heard me talk at the beginning of the year – we've got three missions right now. One is we have a stable and growing core business, which is our dedicated hosting on our own OpenStack public cloud. We're using that as an ongoing vehicle to enable us to leverage ourselves into these new hypergrowth businesses, which is managing AWS, managing Azure, OpenStack private cloud, value-added services like managed security.

Those are early-stage – on a $2 billion base, they will take time to move the needle right on the top, but those are clearly in early hypergrowth traction stage when we share things like we now have over 400 customers collectively on the OpenStack private cloud AWS and Azure platforms. That's up from a very small number – a short number a months ago. So we're seeing this hypergrowth traction, but the revenue carrythrough on a $2 billion base will take time to be accelerate.

And the third mission is while we're doing this, we're also transforming the economics of the business. These new businesses are capital-light. And so you'll see the capital intensity of the business come down over time, and you're seeing that start to show up in the economics of the business this year.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

So let's talk about that and it's a broader conversation on disclosure. So right now you've chosen, because it still makes sense, not to break this business out in terms of financials. And I guess if there's a concern it's that this business is very different in terms of its financial structure. I think, first off, you are recognizing the revenue on a gross basis but what I'll say is a pass-off to AWS or Azure is in that revenue.

The second one is the margin profile itself is different, as is the capital intensity. Is there a risk that the longer you wait, the more those metrics start to get muddled into one, and we on the outside start to misinterpret what's actually happening within the company?

<<Taylor Rhodes, President and Chief Executive Officer>>

Absolutely. So we understand that there is complexity in modeling the business right now. But I think also we've provided lots of information, so let's just kind of go to what we have provided. Right? In these new businesses, what we've said is that they are capital-light. So therefore by definition, EBITDA will be lower than our historical corporate EBITDA because there is no D&A. But we've said if you go further down the P&L to EBIT, you certainly see either similar or slightly better economics, and clearly free cash flow margin will be equal or better than our corporate economics as well.

And so I think we've provided a lot of transparency on what we think the overall economics are. And certainly as we are in the early stages, those economics are proving out. What we're trying to do also is share a lot of the traction along the way. Is having nearly 200 customers on AWS good, bad or indifferent? Well, right now, it's showing that we can appeal to a broad base of the market. We are having the majority of these customers coming net new to Rackspace that have not been working with us before.

They are buying our higher service level, which is at a premium price, which articulates the fact that there is a problem to solve and value to add. And so along the way, what we'll end up doing is continue to share the traction. We'll talk about how the overall economics of those businesses work. And then at the right time, when they have reached the substance and mass to start the impact of corporate economics, we will create more transparency around them.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

Do you still think that's 2017 most likely when we start to see these two businesses being split?

<<Taylor Rhodes, President and Chief Executive Officer>>

Let me answer that later. I think we are playing on that one. By definition, what we've done this year in the guidance we've given for 2016 is we have said, look, these aren't going to move the needle in a huge way. What we said also is that as we get closer to 2017, we'll be evaluating how to create more transparency. So we'll come back to you on that.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

Okay. Let's talk about some of that traction though and get a little bit more color on what's happening. So I guess one of those questions I could ask around that is around Azure as well. So are the customers you're signing up for the Microsoft Azure product, in terms of the managed cloud, the same or different than the ones that you're seeing also signing up for the AWS managed cloud solution?

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes. You know what we're seeing so far is that it's less about cloud 1 or cloud 2 is better for this particular workload. It's more about what's your heritage? What application and technology environment are you coming from? Of course, AWS didn't exist six, seven, eight years ago and so it's getting a lot of workloads that are being born or reborn from the AWS cloud. You contrast that with Microsoft, which has a very large installed base of customers consuming its legacy products. Therefore what you see most of the time is that people who are choosing Azure are choosing it because they are more of a Microsoft shop or part of their enterprise is a Microsoft shop. And they're evolving through on-prem corporate workloads in the data center to Microsoft private cloud and now starting to branch into Azure. And that's the way their evolution is going into the market, because that's the way Microsoft is driving their product roadmap for that ecosystem.

