

RACKSPACE HOSTING, INC. (RAX)

10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filed on 11/9/2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2010.

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (No Fee Required)

For the transition period from _____ to _____.

Commission file number 001-34143

RACKSPACE HOSTING, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

74-3016523
(IRS Employer
Identification No.)

5000 Walzem Rd.
San Antonio, Texas 78218
(Address of principal executive offices, including Zip Code)
(210) 312-4000
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "accelerated filer, large accelerated filer and a smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

On October 29, 2010, 126,117,096 shares of the registrant's Common Stock, \$0.001 par value, were outstanding.

RACKSPACE HOSTING, INC.

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PART I – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

RACKSPACE HOSTING, INC. AND SUBSIDIARIES—
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	December 31, 2009	September 30, 2010 (Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 125,425	\$ 166,557
Accounts receivable, net of allowance for doubtful accounts and customer credits of \$4,298 as of December 31, 2009, and \$2,774 as of September 30, 2010	38,732	44,826
Income taxes receivable	7,509	2,823
Deferred income taxes	9,764	4,234
Prepaid expenses and other current assets	10,239	24,827
Total current assets	191,669	243,267
Property and equipment, net	432,971	474,320
Goodwill	22,329	23,329
Intangible assets, net	10,790	6,658
Other non-current assets	10,886	12,624
Total assets	<u>\$ 668,645</u>	<u>\$ 760,198</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 89,773	\$ 101,427
Current portion of deferred revenue	17,113	14,278
Current portion of obligations under capital leases	46,415	57,266
Current portion of debt	4,893	2,340
Total current liabilities	158,194	175,311
Non-current deferred revenue	2,331	2,407
Non-current obligations under capital leases	63,287	69,255
Non-current debt	52,791	51,316
Non-current deferred income taxes	30,850	29,538
Other non-current liabilities	11,765	19,134
Total liabilities	319,218	346,961
COMMITMENTS AND CONTINGENCIES		
Stockholders' equity:		
Common stock, \$0.001 par value per share: 300,000,000 shares authorized; 123,773,977 shares issued and outstanding as of December 31, 2009, 126,076,915 shares issued and outstanding as of September 30, 2010	124	126
Additional paid-in capital	251,337	283,086
Accumulated other comprehensive loss	(10,257)	(11,017)
Retained earnings	108,223	141,042
Total stockholders' equity	349,427	413,237
Total liabilities and stockholders' equity	<u>\$ 668,645</u>	<u>\$ 760,198</u>

See accompanying notes to the unaudited condensed consolidated financial statements.

RACKSPACE HOSTING, INC. AND SUBSIDIARIES—

CONDENSED CONSOLIDATED STATEMENTS OF INCOME – (Unaudited)

(In thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
Net revenue	\$ 162,399	\$ 199,710	\$ 459,471	\$ 565,829
Costs and expenses:				
Cost of revenue	53,093	64,616	147,538	183,093
Sales and marketing	19,860	24,651	59,442	69,913
General and administrative	43,622	49,131	122,728	142,263
Depreciation and amortization	32,696	39,677	90,211	114,366
Total costs and expenses	149,271	178,075	419,919	509,635
Income from operations	13,128	21,635	39,552	56,194
Other income (expense):				
Interest expense	(2,147)	(2,068)	(6,854)	(6,087)
Interest and other income (expense)	523	(1,263)	165	(264)
Total other income (expense)	(1,624)	(3,331)	(6,689)	(6,351)
Income before income taxes	11,504	18,304	32,863	49,843
Income taxes	3,900	6,495	11,680	17,024
Net income	\$ 7,604	\$ 11,809	\$ 21,183	\$ 32,819
Net income per share				
Basic	\$ 0.06	\$ 0.09	\$ 0.18	\$ 0.26
Diluted	\$ 0.06	\$ 0.09	\$ 0.17	\$ 0.25
Weighted average number of shares outstanding				
Basic	121,501	125,312	119,788	124,633
Diluted	129,160	133,439	125,849	132,824

See accompanying notes to the unaudited condensed consolidated financial statements.

RACKSPACE HOSTING, INC. AND SUBSIDIARIES—

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS – (Unaudited)

(In thousands)	Nine Months Ended September	
	30,	
	2009	2010
Cash Flows From Operating Activities		
Net income	\$ 21,183	\$ 32,819
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	90,211	114,366
Loss on disposal of equipment, net	976	569
Provision for bad debts and customer credits	8,848	2,976
Deferred income taxes	5,103	2,982
Deferred rent	2,049	4,171
Share-based compensation expense	14,866	19,537
Other non-cash compensation expense	599	349
Changes in certain assets and liabilities		
Accounts receivable	(16,991)	(9,074)
Income taxes receivable	8,246	4,352
Accounts payable and accrued expenses	2,620	12,633
Deferred revenue	(2,394)	(2,689)
All other operating activities	(4,112)	(13,026)
Net cash provided by operating activities	131,204	169,965
Cash Flows From Investing Activities		
Purchases of property and equipment, net	(82,640)	(97,894)
Earnout payments for acquisitions	(6,822)	(490)
Other investing activities	—	(75)
Net cash used in investing activities	(89,462)	(98,459)
Cash Flows From Financing Activities		
Principal payments of capital leases	(32,513)	(37,947)
Principal payments of notes payable	(5,908)	(4,029)
Payments on line of credit	(150,000)	—
Payments for debt issuance costs	(367)	—
Proceeds from employee stock plans	9,743	11,373
Net cash used in financing activities	(179,045)	(30,603)
Effect of exchange rate changes on cash and cash equivalents	1,846	229
Increase (decrease) in cash and cash equivalents	(135,457)	41,132
Cash and cash equivalents, beginning of period	238,407	125,425
Cash and cash equivalents, end of period	<u>\$ 102,950</u>	<u>\$ 166,557</u>
Supplemental cash flow information:		
Acquisition of property and equipment by capital leases	\$ 52,294	\$ 54,767
Acquisition of property and equipment by notes payable	3,690	—
Vendor financed equipment purchases	\$ 55,984	\$ 54,767
Shares issued in business combinations	\$ 8,680	\$ 510
Cash payments for interest, net of amount capitalized	\$ 6,266	\$ 5,851
Cash payments for income taxes	\$ 5,300	\$ 15,761

See accompanying notes to the unaudited condensed consolidated financial statements.

RACKSPACE HOSTING, INC. AND SUBSIDIARIES—

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Overview and Basis of Presentation

Nature of Operations

As used in this report, the terms “Rackspace”, “Rackspace Hosting”, “we”, “our company”, “the company”, “us,” or “our” refer to Rackspace Hosting, Inc. and its subsidiaries. Rackspace Hosting, Inc., through its operating subsidiaries, is a provider of hosting solutions. We provide IT as a service, managing web-based IT systems for small and medium-sized businesses as well as large enterprises. We focus on providing a service experience for our customers, which we call Fanatical Support®.

Rackspace Hosting, Inc. was incorporated in Delaware on March 7, 2000. However, our operations began in 1998 as a limited partnership which became our subsidiary through a corporate reorganization completed on August 21, 2001.

We operate consolidated subsidiaries which include, among others, Rackspace US, Inc., our domestic operating entity, and Rackspace Limited, our United Kingdom operating entity.

Basis of Consolidation

The consolidated financial statements include the accounts of our wholly owned subsidiaries located in the United States of America (U.S.), the United Kingdom (U.K.), the Netherlands, Hong Kong and Gibraltar. Intercompany transactions and balances have been eliminated in consolidation.

Basis of Presentation

The accompanying consolidated financial statements as of September 30, 2010, and for the three and nine months ended September 30, 2009 and 2010, are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and Rule 10-01 of Regulation S-X. Accordingly, they do not include all financial information and disclosures required by GAAP for complete financial statements and certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. The unaudited interim consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements and in the opinion of management, reflect all adjustments, which include normal recurring adjustments, necessary for a fair statement of our financial position as of September 30, 2010, our results of operations for the three and nine months ended September 30, 2009 and 2010, and our cash flows for the nine months ended September 30, 2009 and 2010.

These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto as of December 31, 2009 included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 26, 2010, as amended. The results of the three and nine months ended September 30, 2010 are not necessarily indicative of the results to be expected for the year ending December 31, 2010, or for any other interim period, or for any other future year.

Certain reclassifications have been made to prior year balances in order to conform to the current year’s presentation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. On an ongoing basis, we evaluate our estimates, including those related to accounts receivable and customer credits, property and equipment, fair values of intangible assets and goodwill, useful lives of intangible assets, fair value of stock options, contingencies, and income taxes, among others. We base our estimates on historical experience and on other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. We engaged third party valuation consultants to assist management in the purchase price allocation of significant acquisitions.

2. Summary of Significant Accounting Policies

The accompanying financial statements reflect the application of certain significant accounting policies. There have been no material changes to our significant accounting policies that are disclosed in our audited consolidated financial statements and notes thereto as of December 31, 2009 included in our Annual Report on Form 10-K, as amended.

Recently Adopted Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The guidance became effective for us last quarter, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which will become effective for us in the first annual reporting period that begins after December 15, 2010 and for interim periods within that annual reporting period. This new guidance did not have a material impact on our consolidated financial statements.

Recent Accounting Pronouncements

In October 2009, the FASB issued guidance on revenue recognition that will become effective for us beginning January 1, 2011. The new guidance eliminates the requirement that all undelivered elements in a multiple-element revenue arrangement have vendor-specific objective evidence (VSOE) or third-party evidence (TPE) before an entity can recognize the portion of an overall arrangement fee that is attributable to items that already have been delivered. In the absence of VSOE or TPE of the standalone selling price for one or more delivered or undelivered elements in a multiple-element arrangement, entities will be required to estimate the selling prices of those elements. The overall arrangement fee will be allocated to each element (both delivered and undelivered items) based on their relative selling prices, regardless of whether those selling prices are evidenced by VSOE or TPE or are based on the entity's estimated selling price. Application of the "residual method" of allocating an overall arrangement fee between delivered and undelivered elements will no longer be permitted upon adoption. We do not expect the adoption of this new guidance to have a material impact on our consolidated financial statements.

3. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

(In thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
Basic net income per share:				
Net income	\$ 7,604	\$ 11,809	\$ 21,183	\$ 32,819
Weighted average shares outstanding:				
Common stock	121,501	125,312	119,788	124,633
Number of shares used in per share computations	121,501	125,312	119,788	124,633
Earnings per share	<u>\$ 0.06</u>	<u>\$ 0.09</u>	<u>\$ 0.18</u>	<u>\$ 0.26</u>
Diluted net income per share:				
Net income	\$ 7,604	\$ 11,809	\$ 21,183	\$ 32,819
Weighted average shares outstanding:				
Common stock	121,501	125,312	119,788	124,633
Stock options, awards and employee share purchase plan	7,659	8,127	6,061	8,191
Number of shares used in per share computations	129,160	133,439	125,849	132,824
Earnings per share	<u>\$ 0.06</u>	<u>\$ 0.09</u>	<u>\$ 0.17</u>	<u>\$ 0.25</u>

We excluded 0.5 million and 1.9 million potential common shares from the computation of dilutive earnings per share for the three months ended September 30, 2009 and 2010, respectively, and 5.3 million and 1.2 million potential shares for the nine months ended September 30, 2009 and 2010, respectively, because the effect would have been anti-dilutive.

4. Cash and Cash Equivalents

Cash and cash equivalents consisted of:

(In thousands)	December 31, 2009	September 30, 2010
Cash deposits	\$ 64,716	\$ 105,824
Money market funds	60,709	60,733
Cash and cash equivalents	<u>\$ 125,425</u>	<u>\$ 166,557</u>

Our available cash and cash equivalents are held in bank deposits, overnight sweep accounts, and money market funds. We actively monitor the third-party depository institutions that hold our deposits. Our emphasis is primarily on safety of principal while secondarily maximizing yield on those funds.

Our money market mutual funds invest exclusively in high-quality, short-term securities that are issued or guaranteed by the U.S. government or by U.S. government agencies.

5. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. There is a three-tier fair value of hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1 – Observable inputs such as quoted prices in active markets for identical assets or liabilities;

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 – Unobservable inputs that are supported by little or no market activity, which require management judgment or estimation.

There have been no material changes to the valuation techniques utilized in the fair value measurement of assets and liabilities presented on our balance sheet as disclosed in our Form 10-K, as amended, for the year ended December 31, 2009.

Assets and liabilities measured at fair value on a recurring basis are summarized by level below. The table does not include assets and liabilities which are measured at historical costs or any other basis other than fair value.

(In thousands)

	December 31, 2009			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Assets/Liabilities at Fair Value
Assets:				
Money market funds (1)	\$ 60,709	\$ –	\$ –	\$ 60,709
Rabbi trust (3)	576	–	–	576
Total	\$ 61,285	\$ –	\$ –	\$ 61,285
Liabilities:				
Interest rate swap agreement (1)	\$ –	\$ 1,818	\$ –	\$ 1,818
Deferred compensation (2)	586	–	–	586
Total	\$ 586	\$ 1,818	\$ –	\$ 2,404

(In thousands)

	September 30, 2010			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Assets/Liabilities at Fair Value
Assets:				
Money market funds (1)	\$ 60,733	\$ –	\$ –	\$ 60,733
Rabbi trust (3)	736	–	–	736
Total	\$ 61,469	\$ –	\$ –	\$ 61,469
Liabilities:				
Interest rate swap agreement (1)	\$ –	\$ 490	\$ –	\$ 490
Deferred compensation (2)	691	–	–	691
Total	\$ 691	\$ 490	\$ –	\$ 1,181

(1) Money market funds are classified in cash and cash equivalents and the interest rate swap agreement is classified in accounts payable and accrued expenses.

(2) Obligations to pay benefits under a non-qualified deferred compensation plan are classified in other non-current liabilities.

(3) Investments in marketable securities held in a Rabbi Trust associated with a non-qualified deferred compensation plan located in other non-current assets.

6. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consisted of:

(In thousands)	December 31, 2009	September 30, 2010
Prepaid expenses	\$ 7,505	\$ 20,964
Other current assets	2,734	3,863
Prepaid expenses and other current assets	<u>\$ 10,239</u>	<u>\$ 24,827</u>

In June 2010, we entered into a 3-year software license agreement with a reseller of licenses under which we made a prepayment of \$18.0 million in July 2010 for a specified quantity of software licenses through May 2011.

7. Property and Equipment, net

Property and equipment consisted of:

(In thousands)	Estimated Useful Lives	December 31, 2009	September 30, 2010
Computers, software and equipment	1–5 years	\$ 511,279	\$ 620,564
Furniture and fixtures	7 years	22,311	24,559
Buildings and leasehold improvements	2–30 years	134,045	138,317
Land	—	13,860	13,860
Property and equipment, at cost		681,495	797,299
Less accumulated depreciation and amortization		(298,369)	(389,401)
Work in process		49,845	66,422
Property and equipment, net		<u>\$ 432,971</u>	<u>\$ 474,320</u>

Depreciation and leasehold amortization expense, not including amortization expense for intangible assets, was \$31.0 million and \$38.2 million for the three months ended September 30, 2009 and 2010, respectively, and \$85.4 million and \$109.7 million for the nine months ended September 30, 2009 and 2010, respectively.

At December 31, 2009, the work in process balance consisted of build outs of \$35.7 million for office facilities, \$8.0 million for data centers, and \$6.1 million for capitalized software and other projects. At September 30, 2010, the work in process balance consisted of build outs of \$35.7 million for office facilities, \$15.2 million for data centers, and \$15.5 million for capitalized software and other projects.

Capitalized interest was \$0.2 million for the three months ended September 30, 2009 and 2010 and \$0.7 million and \$0.5 million for the nine months ended September 30, 2009 and 2010, respectively.

8. Business Combinations and Goodwill

In October 2008, we acquired two companies for a total purchase price of \$28.0 million, which were accounted for as business combinations. The initial purchase price of the combined acquisitions was \$11.5 million paid in cash and stock, with up to \$16.5 million in additional payouts of cash and stock based on certain earn-out provisions. As of December 31, 2009 earn-outs totaling \$15.5 million had been achieved and paid in a combination of cash and stock. The final \$1.0 million earn-out was achieved in March 2010 and was paid in April 2010 in a combination of cash and stock. The earn-out was accounted for as additional goodwill.

The following table provides a roll forward of our goodwill balance.

(In thousands)	
Balance at December 31, 2009	\$ 22,329
Earn-out payment for acquisition	1,000
Balance at September 30, 2010	<u>\$ 23,329</u>

9. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consisted of:

(In thousands)	December 31, 2009	September 30, 2010
Trade payables	\$ 24,597	\$ 33,586
Accrued compensation and benefits	28,469	26,389
Foreign income taxes payable	6,340	9,021
Vendor accruals	17,806	18,945
Other liabilities	<u>12,561</u>	<u>13,486</u>
Accounts payable and accrued expenses	<u>\$ 89,773</u>	<u>\$ 101,427</u>

10. Debt

Debt outstanding consisted of:

(In thousands)	December 31, 2009	September 30, 2010
Revolving credit facility	\$ 50,000	\$ 50,000
Notes payable	<u>7,684</u>	<u>3,656</u>
Total debt	57,684	53,656
Less current portion of debt	<u>(4,893)</u>	<u>(2,340)</u>
Total non-current debt	<u>\$ 52,791</u>	<u>\$ 51,316</u>

Revolving Credit Facility

Our revolving credit facility includes an aggregate commitment of \$245.0 million. The facility provides for letters of credit up to \$25.0 million. The interest is based on a floating rate, generally the London Interbank Offered Rate (LIBOR) plus a margin spread, which changes ratably from 0.675% to 1.55% dependent on the total funded debt to adjusted earnings before interest, taxes, depreciation, and amortization (EBITDA) ratio. We are required to pay a facility fee of 0.2% per annum on the full amount committed under the facility and a quarterly administrative fee. The facility has a 5-year term and matures in August 2012, and is fully secured by our domestic assets and a portion of our foreign subsidiary equity holdings and governed by financial and non-financial covenants. Financial covenants under our facility include a minimum fixed charge coverage ratio of at least 1.50 to 1.00 and a maximum total funded debt to EBITDA ratio of not greater than 3.00 to 1.00. Also, our foreign cash balance is limited to a balance of \$25 million. As of September 30, 2010, we were in compliance with all of the covenants under our facility.

The revolving credit facility agreement provides us with the ability to borrow under our credit facility in pounds sterling and euros in addition to U.S. dollars; however, we are limited to borrowings of \$75 million in these alternate currencies. As of September 30, 2010 we did not have any borrowings on our credit facility in alternate currencies.

As of September 30, 2010, the amount outstanding under the facility was \$50.0 million, with an outstanding letter of credit of \$0.6 million, resulting in an additional \$194.4 million available for future borrowings.

Interest Rate Swap

We have a cash flow hedge to limit our exposure that may result from the variability of floating interest rates. Effective December 10, 2007, we entered into an interest rate swap agreement with a notional amount of \$50.0 million. The interest rate swap hedges the first \$50.0 million of our outstanding floating-rate debt. This swap converts floating rate interest based on the LIBOR into fixed-rate interest as part of the arrangement with our primary lender and expires in December 2010.

We are required to pay the counterparty a stream of fixed interest payments at a rate of 4.135%, and in turn, receive variable interest payments based on 1-month LIBOR. The margin spread as of September 30, 2010 was 1.05% resulting in an effective fixed rate of 5.185%. The net receipts or payments from the swap are recorded as interest expense. The swap is designated and qualifies as a cash flow hedge. As such, the swap is accounted for as an asset or a liability in the accompanying consolidated balance sheets at fair value. We are utilizing the dollar offset method to assess the effectiveness of the swap. Under this methodology, the swap was deemed to be highly effective for the nine months ended September 30, 2009 and 2010. There was no hedge ineffectiveness recognized in earnings for either period. If the hedge becomes ineffective, or if certain terms of the facility change, the facility is extinguished, or if the swap is terminated prior to maturity, the fair value of the swap and subsequent changes in fair value may be recognized in the accompanying consolidated statements of income. The fair value of the swap was estimated based on the yield curve as of December 31, 2009 and September 30, 2010, and represents its carrying value. See Note 5 for further disclosure on the fair value of the interest rate swap and Note 15 for further information on comprehensive income.

The following table presents the impact of the interest rate swap on the consolidated balance sheets:

(In thousands)	December 31, 2009	September 30, 2010
Accounts payable and accrued expenses	\$ 1,818	\$ 490
Accumulated other comprehensive income (loss), net of tax	\$ (1,182)	\$ (318)

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
Effective gain (loss) recognized in accumulated other comprehensive income, net of tax	\$ 130	\$ 294	\$ 455	\$ 864

As the interest rate swap expires in December 2010, the full amount of other comprehensive income related to the interest rate swap as of September 30, 2010 is expected to be reclassified to expense within the next 3 months.

As of September 30, 2010, we were in a liability position to the counterparty of the swap and therefore had limited counterparty credit risk.

11. Other Non-Current Liabilities

Other non-current liabilities consisted of:

(In thousands)	December 31, 2009	September 30, 2010
Texas Enterprise Fund Grant	\$ 5,000	\$ 5,000
Deferred rent	5,391	10,210
Other	1,374	3,924
Other non-current liabilities	<u>\$ 11,765</u>	<u>\$ 19,134</u>

12. Commitments and Contingencies

Legal Proceedings

We are party to various legal and administrative proceedings, which we consider routine and incidental to our business. In addition, on October 22, 2008, Benjamin E. Rodriguez D/B/A Management and Business Advisors vs. Rackspace Hosting, Inc. and Graham Weston, was filed in the 37th District Court in Bexar County Texas by a former consultant to the company, Benjamin E. Rodriguez. The suit alleges breach of an oral agreement to issue Mr. Rodriguez a 1% interest in our stock in the form of options or warrants for compensation for services he was engaged to perform for us. We believe that the plaintiff's position is without merit and intend to vigorously defend this lawsuit. We do not expect the results of this claim or any other current proceeding to have a material adverse effect on our business, results of operations or financial condition.

On March 26, 2010 Bedrock Computer Technologies LLC's filed its First Amended Answer and Counterclaim to Red Hat, Inc.'s Complaint for Declaratory Judgment (Red Hat, Inc., v Bedrock Computer Technologies, LLC Cause No. 6:09-CV-00549 -LED, United States District Court for the Eastern District of Texas). In its answer and counterclaim, Bedrock has named Rackspace as a third party defendant in a civil action by asserting cross claims against Rackspace and several other companies alleging direct and indirect infringement of United States Patent No. 5,893,120 based on the use of computer equipment configured with or utilizing software based on various versions of the Linux operating system. Bedrock is seeking a finding that the third party defendants, including Rackspace, be enjoined from selling any infringing product, and that Bedrock be awarded actual damages, pre and post judgment interest and attorney's fees. We believe that we have meritorious defenses to the claims and intend to defend ourselves vigorously against these infringement claims. At this time, we do not anticipate that the claims will have a material adverse effect on our business, financial position or results of operations. There can be no assurance, however, that we will be successful in our defense.

On August 31, 2010, Oasis Research, LLC ("Oasis") filed a complaint (Cause No. 4:10-CV-435, United States District Court for the Eastern District of Texas) alleging that Rackspace's products infringe certain United States patents allegedly owned by Oasis. This lawsuit alleges that Rackspace is infringing four patents, including United States Patent Nos. 5,771,354, 5,901,228, 6,411,943 and 7,080,051 by designing and selling products and services related to online backup and storage services. Oasis is seeking unspecified damages for past and continuing or future infringement. We believe that we have meritorious defenses to the claims and intend to defend ourselves vigorously against these infringement claims. At this time, we do not anticipate that the claims will have a material adverse effect on our business, financial position or results of operations. There can be no assurance, however, that we will be successful in our defense.

13. Share-Based Compensation

In January 2010, an additional 5.7 million shares became available for future grant pursuant to the automatic share reserve increase or "evergreen" provision under our Amended and Restated 2007 Long-Term Incentive Plan. As of September 30, 2010, the total number of shares authorized under all of our plans was 48.5 million shares, of which approximately 9.5 million shares were available for future grants.

Outstanding stock awards were as follows:

	December 31, 2009	September 30, 2010
Restricted stock units	2,087,500	2,893,064
Stock options	16,841,232	15,951,645
Total outstanding awards	<u>18,928,732</u>	<u>18,844,709</u>

The following table summarizes our restricted stock unit activity for the nine months ended September 30, 2010:

	Number of Units	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2009	2,087,500	\$ 5.47
Granted	820,265	\$ 18.95
Released	-	\$ -
Cancelled	(14,701)	\$ 19.45
Outstanding at September 30, 2010	<u>2,893,064</u>	<u>\$ 9.22</u>
Expected to vest after September 30, 2010 *	<u>2,746,528</u>	<u>\$ 8.71</u>

* Includes reduction of shares outstanding due to estimated forfeitures

There have been two types of restricted stock units (RSUs) granted in 2010. The first type vests as the employee continues to be employed with us, in four equal installments, on each of the first, second, third and fourth anniversaries of the grant date. Stock-based compensation expense for these service vesting RSUs is measured based on the closing fair market value of the company's common stock on the date of grant and is recognized ratably over the service period. The second type was granted to members of our executive team. The vesting of these RSUs is dependent upon the company's total shareholder return (TSR) on its common stock compared to other companies in the Russell 2000 Index. In addition, the company's TSR must be positive for vesting to occur.

Additionally, as of September 30, 2010, there were 2.0 million RSUs outstanding that were granted in 2009 to our chief executive officer and another member of the executive team. The vesting of these RSUs is dependent on the company's total shareholder return (TSR) on its common stock compared to other companies in the Russell 2000 Index. In addition, the company's TSR must be positive for vesting to occur.

As of September 30, 2010, there was \$18.8 million of total unrecognized compensation cost related to non-vested RSUs that we have granted, which will be amortized using the straight line method over a remaining weighted average period of 2.7 years.

The following table summarizes the stock option activity for the nine months ended September 30, 2010:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2009	16,841,232	\$ 6.02	7.56	\$ 249,801
Granted	1,963,592	\$ 18.87		
Exercised	(2,243,677)	\$ 4.95		
Cancelled	(609,502)	\$ 9.28		
Outstanding at September 30, 2010	15,951,645	\$ 7.62	7.04	\$ 292,793
Vested and exercisable at September 30, 2010	6,380,759	\$ 3.54	5.77	\$ 143,176
Vested and exercisable at September 30, 2010 and expected to vest thereafter *	15,144,186	\$ 7.36	6.98	\$ 282,012

* Includes reduction of shares outstanding due to estimated forfeitures

The stock options that were granted in 2010 vest as the employee continues to be employed with us, in four equal installments, on each of the first, second, third and fourth anniversaries of the grant date and have a term of 7 or 10 years.

The total pre-tax intrinsic value of the stock options exercised during the three months ended September 30, 2009 and 2010, was \$12.5 million and \$17.2 million, respectively, and \$31.9 million and \$32.8 million for the nine months ended September 30, 2009 and 2010, respectively.

The weighted average fair value of stock options issued during the three months ended September 30, 2009 and 2010 was \$9.03 and \$9.08 respectively, and \$3.19 and \$9.82 for the nine months ended September 30, 2009 and 2010, respectively, using the Black-Scholes option pricing model with the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
Expected stock volatility	59%	55% – 56%	59% – 61%	55% – 56%
Expected dividend yield	0.0%	0.0%	0.0%	0.0%
Risk-free interest rate	3.03%	1.44% – 1.76%	2.24% – 3.03%	1.44% – 2.79%
Expected life	6.25 years	4.75 – 6.25 years	6.25 years	4.75 – 6.25 years

As of September 30, 2010, there was \$36.2 million of total unrecognized compensation cost related to non-vested stock options that we have granted, which will be amortized using the straight line method over a weighted average period of 1.8 years.