So oftentimes we'll find a large enterprise that use Microsoft in part of their shop, they use VMware in part of their shop, and they've got AWS now. Well, Microsoft workloads are more likely than not to migrate into the Microsoft cloud. Does that make sense?

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

It does. And I guess let's just talk about the Microsoft private cloud. So that's something where you guys have said you are seeing strong demand for that product. I guess can you give us a little more color on what's driving that? Is it simply that that's the intermediate stop, if you will, on the way to Azure?

<<Taylor Rhodes, President and Chief Executive Officer>>

Well, I think intermediate is probably the wrong word. We are seeing more and more evidence that companies are getting more sophisticated now and kind of tiering out their applications, and saying, based on requirements for that application – what sort of data does it handle? What are its security and compliance requirements? Who has access to it? What's the budget for it? We're starting to see companies build a service menu that says these class of applications are going to a public cloud platform. These are going to be in a private IS private cloud platform, and some of these are never going to be replatformed for the cloud, so they are going to stay on dedicated workloads.

So what drives platform selection is oftentimes the company's requirements on what they need to do with their application. So when you think about this private cloud and interim step, we actually think that there's evidence that there will be a private cloud element to the cloud ecosystem for a long time to come, by choice. We see Microsoft's customers evolving from running Microsoft in the corporate data center, leveraging their private cloud offer, and now with Azure Stack – which is a new product feature that they've launched – it makes it much easier for them to start to burst over and move those workloads into their public cloud.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

And I guess that's a really great point, which is part of the value of providing is that expertise thing. We've done this for X amount of customers. These workloads work better here and you should suggest here, and here what we've seen historically and there should be some value in that expertise.

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes. That's a big part of what we do and always have done, is because we don't invent a lot of the technology ourselves, we are able to be more objective about what is the right evolution path for you, which app should go where.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

And the other question we get here from investors, though, is when we think of AWS and we think of Microsoft, and the argument that the type of solution that you provide around managed cloud will be something that's needed – there's a view that why can't they do that themselves or why won't they at some point? And once the market has been established, once it is big enough that they feel that there's something worth going after, considering how big their businesses are, that they are just going to say thank you for helping but we're going to start doing this more on our own.

<<Taylor Rhodes, President and Chief Executive Officer>>

Sure. So let's go back in time for some corollaries that are probably helpful. Right? You could say the same thing about Microsoft historically in their business. Why did Microsoft choose to offer historically only a limited set of service options around their products? The answer fundamentally is because they are a product company. They offer – today, both Microsoft and AWS offer support. You can call them and ask them questions about what's happening inside of their stack. But it's very different than building a fully managed service where you are in charge of logging into, patching, operating, fixing, and making these applications work.

It's a very different thing. And over time, what you've seen with companies like Microsoft, VMware, Oracle, AWS today, is they choose to stay focused on their product stack and innovating there, and they channel and enable an ecosystem around partners who can deliver managed services around their products. So this isn't a new model. It's not new for Microsoft; certainly they are the kings of channeling technology. And what you're seeing AWS do today is follow a very classic case.

They offer some level of support, but if you think about what they're doing with companies like Rackspace and their entire ecosystem, is they are saying let's go push that out into a set of qualified and certified partners who can do that work for us, because we're growing at 70%, making our product stack better. And that's one thing to think about is, how will this evolve? It is the biggest question about us, right? Will they choose to get an offer of fully managed service? Could they? I'm sure they could; they are a very good company. But would they? – is the question.

I think it's very countercultural for them. They've talked openly about the fact they choose not to do this. And all of their action today is around enabling their partners and training their partners, and getting go-to-market established. So we feel like there's lots of historical precedent here that gives us comfort that we have a good spot in this.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

Okay. I want to step back and just talk a little bit more high level. So there's been a lot of change at Rackspace over the past years in terms of key personnel and strategy. How would you describe the employee morale? Or more broadly, the atmosphere inside of Rackspace today?

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes. So 2014 – we had a CEO change. We also went through a publicly visible strategic process on should the Company stay independent or not, and that was absolutely a bruising time. Rackspace is a strong culture company. We've been doing very, very well up until that point in time. And that was tough. That was a hard transition for us as a company. And we saw our employee turnover elevate in 2014 and into 2015. We saw what we call our Racker engagement scores, which is how our employees are telling us we are doing, go down. And that's been a tough transition. I would say what we can measure today is that the employee turnover is stabilizing, heading back down, that the Racker engagement scores are back up. We just in…

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

Are they at the same levels they were before?

<<Taylor Rhodes, President and Chief Executive Officer>>

They're on the climb back, so – but I would say significantly better. Another external benchmark is companies like Fortune and Forbes survey our employees all the time, and they share a lot of data with us. And one of the key data points from a survey like Fortune or Forbes is this thing they call the Trust Index. They ask a lot of your employees, do you trust your leadership? Do you trust the strategy of the Company? Do you see this as a worthy mission? And we saw a remarkable improvement on the Trust Index scores going into 2016 versus where we were in the first half of 2015.

So we think we're on the other side. The other thing is also Rackers want to believe they're mission-oriented people. Us investing into these new offers where they think we can compete and win is actually what they were looking for. Are we still playing to win? Do we have a worthy cause? And seeing us move in and play to our strengths in these markets I think has been the number one determinant of that turn.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

Great. So it sounds like things are not to where they were pre-2014, but you've certainly troughed and are on your way back up in terms of you feel good about that.

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes, we feel good about that.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

And I guess just last week you announced the appointment of Carla Sublett to the CMO position. Are there any more key roles that you need to fill? Or is the full team effectively now in place? I know there's been a lot of movement; you obviously mentioned Alice as another example. Where are we in terms of getting the right bodies in the right seats?

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes. We've added quite a lot of talent over the last couple of years, as you can imagine. When I looked around the table of the senior leadership team when I became the CEO, I saw us very long on service expertise but short on things like product expertise – that's why we brought Scott Crenshaw in, who really led Linux and KVM, et cetera, at Red Hat from a product perspective. We brought in Alex because he's a global go-to-market leader. He's both built and operated at scale.

Carla has been with us for over a year now; her prior role was the CMO of our Americas division. She's done very good work sort of reestablishing the effectiveness of our marketing. We have high potential for her. And so her becoming the corporate CMO is just a recognition. We're always looking for additional talent. I can't tell you right now that we have one key role open, but you'll see us continue to add talent as we expand into these new businesses.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

Okay. And then part of Alex's strategy, since joining, he has also renewed your focus on adding more enterprise customers. And in the first quarter of 2016, you said your enterprise sales team added four times more customers than the year before. Can you talk about what you're doing to help attract these larger customers again?

<<Taylor Rhodes, President and Chief Executive Officer>>

Sure. First of all, I think you have to have the right offer. Right? So the door-opener for us now, it's different in 2016 than how we started 2015 out. Because in 2015, if you remember, in Q1, we did not have the ability to engage on AWS or Azure or Rackspace, managed security, et cetera. So a lot of the product work we did in 2015 now makes us much more relevant in terms of getting in the door and having a conversation. And that was job one, right?

We also, though, have made changes to our sales model that make it more effective. So we have dedicated a field force that does nothing but hunt new logos, right? In 2015, they were a hybrid force; they could do new customer acquisition as well as grow existing customers. So there was not a part of that sales force that was focused solely on attracting new customers to Rackspace. We made that change. We've got a team now that does nothing but hunt. And with the combination of the right offer – and you can't make your target any other way than bringing in new logos – we are starting to see some good traction there.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

And what's the typical book-to-bill? I mean, it sounds like there's momentum happening in terms of signings and bookings, but when – looking at your financial results, should we start to see it? I'm seeing this now in the numbers.