Share-based compensation expense was recognized as follows:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
Cost of revenue	\$ 778	\$ 1,305	\$ 2,082	\$ 3,437
Sales and marketing	826	1,209	2,245	3,189
General and administrative	4,008	4,669	10,539	12,911
Pre-tax share-based compensation	5,612	7,183	14,866	19,537
Less: Income tax benefit	(1,913)	(2,549)	(5,284)	(6,673)
Total share-based compensation expense, net of tax	\$ 3,699	\$ 4,634	\$ 9,582	\$ 12,864

14. Taxes

We are subject to U.S. federal income tax and various state, local, and international income taxes in numerous jurisdictions. Our domestic and international tax liabilities are subject to the allocation of revenue and expenses in different jurisdictions and the timing of recognizing revenue and expenses. As such, our effective tax rate is impacted by the geographical distribution of income and mix of profits in the various jurisdictions. Additionally, the amount of income taxes paid is subject to our interpretation of applicable tax laws in the jurisdictions in which we file.

We currently file income tax returns in the U.S., and all foreign jurisdictions in which we have entities, which are periodically under audit by federal, state, and international tax authorities. These audits can involve complex matters that may require an extended period of time for resolution. We remain subject to U.S. federal and state income tax examinations for the tax years 2006 through 2009, U.K. income tax examinations for the years 2002 through 2008, Netherlands income tax examinations for the years 2007 and 2008, and Hong Kong income tax examinations for the year 2008. There are no income tax examinations currently in process. Although the outcome of open tax audits is uncertain, in management's opinion, adequate provisions for income taxes have been made. If actual outcomes differ materially from these estimates, they could have a material impact on our financial condition and results of operations. Differences between actual results and assumptions, or changes in assumptions in future periods are recorded in the period they become known. To the extent additional information becomes available prior to resolution, such accruals are adjusted to reflect probable outcomes.

Rackspace takes certain non-income tax positions in the jurisdictions in which it operates and may be subject to audit from these jurisdictions. Rackspace is also involved in related non-income tax litigation matters. We believe our positions are supportable and we have accrued for known exposure; however, significant judgment is required in determining the ultimate outcome of such matters. In the normal course of business, our position and conclusion related to these non-income taxes may be challenged and assessments may be made. To the extent new information is obtained and changes our views on our positions, probable outcome of assessments, or litigation, changes in estimates to accrued liabilities would be recorded in the period the determination is made.

We currently have a refund claim for sales tax paid on certain licenses that has gone through a judicial hearing. It is our position that these licenses are exempt from sales tax based on resale. Our claim for refund was denied at an administrative level and exceptions have been filed to appeal the decision. We are currently waiting to hear if our appeal has been accepted. If our appeal is denied, we will have the option to further pursue our case in district court. We have not recorded a receivable related to this claim for refund.

At June 30, 2010, we estimated taxable income for the full year 2010 and recorded a \$15.5 million income tax receivable and excess tax benefit. On September 27, 2010, the "Small Business Jobs Act of 2010" was signed into law, which included the extension of bonus depreciation through 2010. As a result of the new legislation, we now expect a taxable loss for the full year 2010 and do not anticipate utilizing any benefit in 2010 for tax deductions related to stock compensation. As a result, we have not recognized an income tax receivable or excess tax benefit during the current period.

15. Comprehensive Income

Total comprehensive income was as follows:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
Net income	\$ 7,604	\$ 11,809	\$ 21,183	\$ 32,819
Derivative instrument, net of deferred taxes of \$(70), and \$(158) for the three months ended September 30, 2009 and 2010, and \$(245) and \$(465) for the nine months ended September 30, 2009 and 2010.	130	294	455	864
Foreign currency cumulative translation adjustment, net of taxes of \$109 and \$(274) for the three months ended September 30, 2009 and 2010, and \$(1,588) and \$237 for the nine months ended September 30, 2009 and 2010.	(2,176)	4,965	5,299	(1,624)
Total other comprehensive income (loss)	(2,046)	5,259	5,754	(760)
Total comprehensive income	\$ 5,558	\$ 17,068	\$ 26,937	\$ 32,059

(In thousands)	Derivative Instrument	Translation Adjustment	Accumulated other comprehensive income (loss)
Balance at December 31, 2009	\$ (1,182)	\$ (9,075)	\$ (10,257)
2010 changes in fair value	864	–	864
2010 translation adjustment	–	(1,624)	(1,624)
Balance at September 30, 2010	<u>\$ (318)</u>	<u>\$ (10,699)</u>	<u>\$ (11,017)</u>

16. Segment Information

Operating segments are defined as components of an enterprise for which separate financial information is available and evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Our chief operating decision-maker is our chief executive officer. Our chief executive officer reviews financial information presented on a consolidated basis, accompanied by information by reporting unit and geographic region for purposes of evaluating financial performance and allocating resources. We are organized as, and operate three operating segments based on our product and service offerings, which we refer to as our lines of business. The company's service offerings all (i) provide computing power to similar types of customers, (ii) have similar production processes, (iii) deliver their services in a similar manner, and (iv) use the same data centers and similar technologies. As a result of our evaluation of the criteria for aggregation by products and services, we determined we have one reportable segment, which we describe as Hosting.

Revenue is attributed to geographic location based on the location of the operating entity that enters into the contractual relationship with the customer. We break down the locations into either the U.S. or outside the U.S., which primarily consists of our business operations in the U.K. Total net revenue by geographic region was as follows:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
United States	\$ 119,896	\$ 149,637	\$ 343,769	\$ 423,038
Outside United States	42,503	50,073	115,702	142,791
Total net revenue	\$ 162,399	\$ 199,710	\$ 459,471	\$ 565,829

Our long-lived assets are primarily located in the U.S. and U.K., and to a lesser extent Hong Kong. Property and equipment, net by geographic region was as follows:

(In thousands)	December 31,	September 30,
	2009	2010
United States	\$ 344,353	\$ 378,995
Outside United States	88,618	95,325
Total property and equipment, net	\$ 432,971	\$ 474,320

17. Related Party Transactions

We lease some facilities from a partnership controlled by our chairman of the board of directors. For these leases, we recognized \$180 thousand and \$93 thousand of rent expense on our consolidated statements of income for the three months ended September 30, 2009 and 2010, respectively, and \$546 thousand and \$279 thousand for the nine months ended September 30, 2009 and 2010, respectively.

ITEM 2 – MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

References to “we,” “our,” “our company,” “us,” “the company,” “Rackspace Hosting,” or “Rackspace” refer to Rackspace Hosting, Inc. and its consolidated subsidiaries. We have made forward-looking statements in this Quarterly Report on Form 10-Q that are subject to risks and uncertainties. Forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section and Section 21E of the Securities Exchange Act of 1934, as amended, are subject to the “safe harbor” created by those sections. The forward-looking statements in this report are based on our management’s beliefs and assumptions and on information currently available to our management. In some cases, you can identify forward-looking statements by terms such as “anticipates,” “aspires,” “believes,” “can,” “continue,” “could,” “estimates,” “expects,” “intends,” “may,” “plans,” “projects,” “seeks,” “should,” “will” or “would” or the negative of these terms and similar expressions intended to identify forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance, time frames or achievements to be materially different from any future results, performance, time frames or achievements expressed or implied by the forward-looking statements. We discuss many of these risks, uncertainties and other factors in this document in greater detail under the heading “Risk Factors.” We believe it is important to communicate our expectations to our investors. However, there may be events in the future that we are not able to predict accurately or over which we have no control. The risks described in “Risk Factors” included in this report, as well as any other cautionary language in this report, provide examples of risks, uncertainties and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. You should be aware that the occurrence of the events described in “Risk Factors” and elsewhere in this report could harm our business.

Given these risks, uncertainties and other factors, you should not place undue reliance on these forward-looking statements. Also, these forward-looking statements represent our estimates and assumptions only as of the date of this filing. You should read this document completely and with the understanding that our actual future results may be materially different from what we expect. We hereby qualify our forward-looking statements by these cautionary statements. Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

The following discussion should be read in conjunction with our consolidated financial statements and the related notes contained elsewhere in this document.

Overview of our Business

We are the world’s leader in the hosting and cloud computing industry. Our growth is the result of our commitment to serving our customers, known as Fanatical Support®, and our exclusive focus on hosting and cloud computing. We have been successful in attracting and retaining thousands of customers and in growing our business. We are a pioneer in an emerging category, hybrid hosting, which combines the benefits of both traditional dedicated hosting and cloud computing. We are committed to maintaining our service-centric focus and we will follow our vision to be considered one of the world’s greatest service companies.

We offer a portfolio of hosting services, including managed hosting, cloud hosting and cloud application hosting. The equipment required (servers, routers, switches, firewalls, load balancers, cabinets, software, wiring, etc.) to deliver services is typically purchased and managed by us.

We sell our services to small and medium-sized businesses as well as large enterprises. For the first nine months of 2010, 25.2% of our net revenue was generated by our operations outside of the U.S., mainly from the U.K. In addition to our operations in the U.S. and U.K., we operate a data center in Hong Kong and sales offices in Hong Kong and the Netherlands, which generate minimal revenue. Our growth strategy includes, among other strategies, targeting international customers as we plan to expand our activities in continental Europe and Asia. For the first nine months of 2010, no individual customer accounted for greater than 2% of our net revenue.

Key Metrics

We carefully track several financial and operational metrics to monitor and manage our growth, financial performance, and capacity. Our key metrics are structured around growth, profitability, capital efficiency, infrastructure capacity, and utilization. The following data should be read in conjunction with the consolidated financial statements, the notes to the financial statements and other financial information included in this Quarterly Report on Form 10-Q.

(Dollar amounts in thousands, except annualized net revenue per average technical square foot)	Three Months Ended				
	(Unaudited)				
	September 30, 2009	December 31, 2009	March 31, 2010	June 30, 2010	September 30, 2010
Growth					
Managed hosting customers at period end	19,328	19,304	19,366	19,433	19,435
Cloud customers at period end**	61,616	71,621	80,080	88,590	99,297
Number of customers at period end	80,944	90,925	99,446	108,023	118,732
Managed hosting, net revenue	\$ 147,065	\$ 152,394	\$ 159,536	\$ 164,094	\$ 172,947
Cloud, net revenue	\$ 15,334	\$ 17,122	\$ 19,269	\$ 23,220	\$ 26,763
Net revenue	\$ 162,399	\$ 169,516	\$ 178,805	\$ 187,314	\$ 199,710
Revenue growth (year over year)	17.4%	18.4%	23.2%	23.2%	23.0%
Net upgrades (monthly average) *	1.3%	1.4%	1.1%	1.6%	1.6%
Churn (monthly average) *	-1.1%	-0.9%	-0.9%	-1.0%	-1.1%
Growth in installed base (monthly average) *	0.1%	0.5%	0.2%	0.6%	0.5%
Number of employees (Rackers) at period end	2,730	2,774	2,905	3,002	3,130
Number of servers deployed at period end	54,655	56,671	59,876	61,874	63,996
Profitability					
Income from operations	\$ 13,128	\$ 15,689	\$ 16,728	\$ 17,831	\$ 21,635
Depreciation and amortization	\$ 32,696	\$ 35,018	\$ 36,698	\$ 37,991	\$ 39,677
Share-based compensation expense					
Cost of revenue	\$ 778	\$ 768	\$ 969	\$ 1,163	\$ 1,305
Sales and marketing	\$ 826	\$ 639	\$ 880	\$ 1,100	\$ 1,209
General and administrative	\$ 4,008	\$ 3,851	\$ 4,129	\$ 4,113	\$ 4,669
Total share-based compensation expense	\$ 5,612	\$ 5,258	\$ 5,978	\$ 6,376	\$ 7,183
Adjusted EBITDA (1)	\$ 51,436	\$ 55,965	\$ 59,404	\$ 62,198	\$ 68,495
Adjusted EBITDA margin	31.7%	33.0%	33.2%	33.2%	34.3%
Operating income margin	8.1%	9.3%	9.4%	9.5%	10.8%
Income from operations	\$ 13,128	\$ 15,689	\$ 16,728	\$ 17,831	\$ 21,635
Effective tax rate	33.9%	34.0%	33.6%	33.2%	35.5%
Net operating profit after tax (NOPAT) (1)	\$ 8,678	\$ 10,355	\$ 11,107	\$ 11,911	\$ 13,955
NOPAT margin	5.3%	6.1%	6.2%	6.4%	7.0%
Capital efficiency and returns					
Interest bearing debt	\$ 167,976	\$ 167,386	\$ 169,517	\$ 169,847	\$ 180,177
Stockholders' equity	\$ 330,392	\$ 349,427	\$ 370,425	\$ 397,994	\$ 413,237
Less: Excess cash	\$ (83,462)	\$ (105,083)	\$ (109,840)	\$ (126,018)	\$ (142,592)
Capital base	\$ 414,906	\$ 411,730	\$ 430,102	\$ 441,823	\$ 450,822
Average capital base	\$ 402,188	\$ 413,318	\$ 420,916	\$ 435,963	\$ 446,323
Capital turnover (annualized)	1.62	1.64	1.70	1.72	1.79
Return on capital (annualized) (1)	8.6%	10.0%	10.6%	10.9%	12.5%
Capital expenditures					
Purchases of property and equipment, net	\$ 26,024	\$ 34,652	\$ 39,622	\$ 29,050	\$ 29,222
Vendor financed equipment purchases	\$ 20,664	\$ 12,398	\$ 15,766	\$ 15,793	\$ 23,208
Total capital expenditures	\$ 46,688	\$ 47,050	\$ 55,388	\$ 44,843	\$ 52,430
Customer gear	\$ 28,705	\$ 28,421	\$ 32,488	\$ 29,589	\$ 36,219
Data center build outs	\$ 4,028	\$ 7,880	\$ 16,644	\$ 5,955	\$ 6,162
Office build outs	\$ 5,432	\$ 5,350	\$ 1,220	\$ 1,306	\$ 1,271
Capitalized software and other projects	\$ 8,523	\$ 5,399	\$ 5,036	\$ 7,993	\$ 8,778
Total capital expenditures	\$ 46,688	\$ 47,050	\$ 55,388	\$ 44,843	\$ 52,430
Infrastructure capacity and utilization					
Technical square feet of data center space at period end					
***	167,821	162,848	169,998	169,998	177,148
Annualized net revenue per average technical square foot	\$ 3,764	\$ 4,101	\$ 4,298	\$ 4,407	\$ 4,602
Utilization rate at period end	62.3%	65.3%	66.5%	69.1%	68.9%

* Prior quarter averages have been updated to reflect the new methodology. See below in the "Third Quarter 2010 Overview" section for discussion of the change in methodology and a comparison of the changes. Due to rounding, totals may not equal the sum of the line items in the table above.

** Amounts include SaaS customers for Jungle Disk using a Rackspace storage solution. Jungle Disk customers using a third party storage solution are excluded.

*** Technical square footage as of September 30, 2010 excludes 24,400 square feet and 3,300 square feet for unused portions of the Chicago and Northern

Virginia facilities, respectively.

(1) See discussion and reconciliation of our Non-GAAP financial measures to the most comparable GAAP measures.

In the table above, we continue to define technical square feet of data center space as space that can be utilized to support IT equipment. With respect to square footage and utilization, for data centers that are not yet fully utilized (our Northern Virginia and Chicago area facilities) we include square footage and power capacity based on the agreed upon schedule in the lease agreement. For example, if the agreement has 10 phases and we are in phase five, we include 50% of the total square footage and power capacity called for in the lease agreement.

Non-GAAP Financial Measures

Return on Capital (ROC) (Non-GAAP financial measure)

We define Return on Capital as follows: $ROC = \text{Net operating profit after tax (NOPAT)} / \text{Average capital base}$

$NOPAT = \text{Income from operations} \times (1 - \text{Effective tax rate})$

$\text{Average capital base} = \text{Average of (Interest bearing debt + stockholders' equity - excess cash)} = \text{Average of (Total assets - excess cash - accounts payables and accrued expenses - deferred revenue - other non-current liabilities and deferred income taxes)}$

Year-to-date average balances are based on an average calculated using the quarter end balances at the beginning of the period and all other quarter ending balances included in the period.

We define excess cash as the amount of cash and cash equivalents that exceeds our operating cash requirements, which is calculated as three percent of our annualized net revenue for the three months prior to the period end. We will periodically review the calculation and adjust it to reflect our projected cash requirements for the upcoming year.

We believe that ROC is an important metric for investors in evaluating our company's performance. ROC relates to after-tax operating profits with the capital that is placed into service. It is therefore a performance metric that incorporates both the Statement of Income and the Balance Sheet. ROC measures how successfully capital is deployed within a company.

Note that ROC is not a measure of financial performance under GAAP and should not be considered a substitute for return on assets, which we consider to be the most directly comparable GAAP measure. ROC has limitations as an analytical tool, and when assessing our operating performance, you should not consider ROC in isolation, or as a substitute for other financial data prepared in accordance with GAAP. Other companies may calculate ROC differently than we do, limiting its usefulness as a comparative measure.

ROC increased from 8.6% to 12.5% for the three months ended September 30, 2009 compared to the three months ended September 30, 2010, primarily due to a reduction of operating costs as a percentage of revenue. Included in the average capital base are capital expenditures of \$14.6 million and \$40.7 million related to the build-out of our new corporate headquarters facility and data centers, respectively, since the beginning of the third quarter of 2009.

Return on assets increased from 4.7% for the three months ended September 30, 2009 to 6.4% for the three months ended September 30, 2010. This increase was primarily due to higher revenue and net income, partially offset by a higher tax rate and growth in our asset base due to the purchase of property and equipment to support the growth of our business.

See our reconciliation of the calculation of return on assets to ROC in the following table:

(In thousands, except financial metrics)	Three Months Ended				
	(Unaudited)				
	September 30, 2009	December 31, 2009	March 31, 2010	June 30, 2010	September 30, 2010
Income from operations	\$ 13,128	\$ 15,689	\$ 16,728	\$ 17,831	\$ 21,635
Effective tax rate	33.9%	34.0%	33.6%	33.2%	35.5%
Net operating profit after tax (NOPAT)	\$ 8,678	\$ 10,355	\$ 11,107	\$ 11,911	\$ 13,955
Net income	\$ 7,604	\$ 9,035	\$ 9,812	\$ 11,198	\$ 11,809
Total assets at period end	\$ 625,330	\$ 668,645	\$ 691,729	\$ 720,457	\$ 760,198
Less: Excess cash	\$ (83,462)	\$ (105,083)	\$ (109,840)	\$ (126,018)	\$ (142,592)
Less: Accounts payable and accrued expenses	\$ (77,108)	\$ (89,773)	\$ (92,828)	\$ (97,711)	\$ (101,427)
Less: Deferred revenues (current and non-current)	\$ (18,222)	\$ (19,444)	\$ (18,044)	\$ (16,640)	\$ (16,685)
Less: Other non-current liabilities and deferred taxes	\$ (31,632)	\$ (42,615)	\$ (40,915)	\$ (38,265)	\$ (48,672)
Capital base	\$ 414,906	\$ 411,730	\$ 430,102	\$ 441,823	\$ 450,822
Average total assets	\$ 641,062	\$ 646,988	\$ 680,187	\$ 706,093	\$ 740,328
Average capital base	\$ 402,188	\$ 413,318	\$ 420,916	\$ 435,963	\$ 446,323
Return on assets (annualized)	4.7%	5.6%	5.8%	6.3%	6.4%
Return on capital (annualized)	8.6%	10.0%	10.6%	10.9%	12.5%

Adjusted EBITDA (Non-GAAP financial measure)

We use Adjusted EBITDA as a supplemental measure to review and assess our performance. We define Adjusted EBITDA as Net income, plus income taxes, total other income (expense), depreciation and amortization, and non-cash charges for share-based compensation.

Adjusted EBITDA is a metric that is used in our industry by the investment community for comparative and valuation purposes. We disclose this metric in order to support and facilitate the dialogue with research analysts and investors.

Note that Adjusted EBITDA is not a measure of financial performance under GAAP and should not be considered a substitute for operating income, which we consider to be the most directly comparable GAAP measure. Adjusted EBITDA has limitations as an analytical tool, and when assessing our operating performance, you should not consider Adjusted EBITDA in isolation, or as a substitute for net income or other consolidated income statement data prepared in accordance with GAAP. Other companies may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

Adjusted EBITDA increased \$6.3 million, or 10.1%, from \$62.2 million for the three months ended June 30, 2010 to \$68.5 million in the three months ended September 30, 2010. Adjusted EBITDA as a percentage of revenue increased from 33.2% for the three months ended June 30, 2010 to 34.3% for the three months ended September 30, 2010. The primary drivers of the increase in Adjusted EBITDA percentage were decreases in Cost of Revenue and General and Administrative expenses as a percentage of revenue. The decreases were partially due to changes in non-cash deferred rent and non-equity incentive compensation. In the third quarter of 2009, we began incurring rent expense related to our Northern Virginia and Chicago area data centers, even though we did not begin operations in the Chicago area data center until the first quarter of 2010. Overall non-cash rent decreased from \$1.4 million in the three months ended June 30, 2010 to \$1.0 million in the three months ended September 30, 2010. Non-cash rent expense is expected to increase due to the new data center lease agreement in Chicago signed in May 2010. Non-equity incentive compensation decreased \$2.6 million as we did not meet our preset target.

Employee non-equity incentive compensation through our current non-equity incentive plan, in effect since January 1, 2009, is dependent upon the financial results of the company in relation to a preset target level. Thus, favorable financial performance in comparison to the preset target level is partially offset by increased non-equity incentive compensation expense. If company achievement of the preset target results in a 10% increase in the non-equity incentive compensation percentage payout, this would increase total non-equity incentive compensation by approximately \$0.5 million on an after-tax basis and increase net income by \$0.2 million. Company achievement resulting in a 10% decrease in the non-equity incentive compensation percentage payout would decrease total non-equity incentive compensation by approximately \$0.5 million on an after-tax basis and decrease net income by \$0.2 million.

Income from operations has been favorably impacted by cost containment initiatives particularly in our general and administrative functions as well as a decrease in depreciation and amortization expense as a percentage of revenue. Our operating income margin increased from 8.1% for the three months ended September 30, 2009 to 10.8% for the three months ended September 30, 2010.

See our Adjusted EBITDA reconciliation below.

	Three Months Ended				
	(Unaudited)				
(Dollars in thousands)	September 30, 2009	December 31, 2009	March 31, 2010	June 30, 2010	September 30, 2010
Net revenue	\$ 162,399	\$ 169,516	\$ 178,805	\$ 187,314	\$ 199,710
Income from operations	\$ 13,128	\$ 15,689	\$ 16,728	\$ 17,831	\$ 21,635
Net income	\$ 7,604	\$ 9,035	\$ 9,812	\$ 11,198	\$ 11,809
Plus: Income taxes	\$ 3,900	\$ 4,648	\$ 4,957	\$ 5,572	\$ 6,495
Plus: Total other expense	\$ 1,624	\$ 2,006	\$ 1,959	\$ 1,061	\$ 3,331
Plus: Depreciation and amortization	\$ 32,696	\$ 35,018	\$ 36,698	\$ 37,991	\$ 39,677
Plus: Share-based compensation expense	\$ 5,612	\$ 5,258	\$ 5,978	\$ 6,376	\$ 7,183
Adjusted EBITDA	\$ 51,436	\$ 55,965	\$ 59,404	\$ 62,198	\$ 68,495
Operating income margin	8.1%	9.3%	9.4%	9.5%	10.8%
Adjusted EBITDA margin	31.7%	33.0%	33.2%	33.2%	34.3%

Adjusted Free Cash Flow (Non-GAAP financial measure)

We define Adjusted Free Cash Flow as Adjusted EBITDA plus non-cash deferred rent, less total capital expenditures (including vendor financed equipment purchases), cash payments for interest, net, and cash payments for income taxes, net.

We believe that Adjusted Free Cash Flow is an important metric for investors in evaluating how a company is currently using cash generated, and may indicate its ability to generate cash that can potentially be used by the business for capital investments, acquisitions, reduction of debt, payment of dividends, etc. Note that Adjusted Free Cash Flow is not a measure of financial performance under GAAP and may not be comparable to similarly titled measures reported by other companies.

See our Adjusted Free Cash Flow reconciliation to Adjusted EBITDA below, as well as our reconciliation of Net income to Adjusted EBITDA provided above.

	Three Months Ended	Nine Months Ended
	September 30, 2010	September 30, 2010
(In thousands)		
	(Unaudited)	
Adjusted EBITDA	\$ 68,495	\$ 190,097
Non-cash deferred rent	1,051	4,171
Total capital expenditures	(52,430)	(152,661)
Cash payments for interest, net	(1,795)	(5,723)
Cash payments for income taxes, net	(3,577)	(7,276)
Adjusted free cash flow	\$ 11,744	\$ 28,608

Net Leverage (Non-GAAP financial measure)

We define Net Leverage as Net Debt divided by Adjusted EBITDA (trailing twelve months). We believe that Net Leverage is an important metric for investors in evaluating a company's liquidity. Note that Net Leverage is not a measure of financial performance under GAAP and may not be comparable to similarly titled measures reported by other companies.

See our Net Leverage calculation below.

	As of September 30, 2010
	(Unaudited)
(Dollars in thousands)	
Obligations under capital leases	\$ 126,521
Debt	53,656
Total debt	\$ 180,177
Less: Cash and cash equivalents	(166,557)
Net debt	\$ 13,620
Adjusted EBITDA (trailing twelve months)	\$ 246,062
Net leverage	0.06x

Results of Operations

The following tables set forth our results of operations for the specified periods and as a percentage of our revenue for those same periods. The period-to-period comparison of financial results is not necessarily indicative of future results.

Consolidated Statements of Income (Unaudited):

(In thousands)	Three Months Ended				
	September 30, 2009	December 31, 2009	March 31, 2010	June 30, 2010	September 30, 2010
Net revenue	\$ 162,399	\$ 169,516	\$ 178,805	\$ 187,314	\$ 199,710
Costs and expenses:					
Cost of revenue	53,093	53,405	57,007	61,470	64,616
Sales and marketing	19,860	20,016	21,977	23,285	24,651
General and administrative	43,622	45,388	46,395	46,737	49,131
Depreciation and amortization	32,696	35,018	36,698	37,991	39,677
Total costs and expenses	149,271	153,827	162,077	169,483	178,075
Income from operations	13,128	15,689	16,728	17,831	21,635
Other income (expense):					
Interest expense	(2,147)	(2,096)	(2,144)	(1,875)	(2,068)
Interest and other income (expense)	523	90	185	814	(1,263)
Total other income (expense)	(1,624)	(2,006)	(1,959)	(1,061)	(3,331)
Income before income taxes	11,504	13,683	14,769	16,770	18,304
Income taxes	3,900	4,648	4,957	5,572	6,495
Net income	\$ 7,604	\$ 9,035	\$ 9,812	\$ 11,198	\$ 11,809

Consolidated Statements of Income, as a Percentage of Net Revenue (Unaudited):

(Percent of net revenue)	Three Months Ended				
	September 30, 2009	December 31, 2009	March 31, 2010	June 30, 2010	September 30, 2010
Net revenue	100.0%	100.0%	100.0%	100.0%	100.0%
Costs and expenses:					
Cost of revenue	32.7%	31.5%	31.9%	32.8%	32.4%
Sales and marketing	12.2%	11.8%	12.3%	12.4%	12.3%
General and administrative	26.9%	26.8%	25.9%	25.0%	24.6%
Depreciation and amortization	20.1%	20.7%	20.5%	20.3%	19.9%
Total costs and expenses	91.9%	90.7%	90.6%	90.5%	89.2%
Income from operations	8.1%	9.3%	9.4%	9.5%	10.8%
Other income (expense):					
Interest expense	-1.3%	-1.2%	-1.2%	-1.0%	-1.0%
Interest and other income (expense)	0.3%	0.1%	0.1%	0.4%	-0.6%
Total other income (expense)	-1.0%	-1.2%	-1.1%	-0.6%	-1.7%
Income before income taxes	7.1%	8.1%	8.3%	9.0%	9.2%
Income taxes	2.4%	2.7%	2.8%	3.0%	3.3%
Net income	4.7%	5.3%	5.5%	6.0%	5.9%

Due to rounding, totals may not equal the sum of the line items in the table above.

Third Quarter 2010 Overview

To aid in understanding our operating results for the periods covered by this report, we have provided an executive overview and a summary of the significant events that affected the most recent reporting period. These sections should be read in conjunction with the other portions of management's discussion and analysis of our financial condition and results of operations, our "Risk Factors" section, and our consolidated financial statements and notes included in this report.

The highlights and significant events of the three months ended September 30, 2010 and the impact on our operating results compared to the three months ended, June 30, 2010 were as follows:

Net Revenue

Net revenue increased \$12.4 million, or 6.6%, from \$187.3 million in the three months ended June 30, 2010 to \$199.7 million in the three months ended September 30, 2010. The market for hosting services continues to be highly competitive and we face competition from existing competitors as well as new market entrants. However, we continue to grow our Managed Hosting and Cloud service offerings and believe that this full portfolio of hosting services positions us to benefit from increased IT spending in the future. During the third quarter, we experienced a favorable revenue impact due to a weakening U.S. dollar relative to the pound sterling, which resulted in an increase to revenue of approximately \$1.8 million, or 0.9%, for the three months ended September 30, 2010 compared to the three months ended June 30, 2010, respectively, with a minimal impact to our margins as the majority of customers are invoiced, and substantially all of our expenses associated with these customers are paid, by us or our subsidiaries in the functional currency of our company or our subsidiaries.

Our business model generates approximately 98% of our revenue on a recurring basis. To date, the majority of this recurring revenue has been earned as part of a subscription offering; however, the advent of virtual and cloud technology services provided on a utility basis are becoming more prevalent. During 2010, our recurring revenue has increased across our portfolio of services, but utility based service revenue has grown at a significantly faster rate than our subscription service revenue. We believe that this trend will continue as the market changes the way it consumes computing resources and more companies begin to utilize cloud solutions. As this portion of our revenue continues to increase at a higher rate than our subscription business, our current installed base growth metric may not capture this revenue growth effectively. This is because historically, we have calculated installed base growth on our subscription business only.

As noted in our second quarter 10-Q, we were reviewing a more suitable basis of calculation to capture growth in all of our service offerings and we intended to update this metric. Upon further review, we have updated the calculation to reflect this change in our revenue.

The growth in installed base metric continues to be calculated as the difference between "net upgrades" and defection "churn." Net upgrades measure the incremental monthly recurring revenue from customer upgrades less downgrades as a percentage of total monthly recurring revenue before customer credits. Churn measures the reduction of monthly revenue due to customer terminations as a percentage of total monthly recurring revenue before customer credits. Terminations typically result from customers who (i) no longer need hosting services, (ii) are unable to pay for hosting services, (iii) decide to provide their services in-house, or (iv) switch to another hosting provider. We measure net upgrades at the time a customer upgrades or downgrades services with us and we measure churn in the month we stop providing services to the customer. Net upgrades and churn are expressed as percentage increases (decreases) in the prior month's total monthly recurring revenue before customer credits.

Prior to this quarter, the calculation included the impact of our utility business in the denominator of this calculation, but not the numerator. However, beginning this quarter, we have captured the full impact of our utility business by including it in both the denominator and the numerator. See below for a comparison of the two calculations:

- A) Subscription Net Upgrades: \$50
- B) Utility Net Upgrades: \$10
- C) Prior Month Subscription and Utility Recurring Revenue before Credits: \$1,000

Old Method Installed Base Growth Calculation: 0.5% (A / C)
 New Method Installed Based Growth Calculation: 0.6% ((A + B) / C)

The table below is a comparison of our installed base growth metric over the last five quarters using our old methodology compared to what it would have been if we had been using our new methodology:

	Three Months Ended				
	September 30, 2009	December 31, 2009	March 31, 2010	June 30, 2010	September 30, 2010
Net upgrades (monthly average)					
New Methodology	1.3%	1.4%	1.1%	1.6%	1.6%
Old Methodology	1.2%	1.3%	1.1%	1.4%	1.4%
Difference	0.1%	0.1%	0.0%	0.2%	0.2%
Churn (monthly average)					
New Methodology	-1.1%	-0.9%	-0.9%	-1.0%	-1.1%
Old Methodology	-1.1%	-0.8%	-0.9%	-0.9%	-1.0%
Difference	0.0%	-0.1%	0.0%	-0.1%	-0.1%
Growth in installed base (monthly average)					
New Methodology	0.1%	0.5%	0.2%	0.6%	0.5%
Old Methodology	0.1%	0.4%	0.2%	0.5%	0.4%
Difference	0.0%	0.1%	0.0%	0.1%	0.1%

Cost of Revenue

Our cost of revenue was \$61.5 million for the three months ended June 30, 2010, and \$64.6 million for the three months ended September 30, 2010, an increase of \$3.1 million, or 5.0%. Of this increase, \$2.2 million was attributable to an increase in consulting fees related to data center assessments and improvements. The cost increase was further attributable to increases in license costs of \$0.4 million, data center costs of \$0.4 million related to power and rent, and employee-related expenses of \$0.2 million. The remaining variance was due to small changes in other cost of revenue expenses.

Sales and Marketing Expenses

Our sales and marketing expenses were \$23.3 million for the three months ended June 30, 2010 and \$24.7 million for the three months ended September 30, 2010, an increase of \$1.4 million, or 6.0%. Of this increase, \$1.2 million was attributable to an increase in employee-related expenses. Total compensation increased as a result salary increases and the hiring of additional sales and marketing personnel and the impact of commissions associated with increased sales, partially offset by a decrease in non-equity incentive compensation. The remaining variance was due to small changes in other sales and marketing expenses.

General and Administrative Expenses

Our general and administrative expenses were \$46.7 million for the three months ended June 30, 2010 and \$49.1 million for the three months ended September 30, 2010, an increase of \$2.4 million, or 5.1%. Of this increase, \$0.2 million was attributable to employee-related expenses. The cost increase was further attributable to increases in bad debt expense of \$0.7 million, property insurance and non-income taxes of \$0.4 million, and professional fees of \$0.2 million. The remaining increase was due to small increases in other general and administrative expenses.

Depreciation and Amortization Expense

Our depreciation and amortization expense was \$38.0 million for the three months ended June 30, 2010 and \$39.7 million for the three months ended September 30, 2010, an increase of \$1.7 million, or 4.5%. The increase in depreciation and amortization expense was a direct result of an increase in property and equipment related to depreciable assets to support the growth of our business, which included increases in data center equipment and leasehold improvements due to data center build outs and internally developed and purchased software.

Net Income and Net Income per Share

Net income was \$11.2 million, or \$0.08 per share on a diluted basis for the three months ended June 30, 2010 compared to net income of \$11.8 million, or \$0.09 per share on a diluted basis for the three months ended September 30, 2010. The increase in net income was mainly due to revenue growth. Lower cost of revenue expenses, general and administrative expenses, and depreciation and amortization expenses as a percentage of revenue, for the three months ended September 30, 2010 compared to the three months ended June 30, 2010, were offset by a slight increase in sales and marketing expense as a percentage of revenue as well as an increase in other expense. Additionally, net income was negatively impacted by an increase in our global tax rate from 33.23% in the three months ended June 30, 2010 to 35.48% in the three months ended September 30, 2010 due to a higher percentage of earnings in countries with higher statutory rates, as well as foreign currency losses of \$1.4 million in the three months ended September 30, 2010 compared to foreign currency gains of \$0.8 million in the three months ended June 30, 2010 related to intercompany debt agreements and cash balances held by subsidiaries in a currency other than their functional currency.

Recent Developments

In response to the trend for cloud computing, we recently launched OpenStack, an open source cloud platform that powers our Cloud Files and Cloud Servers offerings. We believe that this initiative will help drive industry standards, prevent vendor lock in and foster the development of cloud technology. By creating an environment that supports further cloud development, we will enhance our opportunities to continue and grow our commitment to serving our customers through Fanatical Support®. While it is difficult to predict the impact that OpenStack will have on our business, we believe that this initiative will enable us to maintain our position as a leader within the cloud computing industry.

In addition to OpenStack, we continue to develop and release additional service offerings and enhancements to existing product offerings that further increases our capabilities around Hybrid Hosting that allows our customers to choose and mix our dedicated, public and Cloud technologies. We continue to focus on the service intensive segment of the market and to this end we are readying for launch our Cloud offering in the UK as well as offering a managed service level on Cloud Servers. This new offering will extend our industry-leading managed services offering to the Rackspace Cloud as it provides an additional level of support on Cloud Servers that includes a higher service level agreement that guarantees performance through monitoring, the operating system, and application infrastructure support as well as technical guidance.

As our business continues to grow, we will require additional data center capacity. In May 2010, we signed an additional lease to expand the capacity in our Chicago data center to accommodate future growth. We will continue to evaluate opportunities to secure further data center capacity in the future.

Three Months Ended September 30, 2009 and September 30, 2010

Net Revenue

Our net revenue was \$162.4 million for the three months ended September 30, 2009 and \$199.7 million for the three months ended September 30, 2010, an increase of \$37.3 million, or 23.0%. The increase in net revenue was primarily due to an increased volume of services provided, resulting from an increasing number of new customers and incremental services rendered to existing customers. Partially offsetting the revenue increase was the negative impact of a stronger U.S. dollar relative to the pound sterling for the three months ended September 30, 2010 compared to the three months ended September 30, 2009. Net revenue for the three months ended September 30, 2010 would have been approximately \$2.9 million higher had the U.S. dollar to the pound sterling exchange rate remained constant from the prior year.

Over the last several quarters, we have experienced fewer customers making prepayments. We have also seen a decline in the amount of setup fees charged to customers. Generally, when setup fees are not included in the pricing of our arrangements, there is an increase in the monthly recurring amount paid by the customer. As a result, this trend has no overall impact on revenue recognized during a period.

Cost of Revenue

Our cost of revenue was \$53.1 million for the three months ended September 30, 2009, and \$64.6 million for the three months ended September 30, 2010, an increase of \$11.5 million, or 21.7%. Of this increase, \$5.6 million was attributable to employee-related expenses due to increases in salaries and benefits of \$5.3 million, and share-based compensation expense of \$0.5 million, partially offset by a decrease in non-equity incentive compensation of \$0.2 million. The overall change in employee-related expenses was primarily due to the hiring of data center and support personnel to support our growth and equity awards granted in 2010, partially offset by lower percentage attainment against the preset target for non-equity incentive compensation. The cost increase was further attributable to an increase in license costs of \$1.8 million, an increase in data center costs of \$0.6 million related to power and rent and an increase in consulting fees related to data center assessments and improvements of \$4.1 million. The remaining increase was due to small increases in other cost of revenue expenses.

Sales and Marketing Expenses

Our sales and marketing expenses were \$19.9 million for the three months ended September 30, 2009 and \$24.7 million for the three months ended September 30, 2010, an increase of \$4.8 million, or 24.1%. Of this increase, \$3.1 million was attributable to an increase in salaries, commissions, benefits, and share-based compensation expense. Total compensation increased as a result salary increases and the hiring of additional sales and marketing personnel and the impact of commissions associated with increased sales. Travel and other employee related expenses increased \$0.5 million and advertising and Internet-related marketing expenditures increased \$1.1 million.

General and Administrative Expenses

Our general and administrative expenses were \$43.6 million for the three months ended September 30, 2009 and \$49.1 million for the three months ended September 30, 2010, an increase of \$5.5 million, or 12.6%. Of this increase, \$2.9 million was attributable to employee-related expenses due to increases in salaries and benefits of \$2.6 million and share-based compensation expense of \$0.7 million, partially offset by a decrease in non-equity incentive compensation of \$0.4 million. These increases are primarily due to additional headcount and equity awards granted in 2010, partially offset by lower percentage attainment against the preset target for non-equity incentive compensation. Professional fees increased \$0.6 million primarily as a result of increased consulting expenses related to accounting and tax services and corporate strategy. In addition, travel and other employee related expenses such as recruiting fees and relocation increased \$1.2 million primarily due to a general increase in hiring during the three months ended September 30, 2010. The overall increase was partially offset by a decrease in bad debt expense of \$0.5 million due to a positive change in customer payment patterns and increased cash collections. The remaining increase was due to small increases in other general and administrative expenses.

Depreciation and Amortization Expense

Our depreciation and amortization expense was \$32.7 million for the three months ended September 30, 2009 and \$39.7 million for the three months ended September 30, 2010, an increase of \$7.0 million, or 21.4%. The increase in depreciation and amortization expense was a direct result of an increase in property and equipment related to depreciable assets to support the growth of our business, which included increases in data center equipment and leasehold improvements due to data center build outs and internally developed and purchased software.

Other Income (Expense)

Our interest expense was \$2.1 million for the three months ended September 30, 2009 and 2010. Interest expense was partially offset by capitalized interest of \$0.2 million for the three months ended September 30, 2009 and 2010.

Interest and other income (expense) was \$0.5 million for the three months ended September 30, 2009 and \$(1.3) million for the three months ended September 30, 2010. In the three months ended September 30, 2009, we recognized \$0.1 million in interest and other income and foreign currency gains of \$0.4 million. In the three months ended September 30, 2010, we recognized \$0.1 million in interest and other income and foreign currency losses of \$(1.4) million.

Income Taxes

Our effective tax rate increased from 33.9% for the three months ended September 30, 2009 to 35.5% for the three months ended September 30, 2010, primarily because more of our earnings for the three months ended September 30, 2010 compared to the three months ended September 30, 2009 were realized in countries where we have higher statutory tax rates. Our foreign earnings are generally taxed at lower rates than in the United States. The differences between our effective tax rate and the U.S. federal statutory rate of 35% principally result from our geographical distribution of taxable income and permanent differences between the book and tax treatment of certain items.

We have current tax benefits from net operating losses relating to bonus that are being utilized to reduce our U.S. taxable income. As such, we expect the U.S. portion of our tax provision to be non-cash.

Nine Months Ended September 30, 2009 and September 30, 2010

The following tables set forth our results of operations for the specified periods and as a percentage of our revenue for those same periods. The period-to-period comparison of financial results is not necessarily indicative of future results.

Consolidated Statements of Income (Unaudited):

(In thousands)	Nine Months Ended	
	September 30, 2009	September 30, 2010
Net revenue	\$ 459,471	\$ 565,829
Costs and expenses:		
Cost of revenue	147,538	183,093
Sales and marketing	59,442	69,913
General and administrative	122,728	142,263
Depreciation and amortization	90,211	114,366
Total costs and expenses	419,919	509,635
Income from operations	39,552	56,194
Other income (expense):		
Interest expense	(6,854)	(6,087)
Interest and other income (expense)	165	(264)
Total other income (expense)	(6,689)	(6,351)
Income before income taxes	32,863	49,843
Income taxes	11,680	17,024
Net income	\$ 21,183	\$ 32,819

(Percent of net revenue)	Nine Months Ended	
	September 30, 2009	September 30, 2010
Net revenue	100.0%	100.0%
Costs and expenses:		
Cost of revenue	32.1%	32.4%
Sales and marketing	12.9%	12.4%
General and administrative	26.7%	25.1%
Depreciation and amortization	19.6%	20.2%
Total costs and expenses	91.4%	90.1%
Income from operations	8.6%	9.9%
Other income (expense):		
Interest expense	-1.5%	-1.1%
Interest and other income (expense)	0.0%	0.0%
Total other income (expense)	-1.5%	-1.1%
Income before income taxes	7.2%	8.8%
Income taxes	2.5%	3.0%
Net income	4.6%	5.8%

Due to rounding, totals may not equal the sum of the line items in the table above.

Net Revenue

Our net revenue was \$459.5 million for the nine months ended September 30, 2009 and \$565.8 million for the nine months ended September 30, 2010, an increase of \$106.3 million, or 23.1%. The increase in net revenue was primarily due to an increased volume of services provided, resulting from an increasing number of new customers and incremental services rendered to existing customers. Partially offsetting the revenue increase was the negative impact of a stronger U.S. dollar relative to the pound sterling for the nine months ended September 30, 2010 compared to the nine months ended September 30, 2009. Net revenue for the nine months ended September 30, 2010 would have been approximately \$1.0 million higher had the U.S. dollar to the pound sterling exchange rate remained constant from the prior year.

Cost of Revenue

Our cost of revenue was \$147.5 million for the nine months ended September 30, 2009, and \$183.1 million for the nine months ended September 30, 2010, an increase of \$35.6 million, or 24.1%. Of this increase, \$18.6 million was attributable to employee-related expenses due to increases in salaries and benefits of \$14.4 million, non-equity incentive compensation of \$1.3 million, share-based compensation expense of \$1.4 million and contract labor related to short-term projects of \$1.5 million. These increases are primarily due to additional headcount, higher percentage attainment against the preset target and equity awards granted in 2010. The cost increase was further attributable to an increase in data center costs of \$4.5 million related to power and rent, an increase in license costs of \$4.4 million and an increase in consulting fees related to data center assessments and improvements of \$7.8 million. The remaining increase was due to small increases in other cost of revenue expenses.

Sales and Marketing Expenses

Our sales and marketing expenses were \$59.4 million for the nine months ended September 30, 2009 and \$69.9 million for the nine months ended September 30, 2010, an increase of \$10.5 million, or 17.7%. Of this increase, \$7.3 million was attributable to an increase in salaries, commissions, benefits, and share-based compensation expense. Total compensation increased as a result of salary increases and the hiring of additional sales and marketing personnel and the impact of commissions associated with increased sales. Travel and other employee related expenses increased \$1.4 million and advertising and Internet-related marketing expenditures increased \$1.6 million.

General and Administrative Expenses

Our general and administrative expenses were \$122.7 million for the nine months ended September 30, 2009 and \$142.3 million for the nine months ended September 30, 2010, an increase of \$19.6 million, or 16.0%. Of this increase, \$13.4 million was attributable to employee-related expenses due to increases in salaries and benefits of \$9.1 million, non-equity incentive compensation of \$1.9 million, and share-based compensation expense of \$2.4 million. These increases are primarily due to additional headcount, higher percentage attainment against the preset target for non-equity incentive compensation and equity awards granted in 2010. Professional fees increased \$2.6 million primarily as a result of increased consulting expenses related to accounting and tax services, corporate strategy and internal system maintenance and improvements. Travel and other employee related expenses such as recruiting fees and relocation increased \$3.9 million primarily due to the addition of several executive level positions and a general increase in hiring during the nine months ended September 30, 2010. Additionally, property tax increased \$1.1 million due to the addition of data center facilities. The overall increase was partially offset by a decrease in bad debt expense of \$3.0 million due to a positive change in customer payment patterns and increased cash collections.

Depreciation and Amortization Expense

Our depreciation and amortization expense was \$90.2 million for the nine months ended September 30, 2009 and \$114.4 million for the nine months ended September 30, 2010, an increase of \$24.2 million, or 26.8%. The increase in depreciation and amortization expense was a direct result of an increase in property and equipment related to depreciable assets to support the growth of our business, which included increases in data center equipment and leasehold improvements due to data center build outs and internally developed and purchased software.

Other Income (Expense)

Our interest expense was \$6.9 million for the nine months ended September 30, 2009 and \$6.1 million for the nine months ended September 30, 2010, a decrease of \$0.8 million, or 11.6%. The decrease was primarily due to the decreased level of indebtedness (including capital leases), as well as decreased borrowing rates. Interest expense was partially offset by capitalized interest of \$0.7 million for the nine months ended September 30, 2009 and \$0.5 million for the nine months ended September 30, 2010.

Interest and other income (expense) was \$0.2 million for the nine months ended September 30, 2009 and \$(0.3) million for the nine months ended September 30, 2010. In the nine months ended September 30, 2009, we recognized \$0.4 million in interest and other income and foreign currency losses of \$(0.2) million. In the nine months ended September 30, 2010, we recognized \$0.2 million of interest and other income and foreign currency losses of \$(0.5) million.

Income Taxes

Our effective tax rate decreased from 35.5% for the nine months ended September 30, 2009 to 34.2% for the nine months ended September 30, 2010, primarily because more of our earnings for the nine months ended September 30, 2010 compared to the nine months ended September 30, 2009 were realized in countries where we have lower statutory tax rates. Our foreign earnings are generally taxed at lower rates than in the United States. The differences between our effective tax rate and the U.S. federal statutory rate of 35% principally result from our geographical distribution of taxable income and permanent differences between the book and tax treatment of certain items.

We have current tax benefits from net operating losses relating to bonus depreciation that are being utilized to reduce our U.S. taxable income. As such, we expect the U.S. portion of our tax provision to be non-cash.

Liquidity and Capital Resources

At September 30, 2010, our cash and cash equivalents balance was \$166.6 million. We use our cash and cash equivalents, cash flow from operations, capital leases, and existing amounts available under our revolving credit facility as our primary sources of liquidity. We currently believe that cash generated by operations, current cash and cash equivalents, and available borrowings through vendor financing arrangements and our credit facility will be sufficient to meet our operating and capital needs in the foreseeable future.

Our revolving credit facility agreement allows us to borrow in pounds sterling and euros in addition to U.S. dollars; however, we are limited to borrowings of \$75 million in these alternate currencies. The option to borrow in other foreign currencies provides some protection against fluctuations in currencies in the countries in which we do business. The credit facility also has financial covenants that include a minimum fixed charge coverage ratio of at least 1.50 to 1.00 each quarter and a maximum funded debt to EBITDA of not greater than 3.00 to 1.00. Also, our foreign cash balance is limited to a balance of \$25 million. As of September 30, 2010, we were in compliance with all of the covenants under our facility.

We maintain debt levels that we establish through consideration of a number of factors, including cash flow expectations, cash requirements for operations, investment plans (including acquisitions), and our overall cost of capital. Outstanding debt under our line of credit remained at \$50.0 million as of September 30, 2010, with an outstanding letter of credit of \$0.6 million. As of September 30, 2010, we had an additional \$194.4 million available for future borrowings. Our credit facility expires in August 2012.

We have vendor finance arrangements in the form of leases and notes payable with our major vendors that permit us to finance our purchases of data center equipment. As of December 31, 2009 and September 30, 2010, we had \$117.4 million and \$130.2 million outstanding with respect to these arrangements. We believe our borrowings from these arrangements will continue to be available, and as long as they are competitive, we expect to continue to finance at least some of our equipment purchases through these arrangements.

Capital Expenditure Requirements

For the full year 2010, we expect to have total capital expenditures between \$185 million and \$235 million.

Our available cash and cash equivalents are held in bank deposits, overnight sweep accounts, and money market funds. Our money market mutual funds invest exclusively in high-quality, short-term securities that are issued or guaranteed by the U.S. government or by U.S. government agencies. We actively monitor the third-party depository institutions that hold our cash and cash equivalents. Our emphasis is primarily on safety of principal while secondarily maximizing yield on those funds. The balances may exceed the Federal Deposit Insurance Corporation or "FDIC" insurance limits or are not insured by the FDIC. While we monitor the balances in our accounts and adjust the balances as appropriate, these balances could be impacted if the underlying depository institutions fail or could be subject to other adverse conditions in the financial markets. To date, we have experienced no loss or lack of access to our invested cash and cash equivalents; however, we can provide no assurances that access to our funds will not be impacted by adverse conditions in the financial markets.

We currently believe that current cash and cash equivalents, cash generated by operations and available borrowings through vendor financing arrangements, data center lease arrangements, and our credit facility will be sufficient to meet our operating and capital needs in the foreseeable future. Our long-term future capital requirements will depend on many factors, most importantly our growth of revenue, and our investments in new technologies and services. Our ability to generate cash depends on our financial performance, general economic conditions, technology trends and developments, and other factors. As our business continues to grow, our need for data center capacity will also grow. Most recently we have financed data center growth through leasing activities and we will continue to evaluate all opportunities to secure further data center capacity in the future. We could be required, or could elect, to seek additional funding in the form of debt or equity.

The following table sets forth a summary of our cash flows for the periods indicated:

(In thousands)	Nine Months Ended	
	September 30,	
	(Unaudited)	
	2009	2010
Cash provided by operating activities	\$ 131,204	\$ 169,965
Cash used in investing activities	\$ (89,462)	\$ (98,459)
Cash provided by (used in) financing activities	\$ (179,045)	\$ (30,603)
Acquisition of property and equipment by capital leases and equipment notes payable	\$ 55,984	\$ 54,767

Operating Activities

Net cash provided by operating activities is primarily a function of our profitability, the amount of non-cash charges included in our profitability, and our working capital management. Net cash provided by operating activities was \$131.2 million in the first nine months of 2009 compared to \$170.0 million in the first nine months of 2010, an increase of \$38.8 million, or 29.6%. Net income increased from \$21.2 million in the first nine months of 2009 to \$32.8 million in the first nine months of 2010. A summary of the significant changes in non-cash adjustments affecting net income and changes in assets and liabilities impacting operating cash flows is as follows:

- Depreciation and amortization expense was \$90.2 million in the first nine months of 2009 compared to \$114.4 million in the first nine months of 2010. The increase in depreciation and amortization was due to the purchases of servers, networking gear and computer software (internally developed technology), and leasehold improvements, as well as the amortization of intangibles.
- Our provision for bad debts and customer credits decreased from \$8.8 million in the first nine months of 2009 to \$3.0 million in the first nine months of 2010 due to positive changes in customer payment patterns and increased cash collections, as well as lower service level agreement credits.
- Deferred income taxes changed from a cash inflow of \$5.1 million in the first nine months of 2009 to a cash outflow of \$3.0 million in the first nine months of 2010.
- The change in deferred rent created a \$2.0 million non-cash increase to cash flow from operating activities in the first nine months of 2009 compared to \$4.2 million in the first nine months of 2010. The change resulted from data center lease arrangements that were entered into in 2009 with terms that included escalating rental payments. As total rent expense for each of these lease arrangements is recorded on a straight-line basis for the term of the lease, there is a difference between rent expense and cash paid for rent during the period.
- Share-based compensation expense was \$14.9 million in the first nine months of 2009 compared to \$19.5 million in the first nine months of 2010. The increase in expense was due to stock options and restricted stock units granted in 2009 and the first nine months of 2010.
- The change in accounts receivable was a cash outflow of \$17.0 million in the first nine months of 2009 compared to a cash outflow of \$9.1 million in the first nine months of 2010.
- The change in income taxes receivable was a cash inflow of \$8.2 million in the first nine months of 2009 compared to a cash inflow of \$4.4 million in the first nine months of 2010. We received federal income tax refunds totaling \$8.4 million in the nine months ended September 30, 2010, related to the 2008 and 2009 tax periods. The remainder of the change in income taxes receivable is due to stock option exercises and other income tax activity.
- The change in accounts payable and accrued expenses created a \$2.6 million cash inflow in the first nine months of 2009 compared to a \$12.6 million cash inflow in the first nine months of 2010. The changes resulted from the timing of payments for trade payables.
- The cash outflow from other all other operating activities increased from \$4.1 million in the first nine months of 2009 to \$13.0 million in the first nine months of 2010 primarily due to an \$18.0 million prepayment for a specified quantity of software licenses.