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes. So these sales cycles can vary somewhere between three and nine months – nine months is the outlier. Let's just call it a six-month sales cycle on the enterprise side. And then you usually have a materialization from the time that the contract is signed to when it's online and billing. That could range from – let's call it a couple of months to a few months. So what we said in the Q1 call is we had a very strong March, and that those deals will take a couple of months to come online and start to contribute to growth in the back half of the year. So you should think about that as the book-to-bill.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

Okay. And I do want to talk about guidance. So on your first-quarter call you provided second-quarter guidance that was lower than expected as a result of this lower-than-expected starting in January and February, driven in part by what you guys described as a weak macro environment and also noted a potential lengthening of the sales cycle. Do you think that was tied to the volatility you were seeing in the market at that time? So, in January and February? Or do you think that there's something that's more profound that's happening right now?

<<Taylor Rhodes, President and Chief Executive Officer>>

Well, we try to look at – is there a big macro effect? What we do see is we see customers going back and checking again and again. What you see is sales cycles get elongated, because they're coming back one more time for a budget review or a project review. So you see extra steps added in before somebody makes the decision to go do spend. That's what we typically see when people are nervous about the macro.

So, that being said, your pace of signing deals slows down. Certain deals will slip from quarter to quarter. So we are seeing evidence of that. I wouldn't call it 2008 by any means, but you definitely are seeing people say, is the budget scrubbed hard enough this year? Could we live for another year without this project? And that impacts us. But we think that the majority of the impact, as we said on the call, is that we have seasonal weakness in Q1 always. If you look at our business, Q1 is always the lowest. Q2 starts to improve. Q3 generally is our strongest quarter of the year, and then Q4 is there or thereabouts. We have some seasonality; particularly as you get into enterprise, those folks don't do business in January and February. It takes some time to get them back off holiday.

Then the changes Alex is making to our go-to-market – we talked about the fact that those would take some time to bend down. So those are the things that got us off to the slower start to the year.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

And I mean, to your point, you did maintain the guidance for 2016. And it sounds like it's really that combination. It's, historically, the back half is seasonally stronger than the front half, particularly in the first quarter. And that based on some of these changes in the large bookings of four times, for example, more enterprise deals than the year before. Knowing when those are going to come online in the back half – I guess those are the two predominant factors that are giving you that conviction into maintaining that guidance?

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes. We don't see anything today that would make us change the guidance range. I mean, I would – you'd have to think that the upper end of the range is a stretch, based on what we shared with you guys in Q1. And you think about that book-to-bill materialization. So, yes, the upper end of the range is a stretch, but we don't see anything today that would make us change the guidance range. And those are the factors that give us comfort.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

Okay. The – I want to talk about the OpenStack private cloud. So in the first quarter, you set a new OpenStack private cloud bookings record and said that revenue is growing in the high-double digits, with your pipeline growing even faster. Can you provide some color on what's driving this? I mean, it seems like – and I'm not going to put words in your mouth – it seems like that even surprised you guys in terms of just the strength that that particular product is having right now.

<<Taylor Rhodes, President and Chief Executive Officer>>

OpenStack is a six-year-old technology that, if you compare it to where Linux was six years in – six years in for Linux was 1995-1996; Linux was being used by nobody, nowhere in 1996. Right? It took until the early 2000's to become a mainstream product. So if you think about where six years has gone with OpenStack, it's made remarkable progress during that time. And I think what's happening with OpenStack, what we are seeing in the market is, when we first invented OpenStack, to the best of our ability, we viewed it as a competing public cloud platform.

What's happened in the market is the world doesn't need another at-scale public cloud. The world is happy with AWS, Azure, Google is going to be in here. What's happening is that there is a huge installed base of companies using VMware and other technologies in their data center. And they are trying hard to think what their next thing is that drives productivity. And they have a mindset that private cloud is going to be a part of their overall cloud thesis. Right? So I think what you've seen with OpenStack private cloud is it's gone through the traditional Gartner hype curve. Early adopters tried to go build it themselves – hire Aransas or somebody else to come build them a snowflake.

They found out it was complex, it didn't scale well, expertise was scarce, and their expectations crashed down. And what we're seeing now is because of the maturity in the product offer, both at the OpenStack level as well as what Rackspace can do with it, you are starting to see people say I've still got to get off that old expensive stack. I know all of these apps aren't going into public so I need a private, and now I can buy OpenStack as a service. It's matured enough and Rackspace has solved enough of the problems, and put four nice SLA around it.

So what we're seeing is that emergence from that trough of companies who are now ready to buy OpenStack as a dial tone rather than trying to manage it themselves. So we had several of our large bookings, as we said in Q1, on OpenStack private cloud. Our pipeline going forward has some very large opportunities for OpenStack private cloud. And we see essentially that installed base of VMware and others as the target market for OpenStack private cloud.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

So it sounds like this is an interim demand and everything is going to ultimately move to your managed cloud. There's a legitimate spot for this product in the long-term evolution of where IT goes.

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes. Think about managed cloud again as the category of services and infrastructure options – private clouds, public clouds predominately are options underneath that value proposition. We don't see private cloud as a transitionary platform. It may be in 10 to 15 years. You may wake up in 10 years and say, whoa, everything has gone all the way public. What we're seeing when we talk to big companies today is they also have a point of view that says, first, as far as I can see, a certain portion of my application portfolio is going to be on private IS.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

So we have about 11 minutes left. I'm going to ask one more set of questions. Assuming Taylor doesn't walk off the stage after I ask them, I'm going to open them up to the audience to see if you guys have any questions. So I'll talk about investor sentiment. So your stock trades about four times 2016 EBITDA. And when I talked to investors, I'd say about 80% don't bring up Rackspace – so it just doesn't come up in my meeting. I'd say 15% don't like your company and I'd say there's probably 5% that do. So the stock is not in good favor right now. What do you think investors are misunderstanding? What do you think has got us here? And what is it that – what's your biggest argument for why there is a misunderstanding clearly in the market at this point?

<<Taylor Rhodes, President and Chief Executive Officer>>

Yes. Look, I 100% empathize with the frustration. As we talk about 2013 to present – 2013 was the first year that we started to see decelerating growth rates and we missed our numbers for the first time, if you just look back in time. And we also grew our target capital model in 2013 – if you remember, it went way up. We invested and saw revenue growth slow at the same time. We had a CEO change. We had to deal with the fact that our OpenStack public cloud was not going to be the rocket ship of the future that we thought it was going to be and that we used to enjoy.

And so what I think – first of all, I 100% empathize with our investors who are frustrated. The story is difficult to model right now, as you know, because of all these transitions. But I think what people are missing is – I always ask myself the simple three questions: one, do you believe that the cloud is going to keep growing and will be a very big market? I think everyone would say yes.

Two, do you believe that, historically, there's a significant portion of the technology market that buys managed services to make technology work for them? If you believe the cloud auto-magically makes that go away, you should go far, far away. We see a lot of evidence that there will be a healthy segment of that market – somewhere between 20% and 40% of the market that will buy managed services and make clouds work.

And then you have to think, does Rackspace have a competitive advantage that makes us one of the winners in that space? If you can answer yes to those three questions, then you can get your head around the thesis, because it's not a stretch. It's very, very consistent with what we've done historically. We've had to lead through lots of inflections in the past. When you think about Linux, you think about VMware, you think about the early days in public cloud, we've had to lead through all of these inflections. And ultimately what happens is these inflections create a very big market for managed services or fanatical support.