Investing Activities

Net cash used in investing activities was primarily capital expenditures to meet the demands of our growing customer base. Historically our main investing activities have consisted of purchases of IT equipment for our data center infrastructure, furniture, equipment and leasehold improvements to support our operations.

Our net cash used in investing activities was \$89.5 million in the first nine months of 2009 compared to \$98.5 million in the first nine months of 2010, an increase of \$9.0 million, or 10.1%. The increase was primarily due to an increase in purchases of customer gear.

We purchase equipment through capital lease arrangements and other types of vendor financing that do not require an initial outlay of cash. Purchases through these arrangements decreased from \$56.0 million for the first nine months of 2009 to \$54.8 million for the first nine months of 2010.

Financing Activities

Net cash used in financing activities was \$179.0 million in the first nine months of 2009 compared to \$30.6 million in the first nine months of 2010, a change of \$148.4 million. This was due primarily to \$150.0 million in net payments to our revolving credit facility during the first nine months of 2009 compared to no repayments or advances in the first nine months of 2010. Principal payments on capital leases and notes payable were \$38.4 million in the first nine months of 2009 compared to \$42.0 million during the first nine months of 2010. Our net leverage as of September 30, 2010 was 0.06 times. See above for our discussion of Non-GAAP Financial Measures.

Contractual Obligations, Commitments and Contingencies

The following table summarizes our contractual obligations as of September 30, 2010:

(In thousands)	Total	2010	2011–2012 (Unaudited)	2013–2014	2015 and Beyond
Capital leases (1)	\$ 133,807	\$ 20,011	\$ 97,604	\$ 16,192	\$ –
Operating leases	348,938	4,745	50,978	52,029	241,186
Purchase commitments	38,465	928	37,537	–	–
Revolving credit facility (2)	50,000	–	50,000	–	–
Software and equipment notes (2)	3,656	864	2,792	–	–
Total contractual obligations	<u>\$ 574,866</u>	<u>\$ 26,548</u>	<u>\$ 238,911</u>	<u>\$ 68,221</u>	<u>\$ 241,186</u>

- (1) Represents principal and interest.
(2) Represents principal only.

Leases

Capital leases are primarily related to expenditures for IT equipment. Our operating leases are primarily for data center facilities and office space.

In May 2010, Rackspace entered into an agreement to lease additional space at our Chicago area data center. The operating lease has a term of 15 years from the commencement date with total estimated financial obligation of approximately \$100 million to \$110 million over the 15 year term, inclusive of base lease payments and Rackspace's pro-rata share of operating expenses. Rackspace has a one-time option to terminate the lease after ten years subject to a penalty, as well as upon expiration of the lease, to renew the lease for two successive five year periods.

In August 2010, Rackspace entered into a lease agreement for office space located in the U.K. that will serve as the Company's new international headquarters. The operating lease has a term of seven years with a total estimated financial obligation of approximately \$15 million.

Purchase commitments

Our purchase commitments are primarily related to costs associated with our data centers including bandwidth and consulting services as well as commitments to prepay for certain software licenses. In June 2010, we entered into a 3-year software license agreement with a reseller of licenses under which we will make a prepayment of \$18.0 million at the beginning of each year of the agreement for a specified quantity of software licenses. We expect to realize a cost savings as a result of entering into the agreement.

Revolving Credit Facility

We have a credit facility with a committed amount of \$245.0 million. As of September 30, 2010, we had \$50.0 million of revolving loans outstanding and a \$0.6 million letter of credit outstanding under the credit facility, resulting in \$194.4 million available for future borrowings. The credit facility has a variable interest rate, which is generally the London Interbank Offered Rate (LIBOR) margin plus a margin spread. The rate was equal to 1.31% at September 30, 2010.

In December 2007, we entered into an interest rate swap agreement converting a portion of our interest rate exposure from a floating rate basis to a fixed rate of 4.135% per annum. The interest rate swap agreement has a notional amount of \$50.0 million and matures in December 2010.

Software and Equipment Notes

We finance certain software and equipment from third-party vendors. The terms of these arrangements are generally one to five years. The interest rates on the arrangements range from 0.0% to 6.0%.

Uncertain Tax Positions

We have excluded \$0.4 million of uncertain tax positions from the table above as we are uncertain as to if or when such amounts will be recognized.

Off-Balance Sheet Arrangements

During the periods presented, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities.

We have entered into various indemnification arrangements with third parties, including vendors, customers, landlords, our officers and directors, stockholders of acquired companies, and third parties to whom and from whom we license technology. Generally, these indemnification agreements require us to reimburse losses suffered by third parties due to various events, such as lawsuits arising from patent or copyright infringement or our negligence. Certain of these agreements require us to indemnify the other party against certain claims relating to property damage, personal injury or the acts or omissions by us, our employees, agents or representatives. To date, there have been no claims against us or our customers pertaining to such indemnification provisions and no amounts have been recorded.

These indemnification obligations are considered off-balance sheet arrangements. To date, we have not encountered material costs as a result of such obligations and have not accrued any liabilities related to such indemnification obligations in our financial statements.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with GAAP. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application, while in other cases, significant judgment is required in making estimates, and selecting among available alternative accounting standards that allow different accounting treatment for similar transactions. These judgments and estimates affect the reported amounts of assets, liabilities, revenue, costs and expenses and related disclosures. We consider these policies requiring significant management judgment and estimates used in the preparation of our financial statements to be critical accounting policies.

We review our estimates and judgments on an ongoing basis, including those related to revenue recognition, service credits, allowance for doubtful accounts, property and equipment, goodwill and intangibles, contingencies, the fair valuation of stock related to share-based compensation, software development, and income taxes.

We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances to determine the carrying values of assets and liabilities. In many instances, we could have reasonably used different accounting estimates, and in other instances changes in the accounting estimates are reasonably likely to occur from period-to-period. Accordingly, actual results could differ significantly from the estimates made by our management. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

A description of our critical accounting policies that involve significant management judgment appears in our Annual Report filed on Form 10-K filed with the SEC on February 26, 2010, as amended, under "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies."

Recent Accounting Pronouncements

For a full description of new accounting pronouncements, including the respective dates of adoption and impact on results of operation and financial condition, see "Notes to the Unaudited Consolidated Financial Statements – Note 2. Summary of Significant Accounting Policies."

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Power Prices. We are a large consumer of power. During the first nine months of 2010, we expensed approximately \$13.0 million that was incurred to power our data centers, representing 2.3% of our net revenue. Because we anticipate further revenue growth for the foreseeable future, we expect to consume more power in the future. Power costs vary by geography, the source of power generation, seasonal fluctuations, and are subject to certain proposed legislation that may increase our exposure to increased power costs. Our largest exposure to energy prices based on consumption currently exists at our Grapevine, Texas data center in the Dallas–Fort Worth area, a deregulated energy market. We currently have a fixed price contract with a provider of electricity for power for our Grapevine data center that expires in September 2011. The contract allows the company to periodically convert the price to a floating market price during the arrangement. In September 2010, we entered into another fixed price contract for our Grapevine data center that begins when the previous arrangement expires in October 2011 and runs through September 2013. Also, in June 2009, we entered into a similar fixed price contract for 12 months for our Slough U.K. data center that has since been extended for an additional 12 months to expire in May 2011. These contracts have been designated as meeting the normal purchases and normal sales exception and thus are not accounted for as derivatives.

During April 2010, the U.K.'s carbon emission trading scheme (CRC Carbon Efficiency Trading Scheme) came into operation and based on our data center energy consumption in the U.K., registration would have been mandatory. However, because we did not meet all of the criteria, we are not required to register under the CRC's first phase. Under the scheme's first phase, the period commencing April 2010 to March 2011 is considered a footprint year under which participant companies are required to track and report their carbon dioxide emissions to the regulatory body. Beginning April 2011, participants will be required to purchase allowances to offset their carbon dioxide emissions. The purchase of these allowances will increase the cost of power. If the government decides to keep the scheme under a second phase, it is likely Rackspace UK will need to register and participate in it. The purchase of carbon allowances under a second phase is not expected until 2012; however, the full financial impact of this scheme will be determined as we enter the second phase, which the company is preparing for in 2011. No legislation has been enacted to date that would impact our U.S. or Hong Kong data centers.

Interest Rates. Our main credit facility is a revolving line of credit with a base rate determined by the London Interbank Offered Rate, or LIBOR. This market rate of interest is fluctuating and exposes our interest expense to risk. Our credit agreement obligates us to hedge part of that interest rate risk with appropriate instruments, such as interest rate swaps or interest rate options. On December 10, 2007, we entered into an at–the–market fixed–payer interest rate swap with a notional amount of \$50.0 million at an annual rate of 4.135%. This swap essentially fixes the rate we pay on the first \$50.0 million outstanding on our revolving credit facility until it expires in December 2010. As we borrow more, we may enter into additional swaps to continuously control our interest rate risk. Generally, we do not hedge our complete exposure. As a result, we may be exposed to interest rate risk on the un–hedged portion of our borrowings. For example, a 100 basis point increase in LIBOR would increase the interest expense on \$10 million of borrowings that are not hedged by \$0.1 million annually. As of September 30, 2010 we did not have exposure to interest rate risk as we only had \$50.0 million outstanding on our revolving credit facility.

Leases. The majority of our purchases of customer gear are vendor financed through capital leases with fixed payment terms generally over three to five years, coinciding with the depreciation period of the equipment. As of September 30, 2010, we have a principal liability for these leases of \$126.5 million on our consolidated balance sheet, of which \$57.3 million is classified as current. Although we believe our borrowings from these arrangements will continue to be available, we have exposure that vendor financing may no longer be available or the borrowing rates, which are fixed rates, may increase.

Foreign Currencies. The majority of our customers are invoiced, and substantially all of our expenses are paid, in the functional currency of our associated operating entity. As such, there is a minimal impact to our margins. A relatively insignificant amount of customers are invoiced in currencies other than the applicable functional currency, such as the euro. Therefore, our results of operations and cash flows are subject to fluctuations in foreign currency exchange rates. We also have exposure to foreign currency transaction gains and losses as the result of certain receivables due from our foreign subsidiaries, which are denominated in both the U.S. dollar and the pound sterling. During the first nine months of 2010, we recognized foreign currency gains of \$0.5 million within other income (expense). We have not entered into any currency hedging contracts, although we may do so in the future. Our revolving credit facility agreement provides us with the ability to borrow from our credit facility in pounds sterling and euros, rather than restricting borrowings to U.S. dollars. We currently do not have borrowings in any alternative currencies from our credit facility. As we grow our international operations, our exposure to foreign currency risk could become more significant.

ITEM 4. – CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures

Under the supervision and with the participation of our senior management, including our chief executive officer and chief financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a–15(e) and 15d–15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”), as amended, as of the end of the period covered by this quarterly report (the “Evaluation Date”). Based on this evaluation, our chief executive officer and chief financial officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective such that the information relating to the Company, including our consolidated subsidiaries, required to be disclosed in our SEC reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in internal control over financial reporting

There were no changes in our internal controls over financial reporting during our most recent fiscal quarter reporting period identified in connection with management’s evaluation that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations of Internal Controls

Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II – OTHER INFORMATION

ITEM 1 – LEGAL PROCEEDINGS

We are party to various legal and administrative proceedings, which we consider routine and incidental to our business. In addition, on October 22, 2008, Benjamin E. Rodriguez D/B/A Management and Business Advisors vs. Rackspace Hosting, Inc. and Graham Weston, was filed in the 37th District Court in Bexar County Texas by a former consultant to the company, Benjamin E. Rodriguez. The suit alleges breach of an oral agreement to issue Mr. Rodriguez a 1% interest in our stock in the form of options or warrants for compensation for services he was engaged to perform for us. We believe that the plaintiff's position is without merit and intend to vigorously defend this lawsuit. We do not expect the results of this claim or any other current proceeding to have a material adverse effect on our business, results of operations or financial condition.

On March 26, 2010 Bedrock Computer Technologies LLC's filed its First Amended Answer and Counterclaim to Red Hat, Inc.'s Complaint for Declaratory Judgment (Red Hat, Inc., v Bedrock Computer Technologies, LLC Cause No. 6:09-CV-00549 -LED, United States District Court for the Eastern District of Texas). In its answer and counterclaim, Bedrock has named Rackspace as a third party defendant in a civil action by asserting cross claims against Rackspace and several other companies alleging direct and indirect infringement of United States Patent No. 5,893,120 based on the use of computer equipment configured with or utilizing software based on various versions of the Linux operating system. Bedrock is seeking a finding that the third party defendants, including Rackspace, be enjoined from selling any infringing product, and that Bedrock be awarded actual damages, pre and post judgment interest and attorney's fees. We believe that we have meritorious defenses to the claims and intend to defend ourselves vigorously against these infringement claims. At this time, we do not anticipate that the claims will have a material adverse effect on our business, financial position or results of operations. There can be no assurance, however, that we will be successful in our defense.

On August 31, 2010, Oasis Research, LLC ("Oasis") filed a complaint (Cause No. 4:10-CV-435, United States District Court for the Eastern District of Texas) alleging that Rackspace's products infringe certain United States patents allegedly owned by Oasis. This lawsuit alleges that Rackspace is infringing four patents, including United States Patent Nos. 5,771,354, 5,901,228, 6,411,943 and 7,080,051 by designing and selling products and services related to online backup and storage services. Oasis is seeking unspecified damages for past and continuing or future infringement. We believe that we have meritorious defenses to the claims and intend to defend ourselves vigorously against these infringement claims. At this time, we do not anticipate that the claims will have a material adverse effect on our business, financial position or results of operations. There can be no assurance, however, that we will be successful in our defense.

ITEM IA – RISK FACTORS

Risks Related to Our Business and Industry

Our physical infrastructure is concentrated in a few facilities and any failure in our physical infrastructure or services could lead to significant costs and disruptions and could reduce our revenue, harm our business reputation and have a material adverse effect on our financial results.

Our network, power supplies and data centers are subject to various points of failure. Problems with our cooling equipment, generators, uninterruptible power supply, or UPS, routers, switches, or other equipment, whether or not within our control, could result in service interruptions for our customers as well as equipment damage. Because our hosting services do not require geographic proximity of our data centers to our customers, our hosting infrastructure is consolidated into a few large facilities. While data backup services and disaster recovery services are available as a part of our hosting services offerings, the majority of our customers do not elect to pay the additional fees required to have disaster recovery services store their backup data offsite in a separate facility, which could substantially mitigate the adverse effect to a customer from a single data center failure. Accordingly, any failure or downtime in one of our data center facilities could affect a significant percentage of our customers. The total destruction or severe impairment of any of our data center facilities could result in significant downtime of our services and the loss of customer data. Since our ability to attract and retain customers depends on our ability to provide customers with highly reliable service, even minor interruptions in our service could harm our reputation. The services we provide are subject to failure resulting from numerous factors, including:

- Power loss;
- Equipment failure;
- Human error or accidents;
- Sabotage and vandalism;
- Failure by us or our vendors to provide adequate service or maintenance to our equipment;
- Network connectivity downtime;
- Improper building maintenance by the landlords of the buildings in which our facilities are located;
- Physical or electronic security breaches;
- Fire, earthquake, hurricane, tornado, flood, and other natural disasters;
- Water damage; and
- Terrorism.

Additionally, in connection with the expansion or consolidation of our existing data center facilities from time to time, there is an increased risk that service interruptions may occur as a result of server relocation or other unforeseen construction-related issues.

We have experienced interruptions in service in the past, due to such things as power outages, power equipment failures, cooling equipment failures, routing problems, hard drive failures, database corruption, system failures, software failures, and other computer failures. While we have not experienced a material increase in customer attrition following these events, the extent to which our reputation suffers is difficult to assess. We have taken and continue to take steps to improve our infrastructure to prevent service interruptions, including upgrading our electrical and mechanical infrastructure. However, service interruptions continue to be a significant risk for us and could materially impact our business.

Any future service interruptions could:

- Cause our customers to seek damages for losses incurred;
- Require us to replace existing equipment or add redundant facilities;
- Affect our reputation as a reliable provider of hosting services;
- Cause existing customers to cancel or elect to not renew their contracts; or
- Make it more difficult for us to attract new customers.

Any of these events could materially increase our expenses or reduce our revenue, which would have a material adverse effect on our operating results.

If we are unable to adapt to evolving technologies and customer demands in a timely and cost-effective manner, our ability to sustain and grow our business may suffer.

Our market is characterized by rapidly changing technology, evolving industry standards, and frequent new product announcements, all of which impact the way hosting services are marketed and delivered. The adoption of new technologies, a change in industry standards or introduction of more attractive products or services could make some or all of our offerings less desirable or even obsolete. These potential changes are magnified by the continued rapid growth of the Internet and the intense competition in our industry. To be successful, we must adapt to our rapidly changing market by continually improving the performance, features, and reliability of our services and modifying our business strategies accordingly. We cannot guarantee that we will be able to identify the emergence of all of these new service alternatives successfully, modify our services accordingly, or develop and bring new products and services to market in a timely and cost-effective manner to address these changes. Our failure to provide products and services to compete with new technologies or the obsolescence of our services would likely lead us to lose current and potential customers or cause us to incur substantial costs by attempting to catch our offerings up to the changed environment.

We could also incur substantial costs if we need to modify our services or infrastructure in order to adapt to these changes. For example, our data center infrastructure could require improvements due to (i) the development of new systems to deliver power to or eliminate heat from the servers we house, (ii) the development of new server technologies that require levels of critical load and heat removal that our facilities are not designed to provide, or (iii) a fundamental change in the way in which we deliver services. We may not be able to timely adapt to changing technologies, if at all. Our ability to sustain and grow our business would suffer if we fail to respond to these changes in a timely and cost-effective manner.

The acceptance and growth of cloud computing is an example of a rapidly changing technology that has impacted our business and our market. Because of the technological advances and the market adoption and utilization of cloud computing, we have adapted to the changing market and implemented the new technology in our hosting service delivery. This change has already required us to make a substantial financial investment to develop and implement cloud computing into our hosting solution model and has required significant attention from management to refine our business strategies to include the delivery of cloud computing and hybrid solutions. As the market continues to adopt this new technology, we expect to continue to make substantial investments in our service solutions and system integrations.

Even if we have developed an attractive solution to the changing technology or standards, our introduction of the new solution could have lower price points than other offerings and may result in our existing customers switching to the lower cost products and services, which could reduce our revenue and have a material, adverse effect of our operating results. For example, the introduction of our cloud computing solutions provides a reasonable alternative to some of our dedicated hosting solutions at a lower price point and some of our dedicated hosting customers have switched to cloud computing solutions. We expect that other customers in this situation will switch to cloud computing in the future.

Finally, even if we succeed in adapting to a new technology or the changing industry standard by developing attractive products and services and successfully bringing them to market, there is no assurance that the new product or service would have a positive impact on our financial performance and could even result in lower revenue, lower margins and/or higher costs and therefore could negatively impact our financial performance.

We may not be able to compete successfully against current and future competitors.

The market for hosting and cloud computing services is highly competitive. We expect to face additional competition from our existing competitors as well as new market entrants in the future.

Our current and potential competitors vary by size, service offerings and geographic region. These competitors may elect to partner with each other or with focused companies like us to grow their businesses. They include:

- Do-it-yourself solutions with a colocation partner such as AT&T, Equinix, SAVVIS, and other telecommunications companies;
- IT outsourcing providers such as CSC, HP, and IBM;
- Hosting providers such as AT&T, British Telecom, SAVVIS, Terremark, The Planet, and Verio; and
- Large technology companies such as Amazon, Microsoft, Google, IBM and Salesforce.com, who are making investments in cloud computing.

The primary competitive factors in our market are: customer service and technical expertise; security reliability and functionality; reputation and brand recognition; financial strength; breadth of services offered; and price.

Many of our current and potential competitors have substantially greater financial, technical and marketing resources, larger customer bases, longer operating histories, greater brand recognition, and more established relationships in the industry than we do. As a result, some of these competitors may be able to:

- Develop superior products or services, gain greater market acceptance, and expand their service offerings more efficiently or more rapidly;
- Adapt to new or emerging technologies and changes in customer requirements more quickly;
- Bundle hosting services with other services they provide at reduced prices;
- Take advantage of acquisition and other opportunities more readily;
- Adopt more aggressive pricing policies and devote greater resources to the promotion, marketing, and sales of their services; and
- Devote greater resources to the research and development of their products and services.

If we do not prevent security breaches, we may be exposed to lawsuits, lose customers, suffer harm to our reputation, and incur additional costs.

The services we offer involve the transmission of large amounts of sensitive and proprietary information over public communications networks, as well as the processing and storage of confidential customer information. Unauthorized access, computer viruses, accidents, employee error or malfeasance, fraudulent service plan orders, intentional misconduct by computer “hackers”, and other disruptions can occur that could compromise the security of our infrastructure, thereby exposing such information to unauthorized access by third parties and leading to interruptions, delays or cessation of service to our customers. Techniques used to obtain unauthorized access to, or to sabotage systems, change frequently and generally are not recognized until launched against a target. We may be unable to implement security measures in a timely manner or, if and when implemented, these measures could be circumvented as a result of accidental or intentional actions by parties within or outside of our organization. Any breaches that occur could expose us to increased risk of lawsuits, loss of existing or potential customers, harm to our reputation and increases in our security costs. Although we typically require our customers to sign agreements that contain provisions attempting to limit our liability for security breaches, we cannot assure you that a court would enforce any contractual limitations on our liability in the event that one of our customers brings a lawsuit against us as the result of a security breach that they may ascribe to us. The outcome of any such lawsuit would depend on the specific facts of the case and legal and policy considerations that we may not be able to mitigate. In such cases, we could be liable for substantial damage awards that may significantly exceed our liability insurance coverage by unknown but significant amounts, which could seriously impair our financial condition.

We provide service level commitments to our customers, which could require us to issue credits for future services if the stated service levels are not met for a given period and could significantly decrease our revenue and harm our reputation.

Our customer agreements provide that we maintain certain service level commitments to our customers relating primarily to network uptime, critical infrastructure availability, and hardware replacement. If we are unable to meet the stated service level commitments, we may be contractually obligated to provide these customers with credits for future services. As a result, a failure to deliver services for a relatively short duration could cause us to issue these credits to a large number of affected customers. In addition, we cannot be assured that our customers will accept these credits in lieu of other legal remedies that may be available to them. Our failure to meet our commitments could also result in substantial customer dissatisfaction or loss. Because of the loss of future revenue through these credits, potential customer loss and other potential liabilities, our revenue could be significantly impacted if we cannot meet our service level commitments to our customers.

If we are unable to maintain a high level of customer service, customer satisfaction and demand for our services could suffer.

We believe that our success depends on our ability to provide customers with quality service that not only meets our stated commitments, but meets and then exceeds customer service expectations. If we are unable to provide customers with quality customer support in a variety of areas, we could face customer dissatisfaction, decreased overall demand for our services, and loss of revenue. In addition, our inability to meet customer service expectations may damage our reputation and could consequently limit our ability to retain existing customers and attract new customers, which would adversely affect our ability to generate revenue and negatively impact our operating results.

Our existing customers could elect to reduce or terminate the services they purchase from us because we do not have long-term contracts with our customers, which could adversely affect our operating results.

Customer contracts for our managed hosting services typically have initial terms of one to two years which, unless terminated, may be renewed or automatically extended on a month-to-month basis. Our customers have no obligation to renew their services after their initial contract periods expire. Moreover, our customers could cancel their managed hosting service agreements before they expire. In addition, most of our other services, such as our cloud computing services, are generally provided on a month-to-month basis and do not have an extended initial term at all. Our costs associated with maintaining revenue from existing customers are generally much lower than costs associated with generating revenue from new customers. Therefore, a reduction in revenue from our existing customers, even if offset by an increase in revenue from new customers, could reduce our operating margins. Any failure by us to continue to retain our existing customers could have a material adverse effect on our operating results.

Customers with mission-critical applications could potentially expose us to lawsuits for their lost profits or damages, which could impair our financial condition.

Because our hosting services are critical to many of our customers' businesses, any significant disruption in our services could result in lost profits or other indirect or consequential damages to our customers. Although we require our customers to sign agreements that contain provisions attempting to limit our liability for service outages, we cannot assure you that a court would enforce any contractual limitations on our liability in the event that one of our customers brings a lawsuit against us as the result of a service interruption or other Internet site or application problems that they may ascribe to us. The outcome of any such lawsuit would depend on the specific facts of the case and any legal and policy considerations that we may not be able to mitigate. In such cases, we could be liable for substantial damage awards that may exceed our liability insurance coverage by unknown but significant amounts, which could materially impair our financial condition.

We may be accused of infringing the proprietary rights of others, which could subject us to costly and time-consuming litigation and require us to discontinue services that infringe the rights of others.

There may be intellectual property rights held by others, including issued or pending patents, trademarks, and service marks that cover significant aspects of our technologies, branding or business methods, including technologies and intellectual property we have licensed from third parties. Companies in the technology industry, and other patent and trademark holders seeking to profit from royalties in connection with grants of licenses, own large numbers of patents, copyrights, trademarks, service marks, and trade secrets and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. These or other parties could claim that we have misappropriated or misused intellectual property rights and any such intellectual property claim against us, regardless of merit, could be time consuming and expensive to settle or litigate and could divert the attention of our technical and management personnel. An adverse determination also could prevent us from offering our services to our customers and may require that we procure or develop substitute services that do not infringe. For any intellectual property rights claim against us or our customers, we may have to pay damages, indemnify our customers against damages or stop using technology or intellectual property found to be in violation of a third party's rights. We may be unable to replace those technologies with technologies that have the same features or functionality and that are of equal quality and performance standards on commercially reasonable terms or at all. Licensing replacement technologies and intellectual property may significantly increase our operating expenses or may require us to restrict our business activities in one or more respects. We may also be required to develop alternative non-infringing technology and intellectual property, which could require significant effort, time, and expense.

Our use of open source software could impose limitations on our ability to provide our services and expose us to litigation, which could adversely affect our financial condition and operating results.

We utilize open source software, including Linux-based software, in providing a substantial portion of our services. The terms of many open source licenses have not been interpreted by U.S. courts, and there is a risk that such licenses could be construed in a manner that could impose unanticipated conditions or restrictions on our ability to offer our services. Additionally, the use and distribution of open source software can lead to greater risks than the use of third-party commercial software, as open source software does not come with warranties or other contractual protections regarding infringement claims or the quality of the code. From time to time parties have asserted claims against companies that distribute or use open source software in their products and services, asserting that open source software infringes their intellectual property rights. We could be subject to suits by parties claiming infringement of intellectual property rights with respect to what we believe to be open source software. In such event, we could be required to seek licenses from third parties in order to continue using such software or offering certain of our services or to discontinue the use of such software or the sale of our affected services in the event we could not obtain such licenses, any of which could adversely affect our business, operating results and financial condition. In addition, if we combine our proprietary software with open source software in a certain manner, we could, under some of the open source licenses, be required to release the source code of our proprietary software.

We have also sponsored an open source project designed to foster the emergence of cloud computing technology standards and cloud interoperability. Our participation in the project includes the release of our previously proprietary core cloud storage code and we expect to release additional core cloud code in the future. Our sponsorship activities could subject us to additional risks of litigation including indirect infringement claims based on third party contributors because of our sponsorship of this project.

We may not be successful in protecting and enforcing our intellectual property rights, which could adversely affect our financial condition and operating results.

We rely primarily on copyright, trademark, service mark, and trade secret laws, as well as confidentiality procedures and contractual restrictions, to establish and protect our proprietary rights, all of which provide only limited protection. We rely on copyright laws to protect software and certain other elements of our proprietary technologies, although to date we have not registered for copyright protection. We cannot assure you that any future copyright, trademark or service mark registrations will be issued for pending or future applications or that any registered or unregistered copyrights, trademarks or service marks will be enforceable or provide adequate protection of our proprietary rights. We currently have one patent in the U.S. Our patent may be contested, circumvented, found unenforceable or invalidated.

We endeavor to enter into agreements with our employees and contractors and agreements with parties with whom we do business to limit access to and disclosure of our proprietary information. The steps we have taken, however, may not prevent unauthorized use or the reverse engineering of our technology. Moreover, others may independently develop technologies that are substantially equivalent, superior to, or otherwise competitive to the technologies we employ in our services or that infringe our intellectual property. We may be unable to prevent competitors from acquiring trademarks or service marks and other proprietary rights that are similar to, infringe upon, or diminish the value of our trademarks and service marks and our other proprietary rights. Enforcement of our intellectual property rights also depends on successful legal actions against infringers and parties who misappropriate our proprietary information and trade secrets, but these actions may not be successful, even when our rights have been infringed.

In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the U.S. Despite the measures taken by us, it may be possible for a third party to copy or otherwise obtain and use our technology and information without authorization. Policing unauthorized use of our proprietary technologies and other intellectual property and our services is difficult, and litigation could become necessary in the future to enforce our intellectual property rights. Any litigation could be time consuming and expensive to prosecute or resolve, result in substantial diversion of management attention and resources, and harm our business, financial condition, and results of operations.

If we fail to hire and retain qualified employees and management personnel, our growth strategy and our operating results could be harmed.

Our growth strategy depends on our ability to identify, hire, train, and retain executives, IT professionals, technical engineers, operations employees, and sales and senior management personnel who maintain relationships with our customers and who can provide the technical, strategic, and marketing skills required for our company to grow. There is a shortage of qualified personnel in these fields, specifically in the San Antonio, Texas area, where we are headquartered and a majority of our employees are located. We compete with other companies for this limited pool of potential employees. There is no assurance that we will be able to recruit or retain qualified personnel, and this failure could cause our operations and financial results to be negatively impacted.

Our success and future growth also depends to a significant degree on the skills and continued services of our management team, especially Graham Weston, our Chairman, and A. Lanham Napier, our Chief Executive Officer and President. We do not have long-term employment agreements with any members of our management team, including Messrs. Weston and Napier. Mr. Napier is the only member of our management team on whom we maintain key man insurance.

Our corporate culture has contributed to our success, and if we cannot maintain this culture, we could lose the innovation, creativity, and teamwork fostered by our culture, and our operating results may be harmed.

We believe that a critical contributor to our success has been our corporate culture, which we believe fosters innovation, creativity, and teamwork. If we implement more complex organizational management structures because of growth or other structural changes, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively impact our future operating results. In addition, being a publicly traded company may create disparities in personal wealth among our employees, which may adversely impact our corporate culture and employee relations.

If we are unable to manage our growth effectively, our financial results could suffer.

The growth of our business and our service offerings has strained our operating and financial resources. Further, we intend to continue expanding our overall business, customer base, headcount, and operations. Creating a global organization and managing a geographically dispersed workforce requires substantial management effort and significant additional investment in our operating and financial system capabilities and controls. If our information systems are unable to support the demands placed on them by our growth, we may be forced to implement new systems which would be disruptive to our business. We may be unable to manage our expenses effectively in the future due to the expenses associated with these expansions, which may negatively impact our gross margins or operating expenses. If we fail to improve our operational systems or to expand our customer service capabilities to keep pace with the growth of our business, we could experience customer dissatisfaction, cost inefficiencies, and lost revenue opportunities, which may materially and adversely affect our operating results.

We may not be able to continue to add new customers and increase sales to our existing customers, which could adversely affect our operating results.

Our growth is dependent on our ability to continue to attract new customers while retaining and expanding our service offerings to existing customers. Growth in the demand for our services may be inhibited and we may be unable to sustain growth in our customer base for a number of reasons, such as:

- A reduction in the demand for our services due to the economic recession;
- Our inability to market our services in a cost-effective manner to new customers;
- The inability of our customers to differentiate our services from those of our competitors or our inability to effectively communicate such distinctions;
- Our inability to successfully communicate the benefits of hosting to businesses;
- The decision of businesses to host their Internet sites and web infrastructure internally or in colocation facilities as an alternative to the use of our hosting services;
- Our inability to penetrate international markets;
- Our inability to expand our sales to existing customers;
- Our inability to strengthen awareness of our brand; and
- Reliability, quality or compatibility problems with our services.

A substantial amount of our past revenue growth was derived from purchases of service upgrades by existing customers. Our costs associated with increasing revenue from existing customers are generally lower than costs associated with generating revenue from new customers. Therefore, a reduction in the rate of revenue increase or a rate of revenue decrease from our existing customers, even if offset by an increase in revenue from new customers, could reduce our operating margins. Any failure by us to continue attracting new customers or grow our revenue from existing customers for a prolonged period of time could have a material adverse effect on our operating results.

Our operating results may be further adversely impacted by unfavorable economic conditions, worldwide political and economic uncertainties and specific conditions in the markets we address.

Recently, general worldwide economic conditions have experienced a deterioration due to among other things, credit conditions resulting from the financial crisis affecting the banking system and financial markets including: slower economic activity, concerns about inflation and deflation, volatility in energy costs, decreased consumer confidence, reduced corporate profits and capital spending, the ongoing effects of the war in Iraq and Afghanistan, recent international conflicts, terrorist and military activity, and the impact of natural disasters and public health emergencies. These conditions can make it extremely difficult for both us and our customers to accurately forecast and plan future business activities. Additionally, they could cause U.S. and foreign businesses to slow spending on our services, which could delay and lengthen our new customer sales cycle and cause existing customers to do one or more of the following:

- Cancel or reduce planned expenditures for our services;
- Seek to lower their costs by renegotiating their contracts with us;
- Move their hosting services in-house; or
- Switch to lower-priced solutions provided by us or our competitors.

Customer collections are our primary source of cash. We have historically grown through a combination of an increase in new customers and revenue growth from our existing customers. Over some recent quarters, we have experienced a decrease in our installed base growth. If the economic conditions were to deteriorate, we may experience additional reductions in our installed base growth, increases in churn and/or longer new customer sales cycles. We could also experience a decrease in revenue and a reduction in operating margins. Further, during challenging economic times, our customers may have difficulty gaining timely access to sufficient credit, which could result in an impairment of their ability to make timely payments to us. We cannot predict the timing, strength or duration of any economic slowdown or subsequent economic recovery. If the economy or markets in which we operate were to deteriorate, we may have to record additional charges related to the impairment of goodwill and other long-lived assets, and our business, financial condition and results of operations could be materially and adversely affected.

Finally, like many other companies, our stock price decreased during the onset of the recent economic downturn. Although our stock price has since recovered, if investors have concerns that our business, financial condition and results of operations will be negatively impacted by an economic downturn, our stock price could decrease again.

If we overestimate or underestimate our data center capacity requirements, our operating margins and profitability could be adversely affected.

The costs of construction, leasing, and maintenance of our data centers constitute a significant portion of our capital and operating expenses. In order to manage growth and ensure adequate capacity for new and existing customers while minimizing unnecessary excess capacity costs, we continuously evaluate our short and long-term data center capacity requirements. Due to the lead time in expanding existing data centers or building new data centers, we are required to estimate demand for our services as far as two years into the future. We currently plan to increase our infrastructure as required through the addition and expansion of data centers in the U.S. and internationally. In contrast to most of our data centers that we have established to date, several of which were acquired relatively inexpensively as distressed assets of third parties, our current expansion plans may require us to pay full market rates for new data center facilities. If we overestimate the demand for our services and therefore overbuild our data center capacity or commit to long term facility leases, our operating margins could be materially reduced, which would materially impair our profitability.

If we underestimate our data center capacity requirements, we may not be able to service the expanding needs of our existing customers. Additionally, we may be required to limit new customer acquisition while we work to increase data center capacity to satisfy demand, either of which may materially impair our revenue growth.

We rely on a number of third-party providers for data center space, equipment, maintenance and other services, and the loss of, or problems with, one or more of these providers may impede our growth or cause us to lose customers.

We rely on third-party providers to supply data center space, equipment and maintenance. For example, we lease data center space from third party landlords, lease or purchase equipment from equipment providers, and source equipment maintenance through third parties. While we have entered into various agreements for these products and services, any failure to obtain additional capacity or space, equipment, or maintenance, if required, would impede the growth of our business and cause our financial results to suffer. For example, if a data center landlord does not adequately maintain its facilities, or provide services for which it is responsible, we may not be able to deliver services to our customers according to our standards or at all. Further, the equipment that we purchase could be deficient in some way, thereby affecting our products and services. If, for any reason, these providers fail to provide the required services, fail to deliver their equipment, or suffer other failures, we may incur financial losses and our customers may lose confidence in our company, and we may not be able to retain these customers.

We may not be able to renew the leases on our existing facilities on terms acceptable to us, if at all, which could adversely affect our operating results.

We do not own the facilities occupied by our current data centers, but occupy them pursuant to commercial leasing arrangements. The initial terms of our main existing data center leases expire over a period ranging from 2012 to 2027, with each having at least one renewal period of no less than three years. Upon the expiration or termination of our data center facility leases, we may not be able to renew these leases on terms acceptable to us, if at all. If we fail to renew any data center lease and are required to move the data center to a new facility, we would face significant challenges due to the technical complexity, risk, and high costs of relocating the equipment. For example, if we are required to migrate customer servers to a new facility, such migration could result in significant downtime for our affected customers. This could damage our reputation and lead us to lose current and potential customers, which would harm our operating results and financial condition.

Even if we are able to renew the leases on our existing data centers, we expect that rental rates, which will be determined based on then-prevailing market rates with respect to the renewal option periods and which will be determined by negotiation with the landlord after the renewal option periods, will be higher than rates we currently pay under our existing lease agreements. If we fail to increase revenue in our existing data centers by amounts sufficient to offset any increases in rental rates for these facilities, our operating results may be materially and adversely affected.

We rely on third-party hardware that may be difficult to replace or could cause errors or failures of our service, which could adversely affect our operating results or harm our reputation.

We rely on hardware acquired from third parties in order to offer our services. This hardware may not continue to be available on commercially reasonable terms in quantities sufficient to meet our business needs, which could adversely affect our ability to generate revenue. Any errors or defects in third-party hardware could result in errors or a failure of our service, which could harm our reputation and operating results. Indemnification from hardware providers, if any, would likely be insufficient to cover any damage to our business or our customers resulting from such hardware failure.

We rely on third-party software that may be difficult to replace or which could cause errors or failures of our service that could lead to lost customers or harm to our reputation.

We rely on software licensed from third parties to offer our services. This software may not continue to be available to us on commercially reasonable terms, or at all. Any loss of the right to use any of this software could result in delays in the provisioning of our services until equivalent technology is either developed by us, or, if available, is identified, obtained, and integrated, which could harm our business. Any errors or defects in third-party software or inadequate or delayed support by the third party could result in errors or a failure of our service which could harm our operating results by adversely affecting our revenue or operating costs.

We engage and rely on third-party consultants who may fail to provide effective guidance or solutions which could result in increased costs and loss of business opportunity.

We engage third-party consultants who provide us with guidance and solutions relating to everything from overall corporate strategy to data center design to employee engagement. We engage these parties based on our perception of their expertise and ability to provide valuable insight or solutions in the areas that we believe need to be addressed in our business. However, these consultants may provide us with ineffective or even harmful guidance or solutions, which, if followed or implemented, could result in a loss of resources, operational failures or a loss of critical business opportunities.

Increased energy costs, power outages, and limited availability of electrical resources may adversely affect our operating results.

Our data centers are susceptible to increased regional, national or international costs of power and to electrical power outages. Our customer contracts do not allow us to pass on any increased costs of energy to our customers, which could affect our operating margins. Further, power requirements at our data centers are increasing as a result of the increasing power demands of today's servers. Increases in our power costs could impact our operating results and financial condition. Since we rely on third parties to provide our data centers with power sufficient to meet our needs, our data centers could have a limited or inadequate amount of electrical resources necessary to meet our customer requirements. We attempt to limit exposure to system downtime due to power outages by using backup generators and power supplies. However, these protections may not limit our exposure to power shortages or outages entirely. Any system downtime resulting from insufficient power resources or power outages could damage our reputation and lead us to lose current and potential customers, which would harm our operating results and financial condition.

Increased Internet bandwidth costs and network failures may adversely affect our operating results.

Our success depends in part upon the capacity, reliability, and performance of our network infrastructure, including the capacity leased from our Internet bandwidth suppliers. We depend on these companies to provide uninterrupted and error-free service through their telecommunications networks. Some of these providers are also our competitors. We exercise little control over these providers, which increases our vulnerability to problems with the services they provide. We have experienced and expect to continue to experience interruptions or delays in network service. Any failure on our part or the part of our third-party suppliers to achieve or maintain high data transmission capacity, reliability or performance could significantly reduce customer demand for our services and damage our business.

As our customer base grows and their usage of telecommunications capacity increases, we will be required to make additional investments in our capacity to maintain adequate data transmission speeds, the availability of which may be limited or the cost of which may be on terms unacceptable to us. If adequate capacity is not available to us as our customers' usage increases, our network may be unable to achieve or maintain sufficiently high data transmission capacity, reliability or performance. In addition, our business would suffer if our network suppliers increased the prices for their services and we were unable to pass along the increased costs to our customers.

Our operating results may fluctuate significantly, which could make our future results difficult to predict and could cause our operating results to fall below investor or analyst expectations.

Our operating results may fluctuate due to a variety of factors, including many of the risks described in this section, which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful. You should not rely on our operating results for any prior periods as an indication of our future operating performance. Fluctuations in our revenue can lead to even greater fluctuations in our operating results. Our budgeted expense levels depend in part on our expectations of long-term future revenue. Given relatively fixed operating costs related to our personnel and facilities, any substantial adjustment to our expenses to account for lower than expected levels of revenue will be difficult and time consuming. Consequently, if our revenue does not meet projected levels, our operating expenses would be high relative to our revenue, which would negatively affect our operating performance.

If our revenue or operating results do not meet or exceed the expectations of investors or securities analysts, the price of our common stock may decline.

We could be required to repay substantial amounts of money to certain state and local governments if we lose tax exemptions or grants previously awarded to us, which could adversely affect our operating results.

In August 2007, we entered into an agreement with the State of Texas (Texas Enterprise Fund Grant) under which we may receive up to \$22.0 million in state enterprise fund grants on the condition that we meet certain employment levels in the State of Texas paying an average compensation of at least \$56,000 per year (subject to increases). To the extent we fail to meet these requirements, we may be required to repay all or a portion of the grants plus interest. In September 2007, we received the initial installment of \$5.0 million from the State of Texas, which was recorded as a non-current liability.

On July 27, 2009, the Texas Enterprise Fund Grant agreement was amended to modify the job creation requirements. Under the amendment, the grant has been divided into four separate tranches. The first tranche, called "Basic Fund" in the amendment, is \$8.5 million with a Job Target of 1,225 new jobs by December 2012 (in addition to the 1,436 jobs in place as of August 1, 2007 for a total of 2,661 jobs in Texas). We already have drawn \$5.0 million of this grant. We can draw an additional \$3.5 million when we reach 1,225 new jobs. If we do not create 1,225 new jobs in Texas by 2012, we will be required to repay the grant at a rate of \$1,263 per job missed per year (clawback). As of December 31, 2009, we had created 617 new jobs. The maximum clawback would be the amounts we draw plus 3.4% interest on such amounts per year. The remaining three tranches are at our option. We can draw an additional \$13.5 million, based on the following amounts and milestones: \$5.5 million if we create a total of 2,100 new jobs in Texas; another \$5.25 million if we create a total of 3,000 new jobs in Texas; and \$2.75 million more if we create a total of 4,000 new jobs in Texas. We are responsible for maintaining the jobs through January 2022. If we eliminate jobs for which we have drawn funds, the clawback is triggered.

On August 3, 2007, we entered into a lease for approximately 67 acres of land and a 1.2 million square foot facility in Windcrest, Texas, which is in the San Antonio, Texas area, to house our corporate headquarters and potentially a future data center operation. In connection with this lease, we also entered into a Master Economic Incentives Agreement ("MEIA") with the Cities of Windcrest and San Antonio, Texas, Bexar County, and certain other parties, pursuant to which we agreed to locate existing and future employees at the new facility location. The agreement requires that we meet certain employment levels each year, with an ultimate job requirement of 4,500 jobs by December 31, 2012, provided that if the job requirement in any grant agreement with the State of Texas is lower, then the job requirement under the MEIA is automatically adjusted downward. Consequently, because the Texas Enterprise Fund Grant agreement has been amended to reduce the state job requirement, we believe the job requirement under the MEIA has been reduced to 1,774. In addition, the MEIA requires that the median compensation of those employees be no less than \$51,000 per year. In exchange for meeting these employment obligations, the parties agreed to enter into the lease structure, pursuant to which, as a lessee of the Windcrest Economic Development Corporation, we will not be subject to most of the property taxes associated with the property for a 14 year period. If we fail to meet these job creation requirements, we could lose a portion or all of the tax benefit being provided during the 14 year period by having to make payments in lieu of taxes (PILOT) to the City of Windcrest. The amount of the PILOT payment would be calculated based on the amount of taxes that would have been owed for that period if the property were not exempt, and then such amount would be adjusted pursuant to certain factors, such as the percentage of employment achieved compared to the stated requirements.

We have significant debt obligations that include restrictive covenants limiting our flexibility to manage our business; failure to comply with these covenants could trigger an acceleration of our outstanding indebtedness and adversely affect our financial position and operating results.

As of September 30, 2010, outstanding indebtedness under our credit facility totaled \$50.0 million, with an outstanding letter of credit of \$0.6 million. Our credit facility requires that we maintain specific financial ratios and comply with covenants, including financial covenants, which contain numerous restrictions on our ability to incur additional debt, pay dividends or make other restricted payments, sell assets, enter into affiliate transactions and take other actions. Our existing credit facility is, and any future financing arrangements may be, secured by all of our assets. If we are unable to meet the terms of the financial covenants or if we breach any of these covenants, a default could result under one or more of these agreements, which may require us to repay all amounts owed under our credit facility.

If we are unable to generate sufficient cash to repay our debt obligations when they become due and payable, either when they mature or in the event of a default, we may not be able to obtain additional debt or equity financing on favorable terms, if at all, which may negatively impact our ability to continue as a going concern.

We also have substantial equipment lease obligations, the principal balance of which totaled approximately \$126.5 million as of September 30, 2010. The payment obligations under these equipment leases are secured by a significant portion of the hardware used in our data centers. If we are unable to generate sufficient cash flow from our operations or cash from other sources in order to meet the payment obligations under these equipment leases, we may lose the right to possess and operate the equipment used in our data centers, which would substantially impair our ability to provide our services, which could have a material adverse effect on our liquidity or results of operations.

We may require additional capital and may not be able to secure additional financing on favorable terms to meet our future capital needs, which could adversely affect our financial position and result in stockholder dilution.

In order to fund future growth, we will be dependent on significant capital expenditures. We may need to raise additional funds through equity or debt financings in the future in order to meet our operating and capital needs. We may not be able to secure additional debt or equity financing on favorable terms, or at all, at the time when we need such funding. If we are unable to raise additional funds, we may not be able to pursue our growth strategy and our business could suffer. If we raise additional funds through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution in their percentage ownership of our company, and any new equity securities we issue could have rights, preferences, and privileges senior to those of holders of our common stock. In addition, any debt financing that we may obtain in the future could have restrictive covenants relating to our capital raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions.

We are exposed to commodity and market price risks that have the potential to substantially influence our profitability and liquidity.

We are a large consumer of power. During the first nine months of 2010, we expensed approximately \$13.0--- million to utility companies to power our data centers. We anticipate an increase in our consumption of power in the future as our sales grow. Power costs vary by locality and are subject to substantial seasonal fluctuations and changes in energy prices. Our largest exposure to energy prices currently exists at our Grapevine, Texas facility in the Dallas–Fort Worth area, where the energy market is deregulated. Power costs have historically tracked the general costs of energy, and continued increases in electricity costs may negatively impact our gross margins or operating expenses. We periodically evaluate the advisability of entering into fixed price utilities contracts. If we choose not to enter into a fixed price contract, we expose our cost structure to this commodity price risk.

Our main credit facility is a revolving line of credit with a base rate determined by the London Interbank Offered Rate, or LIBOR. This market rate of interest is fluctuating and exposes our interest expense to risk. Our credit agreement obligates us to hedge part of that interest rate risk with appropriate instruments, such as interest rate swaps or interest rate options. On December 10, 2007, we entered into an at–the–market fixed–payer interest rate swap with a notional amount of \$50.0 million at an annual rate of 4.135%. This swap essentially fixes the rate we pay on the first \$50.0 million outstanding on our revolving credit facility. As we borrow more, we may enter into additional swaps to continuously control our interest rate risk. Generally, we do not hedge our complete exposure. As a result, we may be exposed to interest rate risk on the un–hedged portion of our borrowings. For example, a 100 basis point increase in LIBOR would increase the interest expense on \$10 million of borrowings that are not hedged by \$0.1 million annually. As of September 30, 2010 we did not have exposure to interest rate risk as we only had \$50.0 million outstanding on our revolving credit facility.

The majority of our customers are invoiced, and substantially all of our expenses are paid, by us or our subsidiaries in the functional currency of our company or our subsidiaries, respectively. However, some of our customers are currently invoiced in currencies other than the applicable functional currency. As a result, we may incur foreign currency losses based on changes in exchange rates between the date of the invoice and the date of collection. In addition, large changes in foreign exchange rates relative to our functional currencies could increase the costs of our services to non–U.S. customers relative to local competitors, thereby causing us to lose existing or potential customers to these local competitors. Thus, our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates. Further, as we grow our international operations, our exposure to foreign currency risk could become more significant. To date, we have not entered into any foreign currency hedging contracts, although we may do so in the future.

We may be liable for the material that content providers distribute over our network and we may have to terminate customers that provide content that is determined to be illegal, which could adversely affect our operating results.

The law relating to the liability of private network operators for information carried on, stored on, or disseminated through their networks is still unsettled in many jurisdictions. We have been and expect to continue to be subject to legal claims relating to the content disseminated on our network, including claims under the Digital Millennium Copyright Act, other similar legislation and common law. In addition, there are other potential customer activities, such as online gambling and pornography, where we, in our role as a hosting provider, may be held liable as an aider or abettor of our customers. If we need to take costly measures to reduce our exposure to these risks, terminate customer relationships and the associated revenue or defend ourselves against such claims, our financial results could be negatively affected.

Government regulation of data networks is largely unsettled, and depending on its evolution, may adversely affect our operating results.

We are subject to varying degrees of regulation in each of the jurisdictions in which we provide services. Local laws and regulations, and their interpretation and enforcement, differ significantly among those jurisdictions. These laws can be costly to comply with, can be a significant diversion to management’s time and effort, and can subject us to claims or other remedies, as well as negative publicity. Many of these laws were adopted prior to the advent of the internet and related technologies and, as a result, do not contemplate or address the unique issues that the internet and related technologies produce. Some of the laws that do reference the internet and related technologies have been and continue to be interpreted by the courts, but their applicability and scope remain largely uncertain.

In addition, future regulatory, judicial, and legislative changes may have a material adverse effect on our ability to deliver services within various jurisdictions. National regulatory frameworks that are consistent with the policies and requirements of the World Trade Organization have only recently been, or are still being, put in place in many countries. Accordingly, many countries are still in the early stages of providing for and adapting to a liberalized telecommunications market. As a result, in these markets we may encounter more protracted and difficult procedures to obtain any necessary licenses or negotiate interconnection agreements, which could negatively impact our ability to expand in these markets or increase our operating costs in these markets.

Privacy concerns relating to our technology could damage our reputation and deter current and potential users from using our products and services.

Since our products and services are web based, we store substantial amounts of data for our customers on our servers (including personal information). Any systems failure or compromise of our security that results in the release of our customers' data could (i) subject us to substantial damage claims from our customers, (ii) expose us to costly regulatory remediation and (iii) harm our reputation and brand. We may also need to expend significant resources to protect against security breaches. The risk that these types of events could seriously harm our business is likely to increase as we expand our hosting footprint.

Regulatory authorities around the world are considering a number of legislative proposals concerning data protection. In addition, the interpretation and application of data protection laws in Europe and elsewhere are still uncertain and in flux. It is possible that these laws may be interpreted and applied in a manner that is inconsistent with our data practices. If so, in addition to the possibility of fines, this could result in an order requiring that we change our data practices, which could have an adverse effect on our business. Complying with these various laws could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business.

Our ability to operate and expand our business is susceptible to risks associated with international sales and operations.

We anticipate that, for the foreseeable future, a significant portion of our revenue will continue to be derived from sources outside of the U.S. A key element of our growth strategy is to further expand our customer base internationally and successfully operate data centers in foreign markets. We have limited experience operating in foreign jurisdictions other than the U.K. and expect to continue to grow our international operations. Managing a global organization is difficult, time consuming, and expensive. Our inexperience in operating our business globally increases the risk that international expansion efforts that we may undertake will not be successful. In addition, conducting international operations subjects us to new risks that we have not generally faced. These risks include:

- Localization of our services, including translation into foreign languages and adaptation for local practices and regulatory requirements
- Lack of familiarity with and unexpected changes in foreign regulatory requirements;
- Longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- Difficulties in managing and staffing international operations;
- Fluctuations in currency exchange rates;
- Potentially adverse tax consequences, including the complexities of transfer pricing, foreign value added tax systems, and restrictions on the repatriation of earnings;
- Dependence on certain third parties, including channel partners with whom we do not have extensive experience;
- The burdens of complying with a wide variety of foreign laws and legal standards;
- Increased financial accounting and reporting burdens and complexities;
- Political, social, and economic instability abroad, terrorist attacks and security concerns in general; and
- Reduced or varied protection for intellectual property rights in some countries.

Operating in international markets also requires significant management attention and financial resources. The investment and additional resources required to establish operations and manage growth in other countries may not produce desired levels of revenue or profitability.

We rely on our Partner Network Program members for a significant portion of our revenues, and we benefit from our association with them. The loss of these members could adversely affect our business.

Our Partner Network Program drives a significant amount of revenue to our hosting services business. Most of our member partners offer services that are complementary to our hosting services. Some of the participants in our network, however, may actually compete with us in one or more of our product or service offerings. These network partners may decide in the future to terminate their agreements with us and to use a competitor's or their own services, which could cause our revenue to decline.

Also, we derive tangible and intangible benefits from our association with some of our network partners, particularly high profile partners that reach a large number of companies through the internet. If a substantial number of these partners terminate their relationship with us, our business could be adversely affected.

Our acquisitions may divert our management's attention, result in dilution to our stockholders and consume resources that are necessary to sustain our business.

We have made acquisitions and, if appropriate opportunities present themselves, we may make additional acquisitions or investments or enter into joint ventures or strategic alliances with other companies. Risks commonly encountered in such transactions include:

- The difficulty of assimilating the operations and personnel of the combined companies;
- The risk that we may not be able to integrate the acquired services or technologies with our current services, products, and technologies;
- The potential disruption of our ongoing business;
- The diversion of management attention from our existing business;
- The inability of management to maximize our financial and strategic position through the successful integration of the acquired businesses;
- Difficulty in maintaining controls, procedures, and policies;
- The impairment of relationships with employees, suppliers, and customers as a result of any integration;
- The loss of an acquired base of customers and accompanying revenue; and
- The assumption of leased facilities, other long-term commitments or liabilities that could have a material adverse impact on our profitability and cash flow.