So we think that the market is frustrated with the time to get the transition going, clearly. The business is hard to model today because it's going through a transition on many fronts. And we have to go execute. So, that's what we're working on. We're laser-focused on those things, but we think that the opportunity is immense and that we feel very competitively advantaged compared to companies like Datapipe and 2nd Watch. We see the telcos exiting this business. We don't compete with them anymore; they are getting out. And you see the product companies very focused on their stacks.

So when you think about traditional enterprise IT services companies getting out or becoming less relevant, and you think about product companies focusing on making their stack better, it opens up a big opportunity to lead in the managed services space.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

And that last part about execution I think is the biggest part now. I think that there is some concern, or at least just based on how the companies performed the last few years, around that. And that's what we've argued to investors – because we have a buy rating on your stock – we've argued to investors that this isn't a stock that's going to go up after one quarter; there has to be consistent execution. You have to gain back the trust of investors. So, assuming you are able to do that, is there anything else in addition that you think you can be doing to improve sentiment? Is it around disclosures? Should you have an Analyst Day? Should you be making more outreach? Let's talk about other things that could potentially be being done besides just us waiting for what you're going to do in the second, third and fourth quarter?

<<Taylor Rhodes, President and Chief Executive Officer>>

Well, look, I think Winston Lin is here – anybody who wants to talk to Rackspace at any time can get a hold of Winston. Winston does a ton of work with the investment community. We do host things like days at the capital that you've been to, with customers, et cetera, to tell the story.

So we're all in on continuing to try to help create understanding of the story, and why do customers buy? Is this in demand? Is it sustainable? Is it differentiated?

So we'll keep doing more of that. As we've already talked about, as the business evolves over time, we'll develop new ways to share transparency into the new businesses. So we're all in on doing whatever we can to help the story. But I do think, fundamentally, it is now time now to say, okay, 2015 – you had to go build a lot of new product, get it into the market. Are you able to take that into the market? Are you able to execute on that? And are you able to see that there's a big audience that wants to buy it? So, those are things we're working on.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

Any questions from the audience at this point – in the front?

Q&A

<Q>: [Question Inaudible]

<Q – Colby Synesael>: So the question is around managed cloud – the size of the market, the opportunity today, how that's going to play out?

<A – Taylor Rhodes>: Yes. Look, I think today the market – if you just look at the market that AWS and Azure and Google and everyone else has – let's just call it a $20 billion spend today on public cloud, right – growing at 70% to 100%. So its 20% to 40% of that is populated by managed services buyers, that's already a very good healthy market. Remember, we're only $2 billion in revenue, so that gives us target markets that are much larger than we are today, and we feel advantaged.

So, no, we don't believe we have to wait around for growth to happen in the industry. What we have to do is go get our name absolutely associated with the leader in managed cloud, and go step in and put their go-to-market resources out to go get that demand. And that's what we're working on. But the good news for us today is we do not feel demand- constrained on these new businesses.

<Q – Colby Synesael>: Any other questions? Yes, second row?

<Q>: [Question Inaudible]

<Q – Colby Synesael>: Sure. Yes, the question is on M&A and both on the buyers and sellers.

<A – Taylor Rhodes>: Yes. So, of course, I can't comment on anything on the M&A, Rack's target – we never comment on any speculation on that. But we are excited about the opportunity to do controlled M&A that make our product offer stronger. You mentioned partnerships. You saw in Q1 we announced an investment in a partnership with cloud technology partners. They are a leading player in helping enterprises understand which platform to move to, migrate applications.

What they’re seeing in their space is more and more of these businesses wanting not just the upfront lift and ship but also the ongoing managed service play. So we are now in an exclusive relationship where they bring us managed service opportunities; we go to market together. We see continuing partnerships about what we call the MSP Plus model, like that. But we also see opportunities to buy technology and people that accelerate our roadmap, and let us add more value around the AWS stack, the Azure stack, et cetera. You’ll see, historically, we try to target those maybe somewhere between $10 million and $50 million size M&A opportunities where you can buy a technology and a team that built it and integrate it into your offer. So those are the types of things that we can sell.