As a result of these potential problems and risks, businesses that we may acquire or invest in may not produce the revenue, earnings, or business synergies that we anticipated. In addition, there can be no assurance that any potential transaction will be successfully identified and completed or that, if completed, the acquired business or investment will generate sufficient revenue to offset the associated costs or other potential harmful effects on our business.

Concerns about greenhouse gas emissions and the global climate change may result in environmental taxes, charges, assessments or penalties.

The effects of human activity on the global climate change have attracted considerable public and scientific attention, as well as the attention of the United States government. Efforts are being made to reduce greenhouse emissions, particularly those from coal combustion by power plants, some of which we may rely upon for power. The added cost of any environmental taxes, charges, assessments or penalties levied on these power plants could be passed on to us, increasing the cost to run our data centers. Additionally, environmental taxes, charges, assessments or penalties could be levied directly on us in proportion to our carbon footprint. Any enactment of laws or passage of regulations regarding greenhouse gas emissions by the United States, or any domestic or foreign jurisdiction we perform business in, could adversely affect our operations and financial results.

Terrorist activity throughout the world and military action to counter terrorism could adversely impact our operating results.

Terrorist attacks and other acts of violence, as well as governments' responses to such activities, may have an adverse effect on business, financial, and general economic conditions internationally. Terrorist activities may disrupt our ability to provide our services or may increase our costs due to the need to provide enhanced security, which would have a material adverse effect on our business and results of operations. These circumstances may also adversely affect our ability to attract and retain customers, our ability to raise capital, and the operation and maintenance of our facilities. We may not have adequate property and liability insurance to cover catastrophic events or attacks brought on by terrorist attacks and other acts of violence. In addition, we depend heavily on the physical infrastructure, particularly as it relates to power, that exists in the markets in which we operate. Any damage to such infrastructure in these markets where we operate may materially and adversely affect our operating results.

Risks Related to the Ownership of Our Common Stock

The trading price of our common stock may be volatile.

The market price of our common stock has been highly volatile and could be subject to wide fluctuations in response to, among other things, the risk factors described in this periodic report, and other factors beyond our control, such as stock market volatility and fluctuations in the valuation of companies perceived by investors to be comparable to us.

Further, the stock markets have experienced price and volume fluctuations that have affected our stock price and the market prices of equity securities of many other companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political, and market conditions, such as recessions, interest rate changes or international currency fluctuations, may negatively affect the market price of our common stock. We may experience additional volatility as a result of the limited number of our shares available for trading in the market.

In the past, many companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business.

Our common stock has only been publicly traded since our initial public offering on August 7, 2008 and the price of our common stock has fluctuated substantially since then and may fluctuate substantially in the future.

Our common stock has only been publicly traded since our initial public offering on August 7, 2008. The trading price of our common stock has fluctuated significantly since then. For example, between December 31, 2009 and September 30, 2010, the closing trading price of our common stock was very volatile, ranging between \$15.51 and \$26.11 per share, including single-day increases of up to 10.7% and declines up to 9.2%. Our trading price could fluctuate substantially in the future due to the factors discussed in this Risk Factors section and elsewhere in this quarterly report on Form 10-Q.

Contractual lock-up restrictions on the sale of approximately 99 million shares held by certain stockholders expired on February 3, 2009 and to the extent a stockholder is not an affiliate, its shares are now eligible for sale without restriction. Affiliate sales are subject to the volume, manner of sale and other restrictions of Rule 144 of the Securities Exchange Act of 1933 which allow the holder to sell up to the greater of 1% of our outstanding common stock or our average weekly trading volume during any three-month period. Shares beneficially held by Graham Weston, Wells Fargo and Company and certain other parties will be subject to such requirements to the extent they are deemed to be our "affiliates" as that term is defined in Rule 144. Additionally, Weston, and certain other holders possess registration rights with respect to some of the shares of our common stock that they hold. If they choose to exercise such rights, their sale of the shares that are registered would not be subject to the Rule 144 limitations. If a significant amount of the shares that become eligible for resale enter the public trading markets in a short period of time, the market price of our common stock may decline.

Additionally, certain of our large stockholders are entities that may from time to time distribute the shares of our stock held by them to their beneficial owners in order to provide them with liquidity with respect to their investment in our stock. The distributed shares may be eligible for immediate resale, in which case all or a significant portion of these shares may be sold by these beneficial owners in the public markets during a short period of time following their receipt of these shares, which may cause the market price for our stock to decline.

The issuance of additional stock in connection with acquisitions, our stock option plans, or otherwise will dilute all other stockholdings.

We have a large number of shares of common stock authorized but unissued and not reserved for issuance under our stock option plans or otherwise. We may issue all of these shares without any action or approval by our stockholders. We intend to continue to actively pursue strategic acquisitions. We may pay for such acquisitions, partly or in full, through the issuance of additional equity. In addition, our Amended and Restated 2007 Long-Term Incentive Plan contains an evergreen provision, which annually increases the number of shares issuable under the plan. Any issuance of shares in connection with our acquisitions, the exercise of stock options or otherwise would dilute the percentage ownership held by our then existing stockholders.

Your ability to influence corporate matters may be limited because a small number of stockholders beneficially own a substantial amount of our common stock.

Our directors and executive officers and their affiliates beneficially own a significant portion of our outstanding common stock. As a result, these stockholders will be able to exercise significant influence over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as a merger or other sale of our company or its assets. Although our directors and executive officers are not currently party to any agreements or understandings to act together on matters submitted for stockholder approval, this concentration of ownership could limit your ability to influence corporate matters and may have the effect of delaying or preventing a third party from acquiring control over us.

Anti-takeover provisions in our organizational documents and Delaware law may discourage or prevent a change of control, even if an acquisition would be beneficial to our stockholders, which could affect our stock price adversely and prevent attempts by our stockholders to replace or remove our current management.

Our restated certificate of incorporation and amended and restated bylaws contain provisions that could delay or prevent a change of control of our company or changes in our board of directors deemed undesirable by our board of directors that our stockholders might consider favorable. Some of these provisions:

- Authorize the issuance of blank check preferred stock which can be created and issued by our board of directors without prior stockholder approval, with voting, liquidation, dividend, and other rights senior to those of our common stock;
- Provide for a classified board of directors, with each director serving a staggered three-year term;
- Prohibit our stockholders from filling board vacancies or increasing the size of our board, calling special stockholder meetings or taking action by written consent;
- Provide for the removal of a director only with cause and by the affirmative vote of the holders of a majority of the shares then entitled to vote at an election of our directors; and
- Require advance written notice of stockholder proposals and director nominations.

In addition, we are subject to the provisions of Section 203 of the Delaware General Corporation Law, which may prohibit certain business combinations with stockholders owning 15% or more of our outstanding voting stock. These and other provisions in our restated certificate of incorporation, amended and restated bylaws and Delaware law could make it more difficult for stockholders or potential acquirers to obtain control of our board of directors or initiate actions that are opposed by our then current board of directors, including a merger, tender offer or proxy contest involving our company. Any delay or prevention of a change of control transaction or changes in our board of directors could cause the market price of our common stock to decline.

ITEM 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3 – DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4 – RESERVED

ITEM 5 – OTHER INFORMATION

None

ITEM 6 – EXHIBITS

<u>Exhibit Number</u>	<u>Description</u>
10.1 *	Property Lease for HPH1 Hyde Park Hayes Millington Road Hayes Middlesex UB3 4AY by and among Rackspace Limited, Hyde Park GP Limited and Hyde Park Nominee Limited, dated August 18, 2010
10.2 *	Service Agreement by and between Rackspace Limited and David Kelly, dated June 24, 2010
31.1 *	Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2 *	Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1 **	Certifications of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2 **	Certifications of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS **	XBRL Instance Document
101.SCH **	XBRL Taxonomy Extension Schema
101.CAL **	XBRL Taxonomy Extension Calculation Linkbase
101.LAB **	XBRL Taxonomy Extension Label Linkbase
101.PRE **	XBRL Taxonomy Extension Presentation Linkbase
*	Filed herewith
**	Furnished herewith

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, on November 9, 2010.
Rackspace Hosting, Inc.

Date: November 9, 2010

By: /s/ Bruce R. Knooihuizen
Bruce R. Knooihuizen
Chief Financial Officer, Senior Vice President and
Treasurer
(Principal Financial Officer)

CERTIFICATION PURSUANT TO RULE 13a-14(a) OR 15d-14(a) OF THE SECURITIES
EXCHANGE
ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002

I, A. Lanham Napier, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Rackspace Hosting, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2010

By: /s/ A. Lanham Napier
A. Lanham Napier
Chief Executive Officer, President and Director
(Principal Executive Officer)

CERTIFICATION PURSUANT TO RULE 13a-14(a) OR 15d-14(a) OF THE SECURITIES
EXCHANGE
ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002

I, Bruce R. Knooihuizen, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Rackspace Hosting, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2010

By: /s/ Bruce R. Knooihuizen

Bruce R. Knooihuizen
Chief Financial Officer, Senior Vice President and
Treasurer
(Principal Financial Officer)

DATED ...18 August 2010.....

Hyde Park GP Limited and Hyde Park Nominee Limited (1)

Rackspace Limited (2)

Lease
of
HPH1 Hyde Park Hayes Millington Road Hayes Middlesex UB3 4AY

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LAND REGISTRY PRESCRIBED CLAUSES

LR1.	Date of lease	18 August 2010
LR2.	Title Number(s)	<p>LR2.1 Landlord's title number(s) Title number(s) out of which this lease is granted. Leave blank if not registered.</p> <p>AGL55140</p> <p>LR2.2 Other title numbers Existing title number(s) against which entries of matters referred to in LR9, LR10, LR11 and LR13 are to be made</p> <p>AGL60220 and AGL30755</p>
LR3.	Parties to this lease	<p>Landlord</p> <p>HYDE PARK GP LIMITED (Company Number 5540632) and HYDE PARK NOMINEE LIMITED (Company Number 5540634) whose registered office is at 33 Cavendish Square London W1A 2NF</p> <p>Tenant</p> <p>RACKSPACE LIMITED (Company Number 03897010) whose registered office is at 4 The Square Stockley Park Uxbridge Middlesex UB11 1ET</p> <p>Other parties</p> <p>None</p> <p>Specify capacity of each party, for example "management company", "guarantor", etc.</p>
LR4.	Property	<p>In the case of a conflict between this clause and the remainder of this lease then, for the purposes of registration, this clause shall prevail.</p> <p>Schedule 1</p>
LR5.	Prescribed statements etc.	<p>LR5.1 Statements prescribed under rules 179 (dispositions in favour of a charity), 180 (dispositions by a charity) or 196 (leases under the Leasehold Reform, Housing and Urban Development Act 1993) of the Land Registration Rules 2003.</p> <p>None</p> <p>LR5.2 This lease is made under, or by reference to, provisions of:</p>
LR6.	Term for which the Property is leased	The term as specified in this lease at clause 1

Give full names and addresses of each of the parties. For UK incorporated companies and limited liability partnerships, also give the registered number including any prefix. For overseas companies, also give the territory of incorporation and, if appropriate, the registered number in England and Wales including any prefix

Insert a full description of the land being leased or Refer to the clause, schedule or paragraph of a schedule in this lease in which the land being leased is more fully described.

Where there is a letting of part of a registered title, a plan must be attached to this lease and any floor levels must be specified.

If this lease includes a statement falling within LR5.1, insert under that sub-clause the relevant statement or refer to the clause, schedule or paragraph of a schedule in this lease which contains the statement.

In LR5.2, omit or delete those Acts which do not apply to this lease.

Include only the appropriate statement (duly completed) from the three options.

NOTE: The information you provide, or refer to, here will be used as part of the particulars to identify the lease under rule 6 of the Land Registration Rules 2003.

LR7. Premium None

Specify the total premium, inclusive of any VAT where payable.

LR8. Prohibitions or restrictions on disposing of this lease This lease contains a provision that prohibits or restricts dispositions.

Include whichever of the two statements is appropriate.

Do not set out here the wording of the provision.

LR9. Rights of acquisition etc. LR9.1 Tenant's contractual rights to renew this lease, to acquire the reversion or another lease of the Property, or to acquire an interest in other land

Insert the relevant provisions in the sub-clauses or refer to the clause, schedule or paragraph of a schedule in this lease which contains the provisions.

None

LR9.2 Tenant's covenant to (or offer to) surrender this lease

None

LR9.3 Landlord's contractual rights to acquire this lease

None

LR10. Restrictive covenants given in this lease by the Landlord in respect of land other than the Property None

Insert the relevant provisions or refer to the clause, schedule or paragraph of a schedule in this lease which contains the provisions.

LR11. Easements LR11.1 Easements granted by this lease for the benefit of the Property

Refer here only to the clause, schedule or paragraph of a schedule in this lease which sets out the easements.

Schedule 2

LR11.2 Easements granted or reserved by this lease over the Property for the benefit of other property

Part 1 of Schedule 3

LR12. Estate rentcharge burdening the Property None

Refer here only to the clause, schedule or paragraph of a schedule in this lease which sets out the rentcharge.

PARTICULARS

Lease Date: 18 August 2010

Owner: HYDE PARK GP LIMITED and HYDE PARK NOMINEE LIMITED

Occupier: RACKSPACE LIMITED

Property: HPH1 Hyde Park Hayes, Millington Road, Hayes, Middlesex UB3 4AY as the same is more particularly described in Schedule 1

Term: 7 years commencing on 18 August 2010 and expiring on 17 August 2017

1954 Act Excluded: No

Rent Commencement Date: In accordance with clause 3.2

Initial Annual Rent: £1,520,000 exclusive of VAT

Review Date: Fifth year of the Term insert date on completion (fixed uplift)

Permitted Use: Offices within Class B1(a) of the schedule to the Town and Country Planning (Use Classes) Order 1987

Break Dates: None

Car Parking Spaces: 500

DATE: 18 August 2010

PARTIES:

- (1) "the Owner" HYDE PARK GP LIMITED (Company Number 5540632) and HYDE PARK NOMINEE LIMITED (Company Number 5540634) whose registered office is at 33 Cavendish Square London W1A 2NF
- (2) "the Occupier" RACKSPACE LIMITED (Company Number 3897010) whose registered office is at 4 The Square Stockley Park Uxbridge Middlesex UB11 1ET

1. DEFINITIONS

1.1. In this Lease unless the context otherwise requires the following expressions shall have the following meanings:

"1925 Act"	the Law of Property Act 1925
"1954 Act"	the Landlord and Tenant Act 1954
"1995 Act"	the Landlord and Tenant (Covenants) Act 1995
"Base Rate"	the base rate from time to time of National Westminster Bank plc (or if that base lending rate stops being used or published then a comparable commercial rate reasonably determined by the Owner)
"Car Parking Spaces"	the 500 car parking spaces within the Estate as the Owner may designate for the Occupiers use from time to time and in accordance with the terms of this Lease and "Car Parking Space" means any one of them
"CDM Regulations"	the Construction (Design and Management) Regulations 2007 (as amended supplemented or replaced from time to time)
"Common Parts"	the pedestrian ways, circulation areas, entrance halls, lifts, lift shafts, landings, staircases, passages, forecourts, service areas, landscaped areas and any other areas of the Estate (except the Other Lettable Areas) which are from time to time during the Term provided by the Owner for the common use by the other occupiers of the Estate
"Conduits"	all drains pipes gutters mains channels flues ducts cables trunking watercourses sewers wires laser optical fibres and data or impulse transmission communications or reception systems and other conducting media
"Determination of the Term"	the end of the Term however it terminates
"Discretionary Services"	Has the meaning given to it in Schedule 5
"EPC"	the energy performance certificate (as defined in the Energy Performance of Buildings (Certificates and Inspections) (England and Wales) Regulations 2007) from time to time obtained by the Owner for the Property
"Estate"	the Estate known as Hyde Park Hayes Millington Road Hayes Middlesex shown edged blue on Plan 1 and registered at the Land Registry with freehold title absolute under title numbers AGL55140 AGL60220 and AGL30755 as varied from time to time to include or exclude such land and buildings as the Owner may designate and including the walkways roads pavements courtyards loading bays car parking areas service and other areas belonging to or serving it
"Excluded"	excluded from the security of tenure provisions contained in sections 24 to 28 (inclusive) of the 1954 Act
"Group Company"	a company which is a member of a group of companies where one company is the holding company of the other company or both companies are subsidiaries of the same holding company ("holding" and "subsidiaries" having the meanings given to them in Section 1159 of the Companies Act 2006)
"Guarantor"	the person named as guarantor in the parties to this Lease (if any) and includes any person who at any time guarantees any or all of the Occupier's Covenants and (if an individual) his personal representatives

“Hazardous Substances”	means any dangerous hazardous toxic or flammable substances materials effluents or waste pollutants contaminants oils petroleum products radioactive substances genetically modified organisms micro-organisms or any substances whether natural or artificial solid or liquid gas or vapour or any mixture thereof which are or may be harmful or prejudicial to the health of any human or other living organism or which have resulted or may result in the pollution of the Environment
“Insurance Rent”	a fair and reasonable proportion (as determined from time to time by the Owner) of the sums reasonably and properly expended or incurred by the Owner (before deduction of any commission or allowance) in or in connection with insuring the Estate against the Insured Risks pursuant to Schedule 4
“Insured Risks”	fire lightning explosion aircraft (other than hostile aircraft) and articles dropped from aircraft riot civil commotion malicious damage earthquake storm tempest flood burst pipes impact subsidence together with terrorism (where insurance is available on reasonable commercial terms) and such other risks as the Owner may insure against from time to time pursuant to Schedule 4 and “Insured Risk” means any one of them
“Landscaping Programme”	the indicative programme prepared by the Owner and attached as Annexure 2 in connection with landscape fencing and other works to be undertaken by the Owner at the Estate
“this Lease”	this lease and any document supplemental to it or entered into pursuant to it
“Liability”	all actions proceedings costs claims demands expenses damages and liabilities
“Loss of Rent”	loss of the Rent for a period of not less than 3 years
“Multi Storey Car Park”	the car park located on the Estate and shown for identification only marked 3 on the attached plan number 2
“Net Profits”	net trading profits or net investment income in each case after tax and extraordinary items (but including exceptional items) as ascertained from the audited accounts of the proposed assignee (such accounts having been prepared in accordance with the Companies Act 2006 and in accordance with generally accepted accounting principles and practices in the United Kingdom so as to show a true and fair view of the results of the proposed assignee for the relevant period)
“Obligatory Services”	has the meaning given to it in Schedule 5
“Occupier	the person named as occupier in the parties to this Lease and includes its successors in title and assigns and (if an individual) his personal representatives
“Occupier’s Covenants”	the covenants obligations and other conditions imposed on the Occupier under this Lease
“Occupier’s Guide”	the Tenant Handbook for the Property dated July 2010 attached as Annexure 3
“Other Land”	adjoining or neighbouring land premises or buildings including the Estate (whether or not belonging to the Owner)
“Other Lettable Areas”	other areas of the Estate which are let or designed to be let to other occupiers and “Other Lettable Area” means any one of them
“Owner”	the person for the time being entitled to the immediate reversion to this Lease
“Owner’s Costs”	all reasonable and proper costs (whether of works or any other nature) charges and expenses (including solicitors’ Counsel’s architects’ surveyors’ and all other professional fees charges disbursements stamp duty land tax and Land Registry fees any commission payable to a bailiff and any fees costs expenses or other charges of any mortgagee or superior owner) properly incurred or payable by the Owner
“Permitted Part”	one or more complete floors of the Property (excluding areas used in common with occupiers of other floors of the Property)
“Permitted Use”	as offices falling within Class B1(a) of the Town and Country Planning (Use Classes) Order 1987
“Planning Acts”	the Town and Country Planning Act 1990; the Planning (Listed Buildings and Conservation Areas) Act 1990; the Planning (Hazardous Substances) Act 1990; the Planning (Consequential Provisions) Act 1990; the Planning and Compensation Act 1991; the Planning and Compulsory Purchase Act 2004; and all other statutes relating to town and country planning from time to time in force

“the Plans” “the Plans”	the plans annexed to this Lease and marked Plans 1, 2 and 3
“Prescribed Rate”	the yearly rate of 3% above the Base Rate
“the Property”	the premises described in Schedule 1 together with for the avoidance of doubt the KVA generator within the Property and all permitted additions and alterations made to it from time to time and all fixtures and fittings in or upon it from time to time (whether originally affixed or fastened to or upon it or otherwise) except those occupier’s fixtures which are capable of being removed from the Property without defacing it
“Quarter Days”	25 March 24 June 29 September and 25 December in every year and “Quarter Day” means any one of them
“Reinstatement Election Notice”	a notice served by the Owner on the Occupier following damage to the Property by an Uninsured Risk in which the Owner elects to reinstate the Property
“Reinstatement Election Period”	the period of 12 months from and including the date of damage to the Property by an Uninsured Risk
“the Rent”	Means: (a) until the date immediately preceding the Rent Commencement a peppercorn if demanded; and (b) from and including the Rent Commencement Date to and including 18 February 2012 the annual sum of ONE MILLION THREE HUNDRED AND TWENTY FIVE THOUSAND POUNDS (£1,325,000); and (c) thereafter the annual sum of ONE MILLION FIVE HUNDRED AND TWENTY THOUSAND POUNDS (£1,520,000) (subject to review under Schedule 7) and any interim rent determined under the 1954 Act
“Rental Liability”	the Rent firstly reserved by this Lease as at the date of the application for consent to assign or underlet (as the case may be)
“Rent Commencement Date”	18 November 2011
“the Rents”	the sums referred to in clause 3.1
“the Review Dates”	the fifth anniversary of the date of commencement of the Term
“the Schedule of Condition”	the schedule prepared by GVA Grimley dated 22 July 2010 and which is annexed at Annexure 1
“the Service Charge”	has the meaning given to it in Schedule 5
“Services”	has the meaning given to it in Schedule 5
“Services and Systems”	the Conduits and all ventilation cooling and heating apparatus all electric gas hydraulic and other mechanical installations plant machinery and equipment and all security fire alarm and sprinkler systems from time to time installed in and forming part of the Property or the Estate
“Term”	a term of seven years commencing on and including 18 August 2010 and expiring on 17 August 2017 and any period of continuation holding over or extension of it (whether by statute or at common law or otherwise)
“Termination Notice”	a notice to terminate this Lease with immediate effect
“Uninsured Risk”	any risk which is not at the relevant time an Insured Risk
“VAT”	value added tax provided for in the Value Added Tax Act 1994 or any similar replacement or additional tax
“Working Day”	any day from Monday to Friday inclusive which is not a statutory public or bank holiday or a day on which clearing banks are not open in England for normal business

- 1.2. In this Lease (unless expressly stated otherwise):
 - 1.2.1. any reference to a clause or Schedule is to the relevant clause of or Schedule to this Lease and any reference to a paragraph is to the relevant paragraph of the Schedule in which it appears
 - 1.2.2. the index and Particulars at the front of this Lease and any clause or schedule headings are included for convenience only and shall not affect the interpretation of this Lease
 - 1.2.3. use of the singular includes the plural and vice versa and use of any gender includes the other genders
 - 1.2.4. words denoting natural persons include firms companies corporations and vice versa
 - 1.2.5. reference to a statute (whether general or specific) includes all instruments orders regulations and other matters made under it and any modification amendment extension consolidation or re-enactment of it or of the instruments orders regulations or other matters made under it from time to time (except in the case of a reference to the Town and Country Planning (Use Classes) Order 1987 which shall be read as originally made)
 - 1.2.6. the terms “including” “include” “in particular” or any similar expression are deemed to have the words “without limitation” following them
 - 1.2.7. reference to “the Property” “the Common Parts” “the Estate” “Other Lettable Areas” or “the Services and Systems” means the whole or any part of them or it
 - 1.3. The Schedules form part of this Lease and shall have effect as if set out in full in the body of this Lease and any reference to this Lease includes the Schedules
 - 1.4. If the Occupier for the time being is more than one person then its covenants under this Lease are to be treated as being made jointly and severally
 - 1.5. An obligation by the Occupier not to do something includes an obligation not to permit or suffer it to be done
 - 1.6. Any obligation on a party to this Lease to do something includes an obligation to procure that it is done
 - 1.7. Any reference in this Lease to an act or omission of the Occupier includes an act or omission of any undertenant and any other person deriving title under the Occupier and also includes an act or omission of their respective employees workmen agents or visitors or anyone at the Property with the express or implied authority of any of them
 - 1.8. Where any consent or approval of the Owner is required under this Lease the relevant provision shall be construed as also requiring the consent of any mortgagee and (where the same is required under any superior lease) of any superior owner (except that nothing in this Lease or in any consent or approval given by the Owner shall imply that the superior owner’s consent will not be unreasonably withheld)
 - 1.9. Reference in this Lease to consent or approval not being unreasonably withheld also means it must not be unreasonably delayed
 - 1.10. Any consent or approval of the Owner required under this Lease must be obtained before the act or event to which it applies is carried out or done and shall be valid only if it is given by deed executed by the Owner or otherwise given in writing and signed by or on behalf of the Owner with an express statement that the Owner waives the requirement for a deed in that (and only that) case
 - 1.11. Any easement right power or discretion excepted reserved or made available to the Owner under this Lease shall be deemed in addition to except reserve and make the same available to any mortgagee and superior owner and in the case of any right of the Owner to have access to the Property such right shall also extend to all persons authorised in writing by the Owner (including agents professional advisers contractors workmen and others)
 - 1.12. Reference in this Lease to a payment being required to be made “on demand” means that payment shall be made on demand from time to time
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2. DEMISE

2.1. The Owner demises the Property to the Occupier for the Term together with (and in common with the Owner and all other persons entitled to them) the rights set out in Schedule 2 but excepting and reserving to the Owner the rights privileges and other matters set out in Part 1 of Schedule 3 and subject to the rights privileges covenants and other matters set out in Part 2 of Schedule 3

3. RENT

3.1. Throughout the Term the Occupier shall pay to the Owner by way of rent without deduction counterclaim or set off:

3.1.1. the Rent

3.1.2. the Insurance Rent in accordance with Schedule 4

3.1.3. the Service Charge in accordance with Schedule 5

3.1.4. any VAT payable by the Occupier in accordance with clause 6.12

3.1.5. any interest payable by the Occupier in accordance with clause 4.2

3.2. The Rent is to be paid by equal quarterly instalments in advance on the Quarter Days and the first payment (being an appropriate proportion calculated from and including the Rent Commencement Date until and including the day before the next Quarter Day) is to be made on the Rent Commencement Date

4. OCCUPIER'S COVENANTS

The Occupier covenants with the Owner:

4.1. Pay Rents

To pay the Rents in accordance with clause 3

4.2. Pay Interest

- 4.2.1. If the Rent is not paid on the due date or if any of the other Rents are not paid within 5 Working Days after falling due (whether formally demanded or not) to pay interest on the unpaid amount at the Prescribed Rate (both before and after judgment) accruing on a daily basis from the date such amount becomes due up to and including the date of actual payment
- 4.2.2. If the Owner refuses to accept any of the Rents so as not to prejudice its rights of re-entry in this Lease to pay interest at the Prescribed Rate on those Rents for the period from and including the due date until acceptance by the Owner

4.3. Pay Outgoings etc.

- 4.3.1. To pay all existing and future rates taxes assessments duties charges and outgoings of every kind (whether or not recurring or of a capital nature and including any of a novel nature) legally payable in respect of the Property by the owner or occupier of it
 - 4.3.2. To pay to the relevant suppliers all charges for gas electricity water telecommunications and other utilities and services (including meter rents and standing charges) consumed in the Property
 - 4.3.3. The obligation in clause 4.3.1 excludes any taxes payable by the Owner (other than VAT) on receipt of the Rent or which arise from a disposal of the Owner's reversionary interest in the Property
 - 4.3.4. Not to agree the rateable value of the Property with any competent authority without first giving the Owner written details of all proposals and counter-proposals made and the progress of all negotiations and appeals (if any) in respect of the value of the Property for rating purposes and to co-operate with the Owner in seeking to procure that any rateable value assessed in respect of the Property is as low as possible
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4.4. Repair and Cleaning

- 4.4.1. Subject to clause 4.4.11 to keep the Property in good and substantial repair and condition excluding damage by:
- (a) an Insured Risk unless any insurance money is withheld due to an act or omission of the Occupier and the Occupier does not make good the withheld amount) and
 - (b) an Uninsured Risk but only to the extent that:
 - (i) damage caused by an Uninsured Risk makes the whole or a substantial part of the Property unfit for occupation and use and
 - (ii) the Uninsured Risk has not become an Uninsured Risk as a result of any act or omission of the Occupier
- 4.4.2. Subject to clause 4.4.11 to renew and replace all Owner's fixtures and fittings (including carpets and other floor-coverings) in or forming part of the Property which may be or become missing broken damaged or stained with new items of an equivalent quality and value to the Owner's reasonable satisfaction
- 4.4.3. To replace immediately all broken or damaged glass in or forming part of the Property at the Occupier's own cost whether or not any insurance monies received are sufficient
- 4.4.4. To keep clean all doors and windows and door and window frames of the Property cleaning as frequently as necessary
- 4.4.5. To keep the Property clean and tidy and to keep the floors of the Property carpeted or otherwise suitably covered
- 4.4.6. Subject to clause 4.4.11 to keep the Conduits within and serving the Property in good condition and clear at all times
- 4.4.7. Subject to clause 4.4.11 to ensure that the Services and Systems at the Property are:
- (a) maintained in good and working order
 - (b) regularly inspected and tested
 - (c) repaired and where necessary replaced
- in all cases by an appropriate qualified person in accordance with the relevant manufacturer's instructions and recommendations
- 4.4.8. To keep full service and maintenance records in respect of the Services and Systems at the Property and to make them available to the Owner at any reasonable time on request
- 4.4.9. In relation to all repairs and other works carried out by the Occupier under this Lease to carry out and complete such works using a reputable contractor
- 4.4.10. Not to negate waive or render less effective or advantageous any guarantee warranty or other right or remedy which may for the time being apply to the Services and Systems or to the Property and whose terms have been notified to the Occupier
- 4.4.11. Nothing in this clause 4.4 shall oblige the Occupier to keep the Property in any better state of repair than at the date of this Lease as evidenced by the Schedule of Condition attached to this Lease save in relation to the Services and Systems at the Property which shall be upgraded in accordance with the provisions of a Licence for Alterations to be entered into between the parties hereto pursuant to a side letter of even date herewith

4.5. Decoration

- 4.5.1. As often as necessary but in any event in the last 3 months before the Determination of the Term to paint decorate and suitably treat the interior of the Property with good quality materials in a proper and workmanlike manner
- 4.5.2. As often as necessary but in any event in the last 3 months before the Determination of the Term to paint varnish and otherwise protect maintain decorate and suitably treat the exterior of the Property with good quality materials in a proper and workmanlike manner
- 4.5.3. In the last 3 months before the Determination of the Term the colours manner and details of all works undertaken pursuant to this clause 4.5 must be approved by the Owner (such approval not to be unreasonably withheld)
- 4.5.4. The Occupier shall not be required under this clause 4.5 to decorate or treat the Property more than once in any 12 month period
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4.6. Alterations

- 4.6.1. Not to increase the floor space in the Property
 - 4.6.2. Not to install or erect any satellite dish receiving aerial or other similar telecommunications apparatus in or on the Property without the prior consent of the Owner (not to be unreasonably withheld)
 - 4.6.3. Not to make any alterations which change the appearance finishes or external features of the Property and not to make any other alteration or addition to the Property save as permitted by a Licence for Alterations to be entered into between the parties hereto pursuant to a side letter of even date herewith unless permitted by clauses 4.6.4 or 4.6.5
 - 4.6.4. The Occupier may carry out internal non-structural alterations to the Property without the Owner's consent provided that:
 - (a) they do not affect the Services and Systems
 - (b) it has submitted full plans specifications and written details of the proposed alterations to the Owner before commencing them
 - 4.6.5. The Occupier may carry out internal non-structural alterations to the Property which affect the Services and Systems and may install or erect telecommunications apparatus in or on the Property provided that:
 - (a) it has obtained the Owner's consent (which shall not be unreasonably withheld)
 - (b) it has submitted full plans specifications and written details of the proposed alterations to the Owner and taken into account any reasonable requirements of the Owner
 - (c) it carries out all alterations to the Owner's reasonable satisfaction not to be unreasonably withheld in accordance with the approved plans and specifications
 - (d) (in the case of alterations which affect the Services and Systems to any material extent):
 - (i) they are in accordance with the terms conditions and quality standards laid down by the British Standards Institute and the Institute of Electrical and Electronics Engineers, Inc. current at the time
 - (ii) they are within the design criteria of the Services and Systems as provided to the Occupier and
 - (iii) the Owner's mechanical and electrical consultants have approved them such approval not to be unreasonably withheld or delayed
 - (e) (in the case of the installation or erection of any telecommunications apparatus):
 - (i) the apparatus is for the exclusive use of the Occupier or other authorised occupiers of the Property in connection with the business carried on from the Property
 - (ii) the apparatus is not subcontracted to or used in any way by a third party other than in the usual course of the Occupiers business
 - (iii) the installation of the apparatus does not adversely affect the health of the Occupier its employees or any other users of the Property or of any Other Land and
 - (iv) the installation of the apparatus does not adversely affect the value of the Owner's reversionary interest in the Property
 - 4.6.6. If the Occupier carries out any works at the Property to which the CDM Regulations apply:
 - (a) to make a declaration to the Health & Safety Executive under the CDM Regulations that the Occupier is the only "client" in respect of those works and to provide the Owner with a copy of the declaration and the acknowledgement of it from the Health & Safety Executive
 - (b) to comply with the CDM Regulations (including all requirements in relation to the provision and maintenance of a health and safety file)
 - (c) to supply all information to the Owner that the Owner reasonably requires from time to time in connection with the CDM Regulations and (if not already retained by the Owner in accordance with the CDM Regulations) to hand over the original health and safety file to the Owner at the Determination of the Term
 - (d) to procure that the Owner is granted free of charge and with full title guarantee a royalty-free irrevocable and non-exclusive licence to copy and use the content of the health and safety file for the works for any purpose connected with the Property and to ensure that such licence carries the right to grant sub-licences on similar terms and is transferable to third parties
 - (e) as soon as reasonably practicable after it becomes aware of any information relevant to health and safety in relation to the Property to provide that information to the Owner
 - 4.6.7. To remove any alterations or additions made or erected in breach of this clause 4.6 and/or to reinstate the Property to its former state and condition within such reasonable period as shall be specified in a notice given by the Owner of the breach (such notice to be without prejudice to the Owner's other rights and remedies which shall remain fully enforceable)
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4.7. Comply with Statute

- 4.7.1. Subject to the provisions of clause 6.16 to comply with the requirements of all statutes and all public or other competent bodies in respect of the Property its use and occupation the employment of personnel in it and any work carried out to it
- 4.7.2. To execute at the Occupier's expense all works (whether improvements or repairs) required to comply with any statute or otherwise required to be executed in or in respect of the Property by the Occupier as occupier
- 4.7.3. To indemnify the Owner against all Liability resulting from any requirement referred to in clause 4.7.1 or from the Occupier's failure to comply with such requirement
- 4.7.4. To refund to the Owner all Owner's Costs incurred in executing all works referred to in this clause 4.7 or in carrying out any works remedying any matter or complying with any requirement relating to the Property in compliance with a notice served by any local public or statutory authority or other competent person

4.8. Comply with Planning Acts

- 4.8.1. To comply with the Planning Acts and all planning permissions granted in relation to the Property
- 4.8.2. Not to make any application under the Planning Acts without the Owner's consent which shall not be unreasonably withheld
- 4.8.3. To supply the Owner with a copy of any application made or permission granted under the Planning Acts as soon as it is made or granted with copies of any plans or drawings relating to it and to keep the Owner informed of the progress of the application and its result
- 4.8.4. Not to implement any planning permission or carry out any development permitted under the Planning Acts without the Owner's consent which shall not be unreasonably withheld
- 4.8.5. To complete any works authorised under the Planning Acts before the Determination of the Term unless the Owner reasonably requires otherwise

4.9. Permit entry to inspect repair etc.

To permit the Owner at all reasonable times during office hours and on not less than 5 days prior written notice (or at any time without notice in emergency) to enter the Property:

- 4.9.1. in order to execute any works of repair maintenance renewal cleaning alteration or other works of or to any Other Land belonging to the Owner
- 4.9.2. to view the state and condition of the Property or its actual user
- 4.9.3. to take schedules or inventories of the fixtures and fittings in the Property
- 4.9.4. to view the Property for re-letting purposes or for the purposes of disposing of the Owner's reversionary interest in the Property
- 4.9.5. for any other necessary or reasonable purpose

provided that any damage caused to the Property or articles plant or equipment thereon is made good as soon as reasonably practicable and that neither the Owner nor anyone else so entering is liable for any disturbance inconvenience loss of business or other Liability to the Occupier resulting from the entry or carrying out of any works or other things unless caused by negligence on the part of the Owner or person so entering

4.10. Rights of entry to remedy breach

- 4.10.1. Within three months (or such lesser period as the Owner may reasonably specify) of service of notice by the Owner to the Occupier of any repairs required to be carried out at the Property to commence to carry out those repairs in accordance with the Occupier's Covenants and thereafter diligently proceed with the same
- 4.10.2. If the Occupier fails to comply with the requirements of any notice referred to in clause 4.10.1 or defaults in the performance of any of the Occupier's Covenants the Owner (without prejudice to its general right of re-entry) may enter the Property on not less than 48 hours prior written notice to execute whatever works are necessary to comply with the relevant notice or the Occupier's Covenants
- 4.10.3. If the Owner enters the Property and carries out any works to pay the Owner's Costs of and incidental to the works on demand with interest at the Prescribed Rate (both before and after any judgment) accruing on a daily basis from the date of demand up to and including the date of actual payment and those costs shall be recoverable as a contractual debt due from the Occupier to the Owner
- 4.10.4. Neither the Owner nor anyone else entering the Property pursuant to this clause 4.10 shall be liable for any disturbance inconvenience loss of business or other Liability to the Occupier resulting from the entry or the carrying out of any works or other things referred to in this clause 4.10 unless caused by negligence on the part of the Owner or the person entering the Property

4.11. Restrictions on lighting sound overloading etc.

- 4.11.1. Not to place any loudspeaker or other productive or reproductive sound device outside the Property and not to play any music or produce or reproduce any sound inside the Property so as to be audible outside the Property
- 4.11.2. Not to install or erect any exterior lighting shade or awning at or outside the Property
- 4.11.3. Not to display any flashing lights in the Property that can be seen from outside the Property
- 4.11.4. Not to display any other lighting arrangement that can be seen from outside the Property if the Owner reasonably considers such lighting arrangement to be undesirable and gives notice to the Occupier to that effect
- 4.11.5. Not to do or bring anything in or upon the Property which may impose strain or put any weight on the floors walls or ceilings of the Property in excess of that which they are calculated to bear (allowing due margin for safety)
- 4.11.6. Not to overload the Services and Systems
- 4.11.7. Not to install any machinery boiler or engine of any kind in the Property except that the Occupier may install normal machinery reasonably necessary for the carrying on of the Occupier's business (with the Owner's consent which shall not be unreasonably withheld) but the Occupier must first carry out any works required to strengthen the Property so that such machinery may be installed and operated without causing damage to the structure of the Property
- 4.11.8. Not to use any telecommunications media or systems in the Property other than for the exclusive use of the Occupier or other authorised occupier of the Property in connection with the business carried on from the Property
- 4.11.9. Not to bring or store any combustible or inflammable substance onto in or upon the Property other than substances normally used for cooking within the kitchens on the Property or for barbecue purposes

Provided Always that the Occupier shall be permitted to install its own electricity check meters without the need for the Owners consent

4.12. User

- 4.12.1. Not to use or occupy the Property other than for the Permitted Use or for such other purposes within Class B1 of the Town and Country Planning (Use Classes) Order 1987 as the Owner may approve in writing (such approval not to be unreasonably withheld)
- 4.12.2. Notwithstanding the Permitted Use not to use the Property for any use where it is open to members of the public visiting without a pre-arranged appointment
- 4.12.3. Not to use or occupy the Property:
 - (a) for any illegal or immoral purpose
 - (b) for any noisy offensive or dangerous trade or business
 - (c) in such a way as causes or is likely to cause damage or nuisance annoyance or disturbance to the Owner or to the owners or occupiers of any Other Land
 - (d) for any sale by auction
- 4.12.4. Not to permit any person to sleep or reside in the Property
- 4.12.5. Not without the Owner's prior written consent to bring into or keep in the Property any non-human living creature save for guide or hearing dogs in the control of visually or aurally impaired persons respectively

4.13. Signage

Not to place or display on the exterior of the Property or on the windows or inside the Property so as to be visible from outside the Property any name writing notice sign placard poster board display hoarding flagpole sticker or advertisement other than:

- 4.13.1. signs of a type size and design approved by the Owner (such approval not to be unreasonably withheld which shall include but not be limited to the manner of affixing such signage on external parts of the Property which shall exclude the cladding) showing the Occupier's name and business in conformity with the Occupier's national or corporate identity from time to time
- 4.13.2. notices which the Occupier is legally required to display

Provided always that the Occupier may subject (to the Owner's approval as to type size and location which shall not be unreasonably withheld) erect signage in the Common Parts which for the avoidance of doubt shall be in keeping with other Estate signage

4.14. Permit Owner to Affix Notices

To permit the Owner to fix and retain upon the outside of the Property a sign or notice (during the last 6 months of the Term) for relating the Property

4.15. Sharing occupation

Notwithstanding clause 4.16 the Occupier may at any time share occupation of the Property with a Group Company provided that:

- 4.15.1. the Occupier first gives notice to the Owner of the intended occupation with full details of it
 - 4.15.2. no relationship of Owner and Occupier is created
 - 4.15.3. the Property continues to give the appearance of a single business unit at all times and
 - 4.15.4. the right of the Group Company to share occupation terminates immediately the Group Company ceases to be a Group Company of the Occupier (in which case the Occupier must promptly give notice of that fact to the Owner)
-

4.16. Assignment and Underletting

- 4.16.1. Not to part with or share the possession or occupation of the whole or any part of the Property except as permitted by clause 4.15
 - 4.16.2. Not to assign mortgage charge or underlet part only of the Property except by way of an underletting of a Permitted Part
 - 4.16.3. Not to assign mortgage charge or underlet the whole of the Property or underlet a Permitted Part without:
 - (a) complying with the other provisions of this clause 4.16 and
 - (b) obtaining the Owner's consent (which shall not be unreasonably withheld)
 - 4.16.4. The Owner may for the purposes of section 19(1)(A) of the Landlord and Tenant Act 1927 impose the conditions set out in clause 4.16.5 as a condition of its consent to any assignment
 - 4.16.5. The conditions referred to in clause 4.16.4 are:
 - (a) that if at the date of the assignment the proposed assignee is resident or registered outside England and Wales it provides at its own cost a written opinion letter signed by lawyers practising in the jurisdiction in which the assignee is registered confirming that the proposed assignee has the appropriate powers and status to enter into the assignment and also confirming any other matters which the Owner may reasonably require
 - (b) that the proposed assignee's Net Profits for each of its 3 completed financial years of accounting immediately before the date of the application for consent to assign were at least 3 times the Rental Liability
 - 4.16.6. Nothing in this clause 4.16 shall prevent the Owner from giving consent to any assignment subject to any other reasonable condition (including requiring an Authorised Guarantee Agreement if reasonable to do so in circumstances other than those set out in clause 4.16.5(a)) nor from refusing consent to any assignment in any other circumstances if reasonable to do so
-

4.16.7. Not to underlet the whole or a Permitted Part of the Property:

- (a) at a fine or premium or reverse premium
 - (b) at a rent less than the open market rental value of the underlet premises at the time of underletting or any prior agreement for underletting
 - (c) at a rent which is commuted or is payable more than 3 months in advance
 - (d) unless the underlease is Excluded and the Occupier has supplied certified copies to the Owner of:
 - (i) the warning notice served by the Occupier on the proposed undertenant and undertenant's guarantor (if any)
 - (ii) the proposed undertenant's and undertenant's guarantor's (if any) declaration or statutory declaration (as appropriate)
 - (e) unless the undertenants Net Profits for the completed financial year of accounting immediately before the date of application for consent to underlet were at least 3 times the Rental Liability
 - (f) unless the underlease is in a form approved by the Owner and contains:
 - (i) in the case of an underlease of the whole of the Property an absolute prohibition against any assignment mortgage charge underletting or parting with or sharing the possession or occupation of the whole or any part of the Property other than an assignment or charge or underletting of the whole of the Property or an underletting of a Permitted Part with the Owner's consent (which may not be unreasonably withheld)
 - (ii) in the case of an underlease of a Permitted Part an absolute prohibition against any assignment mortgage charge underletting or parting with or sharing the possession or occupation of the whole or any part of the Permitted Part other than an assignment or charge of the whole of the Permitted Part with the Owner's consent (which may not be unreasonably withheld)
 - (iii) in the case of an underlease for a term of over 5 years provisions for the review of the underlease rent corresponding in time and substance with the provisions for the review of the Rent in this Lease
 - (iv) covenants rights and conditions which do not materially conflict with the terms of this Lease
 - (v) all the relevant terms of the underlease expressly stated within the body of the underlease or incorporated within the underlease by the physical annexation of a copy of this Lease to the underlease
 - (vi) in the case of an underlease of a Permitted Part due and proper provision for common access areas and provisions for recovery of service charge for management administration and services of common parts
 - (g) without first procuring that the proposed undertenant covenants direct with the Owner:
 - (i) in the case of an underlease of the whole of the Property not to assign mortgage charge underlet or part with or share the possession or occupation of the whole or any part of the Property other than by an assignment or charge or underletting of the whole of the Property or an underletting of a Permitted Part with the Owner's consent (which may not be unreasonably withheld)
 - (ii) in the case of an underlease of a Permitted Part not to assign mortgage charge underlet or part with or share the possession or occupation of the whole or any part of the Permitted Part other than by an assignment or charge of the whole of the Permitted Part with the Owner's consent (which may not be unreasonably withheld)
 - (iii) to observe and perform the covenants on the proposed undertenant's part in the underlease
 - (iv) (if applicable) to use all reasonable endeavours to procure the registration and/or noting of the underlease at the Land Registry as soon as practicable after completion of the underlease and to deal promptly and properly with any requisitions raised by the Land Registry in connection with any application for registration and/or noting and within 10 Working Days of completion of the registration and/or noting to provide evidence of it to the Owner's solicitors
-

4.16.8. In relation to any underlease granted:

- (a) to enforce the observance and performance by the undertenant of the undertenant's obligations contained in the underlease and not to release any of them
- (b) not to waive either expressly or by implication any breach of the undertenant's obligations
- (c) not to vary or waive the terms of the underlease without the Owner's consent (which may not be unreasonably withheld)

4.16.9. In respect of any review of rent payable under any underlease granted:

- (a) to ensure that such rent is reviewed in accordance with the provisions of the underlease
 - (b) to notify the Owner as soon as reasonably practicable of the outcome of any such review of rent
-

4.17. Register dealings and provide information

4.17.1. Within one month after:

- (a) any assignment underlease assignment or subletting of any underlease mortgage charge transfer disposition or devolution of the Property or a Permitted Part
- (b) the commencement of any sharing of occupation with a Group Company permitted by clause 4.15 (whether effected orally or in writing)

to give notice of such transaction in duplicate to the Owner's solicitors and to supply at the Occupier's expense 3 certified copies of the document or memorandum (if effected orally) evidencing the transaction and to pay to the Owner's solicitors a fee of £50 plus VAT for the registration of the transaction

4.17.2. In respect of every transaction referred to in clause 4.17.1 that is registrable at the Land Registry as soon as practicable after completion of the transaction to procure the registration and/or noting of the transaction at the Land Registry and to deal promptly and properly with any requisitions raised by the Land Registry in connection with any application for registration and/or noting and within 10 Working Days of completion of the registration and/or noting to provide evidence of it to the Owner's solicitors

4.17.3. Within one month of the conclusion of any review of rent payable under any underlease of the Property to serve on the Owner a certified copy of the memorandum signed on behalf of the undertenant recording the amount of the reviewed rent

4.17.4. To provide the following information immediately on receiving a request from the Owner:

- (a) full names and addresses of all legal entities in actual occupation of the Property
- (b) the precise part of the Property which those legal entities occupy
- (c) a certified copy of the document or (if none) a written memorandum of the agreement and parties to it under which each legal entity is or claims to be entitled to occupy the Property
- (d) full names and addresses of all legal entities entitled or claiming to be entitled to an interest in the Property (whether at law or in equity)
- (e) the precise part of the Property in which each legal entity is or claims to be entitled to an interest
- (f) a certified copy of the document or (if none) a written memorandum of the agreement and parties to it under which each party is or claims to be entitled to an interest in the Property

4.17.5. To ensure that the Owner and the local police force each have notice of the name home address and home telephone number of at least 2 keyholders of the Property at all times

4.17.6. To supply to the Owner a certified copy of any certificate or deed evidencing any change of name of the Occupier and/or Guarantor for the time being within 20 Working Days of such change of name taking effect

4.18. Pay Owner's Costs on breach of covenant

- 4.18.1. To pay within a reasonable period and indemnify the Owner against all Owner's Costs incurred in connection with or in reasonable contemplation of:
- (a) the preparation and service of a notice under sections 146 or 147 of the 1925 Act and/or any proceedings pursuant to such notice (whether or not forfeiture is avoided otherwise than by relief granted by a competent court)
 - (b) the preparation and the service of all notices and schedules and subsequent proceedings relating to wants of repair to the Property accruing during the Term
 - (c) the non-observance non-performance or breach by the Occupier of any of the provisions of this Lease
 - (d) remedying any breach of the Occupier's Covenants
 - (e) the recovery or attempted recovery of any of the Rents which are due and unpaid
 - (f) a notice under Section 17 of the 1995 Act
 - (g) obtaining any superior owner's or mortgagee's consent or approval arising from an application made by the Occupier under this Lease
- 4.18.2. To pay on demand and indemnify the Owner against all reasonable Owner's Costs in connection with any application made by the Occupier for consent or approval under this Lease whether the consent or approval is granted or refused or whether the application is withdrawn

4.19. No encroachment etc.

- 4.19.1. Not to stop up darken or obstruct any windows doors or openings in the Property
- 4.19.2. Not to permit any encroachment or easement to be made or acquired over or against the Property
- 4.19.3. If any encroachment or easement is or is attempted to be made or acquired to give immediate notice to the Owner as soon as the Occupier is aware of the same and (at the Owner's cost and request) take all proper and reasonable steps to prevent obstruct restrain or prohibit such encroachment or easement

4.20. No obstruction etc.

- 4.20.1. Not to cause the Common Parts to become untidy or dirty
- 4.20.2. Not to cause damage to or obstruct the Common Parts and in particular not to obstruct any roads footpaths or accessways leading to and from the entrance to the Property
- 4.20.3. To place all refuse and rubbish in the containers and receptacles from time to time designated for the purpose by the Owner
-

4.21. Comply with Regulations for the Estate

- 4.21.1. To observe and comply with any reasonable regulations made by the Owner from time to time and notified to the Occupier having as their object the safety promotion maintenance management and general amenity of the Estate
- 4.21.2. To comply with the requirements of the Occupier's Guide and where there is a conflict between the Occupier's Guide and this Lease the terms of this Lease shall apply

4.22. Give notice of damage

To give the Owner notice of any material damage to the Property immediately the Occupier becomes aware of it

4.23. Give notice of defects

To give notice to the Owner immediately the Occupier becomes aware of any defect in the state of the Property which would or might give rise to an obligation on the Owner to do or refrain from doing something in order to comply with the duty of care imposed on the Owner pursuant to the Defective Premises Act 1972

4.24. Give Owner details of notices

Immediately upon receipt to produce to the Owner a certified copy of any notice order permission or proposal affecting the Property and if required by the Owner but at the Owner's cost to join in making whatever objections or representations relating to it the Owner may reasonably require

4.25. Yield Up

At the Determination of the Term:

- 4.25.1. To yield up the Property with vacant possession and in compliance with the Occupier's Covenants
- 4.25.2. At the Occupier's expense to remove all occupier's fixtures and fittings and signs erected by the Occupier either during the Term or during any period of occupation under licence prior to the commencement of the Term and to make good all damage caused by the removal to the Owner's reasonable satisfaction
- 4.25.3. At the Occupier's expense (unless otherwise required by the Owner) to reinstate the Property to its state and condition prior to the carrying out of any works or alterations to the Property either during the Term or during any period of occupation by the Occupier or its predecessors in title prior to the commencement of the Term to the Owner's reasonable satisfaction

Provided always that the Occupier's liability in respect of any dilapidations payment to the Owner in connection with these obligations shall apply only to an amount in excess of £1,995,000

4.26. Indemnity against claims etc.

To indemnify the Owner against all Liability resulting from:

- 4.26.1. any injury to or the death of any person or damage to the Property or to any Other Land caused by the Occupiers failure to comply with its covenants relating to the state of repair or condition of or the use of or any alteration to the Property
 - 4.26.2. any interference or alleged interference with or obstruction by the Occupier of any right or alleged right of light air drainage or other right or alleged right benefiting the Property or any Other Land
 - 4.26.3. any blockage by the Occupier of the drains used in common with the owners or occupiers of any Other Land
 - 4.26.4. any breach of the Occupier's Covenants or any act or omission of the Occupier
-

4.27. Observe covenants etc.

To comply with all covenants and other matters set out or referred to in Part 2 of Schedule 3 so far as they relate to or affect the Property

4.28. Sustainability and EPC

To co-operate with the Owner in providing (but only at reasonable intervals) whatever information the Owner reasonably requires relating to the energy and water consumption and waste management statistics for the Property

4.29. Car Park obligations

- 4.29.1. Not to use the Car Parking Spaces other than for the parking of one private motor vehicle in each Car Parking Space
- 4.29.2. Not to wash or valet any vehicles or carry out any maintenance or repair works to any vehicles (other than essential repairs in emergency) in the Car Parking Spaces
- 4.29.3. Not to leave vehicle engines running for longer than is absolutely necessary to ensure arrival departure and correct parking in the Car Parking Spaces without unreasonable delay or noise
- 4.29.4. On 48 hours notice (or immediately if causing an obstruction) to remove from any Car Parking Space any broken-down or abandoned vehicle or any vehicle which is causing an obstruction

4.30. Replace Guarantor

- 4.30.1. Where a Guarantor has been provided to give notice to the Owner within 20 Working Days of the death of the Guarantor or of the Guarantor becoming bankrupt or having an administration order made against it or entering into liquidation or otherwise ceasing to exist
- 4.30.2. Within 20 Working Days of a request by the Owner to procure (at the Occupier's expense) that some other person acceptable to the Owner executes a deed of guarantee in the form set out in Part 1 of Schedule 5 (mutatis mutandis) with whatever amendments the Owner reasonably requires

4.31. Registration of this Lease

- 4.31.1. Promptly following the grant of this Lease to apply to register this Lease at the Land Registry and have it noted in the registers of any superior titles
- 4.31.2. To deal promptly and properly with any requisitions raised by the Land Registry in connection with that application
- 4.31.3. Within 10 Working Days after completion of the registration to send the Owner's solicitors official copies of the Occupier's registered title of this Lease and of any superior titles against which this Lease has been noted

4.32. Closure of Registered Title

- 4.32.1. Immediately on the Determination of the Term (and notwithstanding that the Term has ended) to apply to close the registered title of this Lease at the Land Registry and to remove any note of this Lease from the register(s) of any superior titles
- 4.32.2. To deal promptly and properly with any requisitions raised by the Land Registry in connection with that application
- 4.32.3. To keep the Owner informed of the progress and completion of that application

4.33. Exempt Information of Documents

- 4.33.1. Not to apply to the Land Registry to designate this Lease as an exempt information document
 - 4.33.2. Not to object to an application by the Owner to the Land Registry to designate this Lease as an exempt information document
 - 4.33.3. Not to apply for an official copy of any exempt information document version of this Lease
-

5. OWNER'S COVENANTS

Subject to the Occupier paying the Rents and observing and performing the Occupier's Covenants the Owner covenants with the Occupier (but not so as to impose any liability on the Owner after it has parted with the immediate reversion to this Lease):

5.1. Quiet enjoyment

To allow the Occupier peaceably to hold and enjoy the Property throughout the Term without any interruption by the Owner or by any person rightfully claiming under or in trust for the Owner

5.2. Insurance

To observe and perform its insurance obligations in Schedule 4

5.3. Provide Obligatory Services

Unless prevented by causes beyond the Owner's control which the Owner has used all reasonable endeavours to mitigate to use reasonable endeavours to provide the Obligatory Services and otherwise to observe and perform its obligations in Schedule 5

5.4. Generator

As soon as possible following the date hereof to procure a split of power from the existing generator in the Property so to provide power both to the Property and to the Multi-storey Car park and so that on completion of that split 1000KVA will be provided to the Property which generator shall be maintained by the Occupier and form part of the Property

5.5. Landscaping

5.5.1. Within 6 months of the date of this Lease to use all reasonable endeavours to fully landscape plant and thereafter properly maintain until (if appropriate) redevelopment thereof the land shown in the Landscaping Programme to the standard of the landscaped areas on the rest of the Estate

5.5.2. To carry out the works to the Estate which are set out as indicative only set out in the Landscaping Programme including the improvement of the appearance of the hoardings surrounding the plot labelled "C" on Plan 3 annexed hereto but so that the Owner shall not be obliged to follow the Landscaping Programme which shall be indicative of its intentions to landscape only

5.6. Enforce Warranties

Where the Owner has the benefit of any rights in respect of works carried out to the Estate (whether under a building contract consultants appointment or any collateral warranty or otherwise) to use all reasonable endeavours to enforce the same

5.7. Title Matters

To comply with the covenants restriction, obligations and other matters contained or referred to in the Property and Charges Registers of Title Numbers AGL55140, AGL60220 and AG30755 in so far as they affect or relate to the Estate

5.8. Multi-Storey Car Park

To carry out such works of cleaning, decoration and repairs to the lighting systems together with any other works which are required to put the Multi-Storey Car Park into a good state of repair and to allow it to function properly and safely as a car park in accordance with all health and safety and other statutory requirements.