<Q – Colby Synesael>: Do you think those are still relevant with this new strategy as much so as they were with the previous strategy?

<A – Taylor Rhodes>: Yes. Because one of the things we do historically is, we add value around the product OEM stuff. So, for instance, one of the things that we see today is one of the biggest challenges for companies who are adopting clouds is governing them. Who is spending what? Are they spending at the right level? Am I adhering to best practices? Is it secure? How do I make this interact with the rest of my IT model? There are lots of companies out there are developing tools around these clouds that make them more consumable, more manageable. So we see opportunities to accelerate our roadmap and add business value on top of those clouds by doing opportunities like that.

<Q – Colby Synesael>: There’s a question in the third row.

<Q>: [Question Inaudible]

<A – Taylor Rhodes>: Well, I think, as I said on the call, there are deals that are well-qualified. We feel competitive. We’re having late-stage conversations with those buyers. So, generally, we know how to gauge whether or not we feel well-positioned on those. And they’re in the Q2 pipeline, flagged as closable in the quarter. So those are the things that give us confidence.

<Q – Colby Synesael>: A question in the back?

<Q>: [Question Inaudible]

<Q – Colby Synesael>: Sure. A question about competitive landscape versus where system integrators play, particularly I think as it relates to the managed cloud?

<A – Taylor Rhodes>: Right. So, good question. We historically partner up with SIs, because if you think about the completion of the model, an SI generally gets engaged, and what’s my application strategy and then how am I going to move it? How am I going to build new and how do I migrate old? It’s not so much then on the other side of let me go provide ongoing operational ownership of that. So historically, we partner with companies like Accenture and Deloitte and EOI, et cetera, in a go-to-market model. We think, in the cloud, they will play to their strengths, which is that big piece of work of legacy migrations happening into public

clouds. But we continue to see the partnership opportunity there to provide the ongoing services on the back of that initial PS engagement.

<Q>: [Question Inaudible]

<A – Taylor Rhodes>: We have historical go-to-market relationships with those companies, so there's nothing new there; we simply maintain the relationship. And we go out, and where they see a customer who is more of a managed service buyer, they have the option to bring Rackspace in. And that's what we've historically done with them.

<Q – Colby Synesael>: Any other questions? I have just one quick one since we have about only a minute left. So I want to talk about buyback – this is sometimes not appreciated. So, in the first quarter, you guys bought back $68 million of stock and you indicated you would buy at least another $65 million in this quarter, at which point you are still going to have $500 million available on your current share repurchase authorization. So a lot of opportunity for buybacks. Keeping in mind you have a target leverage ratio, should we assume you continue to buy some amount of stock every quarter on a go-forward basis?

<A – Taylor Rhodes>: Yes. So I think, just to refresh everybody's memory, what we did in August of 2015 is the Board authorized a capital structure that got us to 0.75x EBITDA. That implied about a – you know, they had a $1 billion share buyback authorization, we said we do the first $500 million buy Q2 of this year. So far to date, we are on schedule to doing what we said we would do. And you should anticipate us continuing to give you post every quarter, we'll update you on what we've done. The reason we're doing that is, in the past, we've talked too much about it, I think. And we've seen opportunistic trading around when we were going to go to our buybacks. So our policy now is we will update you every single quarter on what we've done in the previous quarter.

<Q – Colby Synesael>: But the goal is to maintain some form of leverage. And, by definition, if you're growing EBITDA, you will have no choice but to give some form of capital back to investors?

<A – Taylor Rhodes>: Yes.

<<Colby Synesael, Analyst, Cowen & Co. LLC>>

Great. With that, we're out of time, so thank you very much. Appreciate it.

<<Taylor Rhodes, President and Chief Executive Officer>>

Thank you, Colby.