6. PROVISOS AGREEMENTS AND DECLARATIONS

6.1. Forfeiture

6.1.1. The Owner may re-enter the Property at any time if:

- (a) the Rents or any other sums payable under this Lease are not paid within 20 Working Days after they become due (whether formally demanded or not)
- (b) the Occupier is in breach of the Occupier's Covenants
- (c) an Event of Insolvency (as defined in clause 6.1.2) occurs
- (d) any distress or execution is levied on the Occupier's goods at the Property

and this Lease will then terminate immediately but without prejudice to any accrued claim or right of the Owner against the Occupier or any Guarantor

6.1.2. "Event of Insolvency" means an event where the Occupier:

- (a) is unable to or has no reasonable prospect of being able to pay its debts
- (b) makes a proposal to enter or enters into any arrangement scheme compromise moratorium or composition with its creditors or any of them
- (c) calls (or a nominee calls on its behalf) a meeting of its creditors or any of them
- (d) has an interim receiver a receiver and/or a manager appointed in respect of all or any part of its property
- (e) (being an individual):
 - (i) makes an application to the Court for an interim order
 - (ii) is adjudged bankrupt in any jurisdiction
- (f) (being a corporation):
 - (i) has a notice of appointment of an administrator filed against it
 - (ii) resolves to give notice of an intention to appoint an administrator or an administrative receiver or receiver
 - (iii) passes a winding-up resolution (except in connection with a members' voluntary winding up for the purposes of an amalgamation or re-construction)
 - (iv) calls a meeting of its creditors to consider a resolution that it be wound up voluntarily
 - (v) resolves to present its own winding-up petition
 - (vi) is wound up
 - (vii) is dissolved or is removed from the Register of Companies or otherwise ceases to exist
 - (viii) is a corporation incorporated outside the United Kingdom and is the subject of proceedings or an event similar to or the same as those referred to above in the country of its incorporation

and in relation to the various Events of Insolvency they are wherever appropriate to be interpreted in accordance and conjunction with the relevant provisions of the Insolvency Act 1986 and the Enterprise Act 2002

6.2. Power for Owner to deal with Other Land

- 6.2.1. The Owner may deal as it thinks fit with any Other Land belonging to the Owner and may erect or permit to be erected any buildings on any Other Land irrespective of whether they affect or diminish the light or air which may now or at any time be enjoyed by the Occupier or the occupiers for the time being of the Property provided that such works do not otherwise adversely affect the Occupiers use and enjoyment of the Property or any rights granted by this Lease
- 6.2.2. The Occupier shall not be entitled to any rights of light or air or other easements or quasi-easements in respect of any property not demised by this Lease other than those granted (if any) in Schedule 2
- 6.2.3. Section 62 of the 1925 Act does not apply to this Lease

6.3. No Warranty as to Use

Nothing in this Lease or in any consent granted by the Owner under this Lease shall imply or warrant that the Property may lawfully be used under the Planning Acts for the Permitted Use (or for any other use subsequently authorised)

6.4. Exclusion of Owner's Liability

So far as may be permitted by statute the Owner shall not be responsible to the Occupier or anyone else for:

- 6.4.1. any accident or injury suffered by any person or any damage to or loss of any goods or property sustained on the Property arising from any works carried out or other things done by the Owner permitted or required by this Lease unless caused by negligence on the part of the Owner its employee's agents or persons under its control
- 6.4.2. impeding or temporarily obstructing any entrances doors or access routes giving access to the Property or the Car Parking Spaces provided that sufficient access is mentioned at all times
- 6.4.3. any loss or damage to or theft from or of any vehicle or other property in the Car Parking Spaces or damage or injury to any person using the Car Parking Spaces or for the prevention of access to and from the Car Parking Spaces caused by unauthorised use of the Car Parking Spaces unless caused by negligence on the part of the Owner its employees, agents or persons under its control

6.5. Acceptance of Rent is No Waiver

Notwithstanding the demand for or acceptance of the Rent or any of the Rents by or on behalf of the Owner with knowledge of a breach of any of the Occupier's Covenants the Owner's right to forfeit this Lease on the ground of such breach shall remain in force and the Occupier shall not be entitled in any proceedings for forfeiture to rely on any such demand or acceptance as a defence

6.6. Concessions for Due Dates for Payment

If the Owner allows the Occupier to defer payment of any money due under this Lease then for all purposes in connection with this Lease (and particularly in relation to Section 17 of the 1995 Act) that money shall be deemed to fall due on the later date allowed by the Owner instead of the earlier date when it originally fell due

6.7. Exclusion of Compensation

To the extent permitted by statute any right of the Occupier to claim compensation from the Owner (whether on vacating the Property or otherwise) is excluded

6.8. Removal of Goods after Determination of the Term

- 6.8.1. The Occupier irrevocably appoints the Owner as its agent to store or dispose of any goods left in the Property by the Occupier or other occupier of the Property which remain there more than 5 Working Days after the Determination of the Term
- 6.8.2. The Owner may store or dispose of those goods as it sees fit without liability to the Occupier but will account to the Occupier for any proceeds of sale of those goods after deducting the costs and expenses of removal storage and sale
- 6.8.3. The Occupier will indemnify the Owner against any Liability incurred to any third party whose goods have been sold by the Owner in the bona fide mistaken belief (which is presumed unless the contrary is proved) that those goods belonged to the Occupier and were liable to be dealt with as such under this clause 6.9.3

6.9. Understanding and Representations

- 6.9.1. This Lease embodies the entire agreement and understanding of the parties relating to the Property and to all the matters dealt with by any of the provisions of this Lease
- 6.9.2. The Occupier acknowledges that it has not entered into this Lease in reliance wholly or partly on any statement or representation made by or on behalf of the Owner other than statements which were not capable of being independently verified by search or enquiry or written statements made by the Owner's solicitors in correspondence with or in answer to preliminary enquiries raised by the Occupier's solicitors prior to the grant of this Lease
- 6.9.3. Nothing in clause 6.10.2 shall operate to limit or exclude any liability for fraud or deliberate misrepresentation

6.10. Notices

- 6.10.1. Any notice given under this Lease shall be in writing and signed by or on behalf of the party giving it
- 6.10.2. Section 196 of the 1925 Act (as amended by the Recorded Delivery Service Act 1962) shall apply to all notices required or permitted to be served under this Lease provided that:
 - (a) so long as the Owner is Hyde Park GP Limited and Hyde Park Nominee Limited then notices served on the Owner shall be addressed to and served upon the Company Secretary at LaSalle Investment Management, 33 Cavendish Square, P.O. Box 2326, London W1A 2NF or such other name and/or address and/or fax number notified to the Occupier in writing from time to time and
 - (b) so long as the Occupier is Rackspace Limited then notices served on the Occupier shall be addressed to and served upon the Company Secretary at the Property or such other name and/or address and/or fax number notified to the Owner in writing from time to time
- 6.10.3. Notice given under this Lease shall not be validly served if sent by e-mail or fax

6.11. Pay VAT

- 6.11.1. The Rents and any other sums payable by the Occupier to the Owner under the terms of this Lease are exclusive of VAT and the Occupier shall pay any VAT chargeable on them on the date they fall due
 - 6.11.2. The Occupier shall only be responsible for paying VAT on the Owner's Costs where the Owner is unable to recover the VAT under its usual accounting procedures
 - 6.11.3. The Occupier covenants with the Owner that the Property will not be occupied for any purpose which either alone or in conjunction with any other factors causes an election to waive exemption from VAT which the Owner has made or may make to be disapplied for VAT purposes
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6.12. Severance

If any provision of this Lease:

- 6.12.1. is rendered void by virtue of section 25 of the 1995 Act or is otherwise held to be void or unenforceable by any court of competent jurisdiction that provision shall be severed from all remaining provisions of this Lease and the remaining provisions shall be preserved
- 6.12.2. extends beyond the limits permitted by section 25 of the 1995 Act that provision shall be deemed to be varied so as not to extend beyond those limits

6.13. Arbitration

If any matter is referred to arbitration under this Lease then (whether or not specifically provided for):

- 6.13.1. the matter is to be conducted in accordance with the Arbitration Act 1996
- 6.13.2. the date of the arbitrator's award shall be the date on which the award signed by the arbitrator is notified in writing to the Owner
- 6.13.3. the arbitrator must give written reasons for his award together with the notification of the award

6.14. Governing Law and Jurisdiction

This Lease and any dispute or claim (including non-contractual disputes or claims) arising out of or in connection with it its subject matter or its formation shall be governed by and construed in accordance with the law of England and Wales and the parties irrevocably agree that the courts of England and Wales shall have exclusive jurisdiction to settle any such dispute or claim

6.15. Third Party Rights

No term of this Lease is intended to be enforceable under the Contracts (Rights of Third Parties) Act 1999 by any person who is not a party to it other than the successors in title to the Owner and the Occupier (but this shall not affect any right or remedy of a third party which exists or is available apart from under that Act)

6.16. Historic Contamination

- 6.16.1. Notwithstanding the Occupier's covenants in this Lease the Occupier shall not be liable pursuant to the terms of this Lease or otherwise in respect of any liability which arises directly or indirectly from the presence in on over or under the Property of Hazardous Substances or environmental damage ("Contamination") being Contamination which was present on or before the date of this Lease.
- 6.16.2. It is agreed that without prejudice to the generality of clause 6.16.1 the Occupier shall not be required by any of the Occupier's covenants contained in this Lease or otherwise to make good or rectify (or pay to make good or rectify) any defect or want or repair resulting from Contamination nor shall the Occupier be required to rectify remove treat or render harmless Contamination or rectify any damage or other adverse consequence directly or indirectly attributable to any Contamination.

7. RENT REVIEW

The Rent shall be reviewed in accordance with Schedule 7

This Lease is executed as a Deed by the parties to it and is delivered and takes effect on the date set out at the beginning of it

SCHEDULE 1
The Property

The premises known as HPH1 Hyde Park Hayes and shown edged red on Plan 1 the freehold title to which is registered at the Land Registry under title number AGL55140

SCHEDULE 2
Rights And Privileges Granted

1. The right (in common with all persons having the like right):
 - 1.1 to use the accessways within the Common Parts to gain access on foot to and from the Property and the Car Parking Spaces
 - 1.2 to pass and re-pass on foot and with vehicles over and along the vehicular access routes and pedestrian walkways from time to time within the Common Parts to gain access to and from the Property and the Car Parking Spaces
 2. The right (solely in connection with the Occupier's use and occupation of the Property and not in connection with the use or occupation of any other premises) to park 500 private motor vehicles in the Car Parking Spaces
 - 2.1 Provided always as follows:-
 - 2.1.1 28 Car Parking Spaces shall be available for use within the area of the Common Parts marked 2 on Plan 2; and
 - 2.1.2 472 of the Car Parking Spaces shall (until the land edged green on Plan 3 has been developed and a tenant or tenants are in occupation) shall be allocated by the Owner as Car Parking Spaces in the Multi Storey Car Park
 - 2.2 thereafter the number of Car Parking Spaces available to the Occupier in the Multi Storey Car Park shall be reduced to 432 and 40 Car Parking Spaces shall be available for use as designated by the Owner from time to time within the area of the Common Parts marked 1 on Plan 2
 - 2.3 the Occupier shall also have the right to park motorcycles in the designated area within the multi-storey car park set aside for motorcycles and to erect cycle racks for the parking of bicycles on some of the car parking spaces within the multi-storey car park within the Car Parking Spaces referred to in this paragraph 2
 3. The right (in common with all other persons having a like right) and only until such time as the land is redeveloped by the Owner to use as amenity land and for the purposes of recreation including the holding of barbecues in conjunction with its use of the Property the piazza area shown on the Landscape Programme Provided always that the Occupier shall comply with all relevant Estate regulations and shall leave the land clean and tidy and ensure no fires or damage is caused to the land and to make good all damage caused to the satisfaction of the Owner
 4. The right to use the roof of the Property as a roof terrace subject to the Occupier obtaining and complying with all requisite Planning Acts
 5. the free and uninterrupted passage and running of water, gas, soil, electricity, telephone and other utilities and services from and to the Property through and along Conduits that are now or may be laid from time to time during the Term in, over or under the Estate
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SCHEDULE 3
PART 1
Exceptions and Reservations

1. The right on the giving of reasonable prior written notice to enter upon the Property for all or any of the purposes mentioned in this Lease provided that the person exercising such right causes as little damage and inconvenience as possible and makes good all damage caused to the Property and to any articles plant or equipment therein as soon as reasonably practicable to the reasonable satisfaction of the Occupier
 2. The free and uninterrupted passage and running of water gas soil electricity telephone and other utilities and services from and to any Other Land (whether or not belonging to the Owner) through and along all Conduits that are now or may be laid from time to time during the Term in over or under the Property
 3. The right on the giving of reasonable prior notice to enter upon the Property where entry is necessary to construct or install in over or under it any Conduits for the benefit of any Other Land (whether or not belonging to the Owner) and to connect to and use those Conduits and inspect clean repair replace and renew them making good all damage caused to the Property as soon as reasonably practicable
 4. The right to withdraw or vary at the Owner's absolute discretion any of the rights listed in Schedule 2 or their routes so long as the Occupier's enjoyment and use of the Property are not materially impaired
 5. All rights of support and protection and all other easements or other rights in the nature of easements or quasi-easements now enjoyed or capable of being enjoyed by any Other Land
 6. The right to erect scaffolding clean decorate repair alter build on rebuild develop deal with and use any Other Land in such manner as is reasonable without materially affecting the amenity of the Property and without any liability to pay any compensation but subject to the person exercising such right making good all damage caused to the Property and to any articles plant or equipment therein as soon as reasonably practicable
 7. The right to tie into or to build or lay on or into any boundary or party walls of the Property whatever footings and foundations the Owner reasonably considers appropriate together with a right of support and protection for the same and for such purpose to excavate the Property along the said boundary or party wall provided that reasonable prior written notice is given of any proposed works and that the person exercising such right causes as little damage and inconvenience as possible and makes good all damage caused to the Property or to any articles plant or equipment therein as soon as reasonably practicable to the reasonable satisfaction of the Occupier
 8. Provided the amenity of the Property is not materially affected the right to regulate and control the use of the Common Parts and in particular (but without prejudice to the generality of the foregoing) to:-
 - (a) vary alter change the use of close or control access to the whole or any part thereof
 - (b) use the Common Parts for displays exhibitions or other forms of promotional activity and to maintain thereon such gardens features appurtenances and fittings or ornament or utility in all cases as the Owner from time to time shall think reasonably fit
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PART 2
Matters To Which The Demise Is Subject

All rights easements covenants restrictions and other matters referred to in the Property and Charges Registers of Title Number AGL55140 AGL60220 and AG30755 insofar as they affect or relate to the Property or the exercise of rights granted by this Lease

SCHEDULE 4
Insurance Provisions

1. Owner's Insurance covenants

1.1. The Owner covenants with the Occupier:

- 1.1.1. to insure the Estate against loss or damage by the Insured Risks with an insurer of repute on fair and reasonable terms that represent value for money in a sum reasonably determined by the Owner from time to time as representing the full reinstatement cost of the Estate (including the cost of site protection shoring up demolition site clearance and removal of debris statutory fees planning costs and professional and incidental fees expenses and VAT)
- 1.1.2. to insure for Loss of Rent and any other of the Rents as the Owner reasonably considers appropriate
- 1.1.3. if practicable (and subject always to paragraph 1.2 of this Schedule) to insure the Estate against damage arising from a terrorist act but not so that the Owner is under any continuing obligation to obtain insurance cover in respect of terrorism either at the best value or at all
- 1.1.4. to notify its insurers of the Occupier's interest in the Property and if practicable have it noted on the policies of insurance (whether generically or otherwise)
- 1.1.5. annually to provide the Occupier with a summary of the insurance cover for the Property and confirmation that the most recent premium has been paid
- 1.1.6. to notify the Occupier of any changes to the insurance cover for the Estate and to provide the Occupier with full details of the insurance policy upon reasonable request

1.2. The Owner's obligation to insure is subject to :

- 1.2.1. any excesses exclusions limitations and conditions that the Owner may agree with its insurers
- 1.2.2. insurance cover being ordinarily available in the London insurance market on reasonable terms acceptable to the Owner

1.3. The Owner is not obliged to insure against any fixtures and fittings installed by the Occupier until the Occupier has given notice of their reinstatement value to the Owner and the insurers have accepted the risk

1.4. The Owner may retain for its exclusive benefit any discount on the insurance premiums or commission paid or allowed to it by insurers but must disclose details of such discounts or commissions if reasonably requested by the Occupier

2. Occupier's Insurance covenants

The Occupier covenants with the Owner:

- 2.1. to pay the Insurance Rent within 10 Working Days after demand
 - 2.2. not to do or omit to do anything which:
 - 2.2.1. would make the insurance of the Estate wholly or partly void or voidable or would otherwise hinder the Owner from carrying out its insuring obligations under this Lease
 - 2.2.2. may cause an Insured Risk to become an Uninsured Risk
 - 2.3. not to do or omit to do anything which may cause the insurance premiums to be higher than the usual premiums or rate payable for premises of a similar nature and let on a similar basis as the Property and to reimburse the Owner on demand with the cost of any increased or additional premium payable as a result of any breach by the Occupier of this provision
 - 2.4. not to effect any insurance of the Property against any Insured Risk
 - 2.5. to take all reasonable precautions to prevent damage to the Property and the Estate by an Insured Risk or an Uninsured Risk
 - 2.6. to observe and comply with the requirements of the insurers relating to the Property and (where applicable) the Estate where made known to the Occupier
 - 2.7. if an excess in an insurance policy relating to the Property becomes applicable to pay to the Owner within 10 Working Days after demand the whole of the amount of the excess
 - 2.8. to give immediate notice to the Owner of any circumstances which may lead to or affect an insurance claim or which any insurer may treat as material in deciding whether or on what terms to insure or continue to insure the Property or the Estate
 - 2.9. if the Property is damaged by an Insured Risk and any insurance money is withheld due in whole or in part to an act or omission of the Occupier then immediately to pay to the Owner the whole or a fair and reasonable proportion (as the case may be) of the amount withheld
 - 2.10. to apply all money it receives from any insurance policy for the Property or for items in or attached to the Property in making good the relevant loss or damage
 - 2.11. to pay to the Owner within 10 Working Days after demand the cost of any insurance valuation of the Property
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3. To Reinstate

- 3.1. Subject to paragraph 3.2 the Owner covenants with the Occupier that if the Property is damaged by an Insured Risk the Owner will apply all insurance monies received (except in respect of Loss of Rent) in clearing the site and reinstating the Property (excluding the Occupier's fixtures and fittings where the insurers have not accepted the risk) to substantially as it was before the damage (subject to paragraph 3.3) and will make up any shortfall in the cost of reinstating the Property out of its own money (other than the amount of any excess which the Occupier is liable to pay to the Owner pursuant to paragraph 2.7 of this Schedule)
 - 3.2. The Owner's obligation to reinstate does not apply if:
 - 3.2.1. the necessary labour and materials are not readily available
 - 3.2.2. after using its reasonable endeavours the Owner is unable to obtain any necessary planning or other consents required to rebuild or reinstate the Property
 - 3.2.3. the Occupier has not paid the Insurance Rent
 - 3.2.4. any insurance money is withheld because of an act or omission of the Occupier and the Occupier has not paid an equivalent sum to the Owner
 - 3.2.5. a Termination Notice is served pursuant to paragraph 6 of this Schedule
 - 3.3. In reinstating the Property the Owner:
 - 3.3.1. shall not be obliged to provide accommodation identical in layout if it would not be sensibly practical to do so provided that any reinstated property shall be where possible of no less amenity
 - 3.3.2. may do so to modern standards of design and construction practice using methods and materials in accordance with any reasonable and proper principles contained in any reasonable policy it may have relating to responsible property investment
 - 3.3.3. may install whatever Services and Systems it considers appropriate having regard to any reasonable and proper principles contained in any reasonable policy it may have relating to responsible property investment
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4. Rent Suspension

4.1. If:

- 4.1.1. the Property is damaged by an Insured Risk or an Uninsured Risk and
- 4.1.2. as a result the whole or a substantial part of the Property is unfit for occupation and use and
- 4.1.3. (in the case of damage by an Insured Risk) no insurance money is withheld due to an act or omission of the Occupier or
- 4.1.4. (in the case of damage by an Uninsured Risk) the damage was not caused by an act or omission of the Occupier (including an act or omission which caused a previously Insured Risk to become an Uninsured Risk)

then the Rent and the Service Charge (or an appropriate proportion according to the nature and extent of the damage) will be suspended until the Property is fit for occupation and use again by the Occupier and ready to receive the Occupier's fitting-out works or (if earlier) until the date the Loss of Rent insurance expires (or in the case of damage by an Uninsured Risk would have expired had the damage been caused by an Insured Risk)

- 4.2. Any dispute as to the amount of the Rent and the Service Charge suspended or the period of suspension may be referred by either the Owner or the Occupier to arbitration

5. Damage by Uninsured Risks

- 5.1. If the Property is damaged by an Uninsured Risk so that the whole or a substantial part of the Property is unfit for occupation and use the Owner may serve on the Occupier either a Reinstatement Election Notice during the Reinstatement Election Period or a Termination Notice at any time before commencing the reinstatement works

5.2. If the Owner serves a Reinstatement Election Notice:

- 5.2.1. it must reinstate the Property at its own cost unless the damage to the Property was caused by an act or omission of the Occupier (including an act or omission which caused a previously Insured Risk to become an Uninsured Risk) in which case the Occupier may pay to the Owner the whole of the cost of reinstatement
- 5.2.2. in all other respects paragraph 3 of this Schedule will apply to the reinstatement of the Property as it would have applied had the Property been damaged by an Insured Risk

- 5.3. If the Owner does not serve a Reinstatement Election Notice during the Reinstatement Election Period the Occupier may within 3 months after the end of the Reinstatement Election Period serve a Termination Notice on the Owner
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6. Termination provisions

6.1. If the Property is damaged by an Insured Risk or an Uninsured Risk and has not been reinstated so as to be fit for occupation and use by the Occupier and ready to receive the Occupier's fitting-out works by the expiry of a period of 24 months or the date the Loss of Rent insurance expires if earlier (or in the case of damage by an Uninsured Risk would have expired had the damage been caused by an Insured Risk) then either party may terminate this Lease by serving a Termination Notice on the other at any time after that date but the Occupier may not serve a Termination Notice:

6.1.1. unless the Property is still unfit for occupation and use by the Occupier at the date of the Termination Notice

6.1.2. more than 6 months after the date the Loss of Rent insurance expires (or in the case of damage by an Uninsured Risk would have expired had the damage been caused by an Insured Risk)

6.1.3. if:

(a) (in the case of damage by an Insured Risk) any insurance money is withheld due to an act or omission of the Occupier or

(b) (in the case of damage by an Uninsured Risk) the damage was caused due to an act or omission of the Occupier (including an act or omission which caused a previously Insured Risk to become an Uninsured Risk)

Unless the Occupier pays an equivalent sum to the amount withheld to the Owner

6.2. If a Termination Notice is served:

6.2.1. this Lease will end immediately (unless paragraph 6.3 applies) but without prejudice to any right of action of either party in respect of any previous breach of this Lease by the other and

6.2.2. the Owner shall be entitled to all insurance money absolutely

6.3. If the Owner serves a Termination Notice and the Occupier either seeks to assert security of tenure under the 1954 Act or any other rights of security or on receipt of written request from the Owner fails to give written confirmation that it does not intend to assert security of tenure or other rights then

6.3.1. the Owner will be under no obligation to reinstate the Property and

6.3.2. paragraph 4 of this Schedule shall not apply and the Occupier shall continue to be liable to pay the Rent throughout the Term notwithstanding the damage to the Property

7. Time of the Essence

Time will be of the essence in respect of the service of any notice under this Schedule

8. Warranty re Convictions

The Occupier warrants that before the date of this Lease it has disclosed to the Owner full details of any conviction judgment or finding of any court or tribunal relating to the Occupier or any of its directors or other officers or major shareholders which might reasonably affect the decision of any underwriter or insurer to grant or continue insurance of the Property

SCHEDULE 5
Service Charge
PART 1
Service Charge Provisions

1. Definitions

In this Schedule the following expressions have the following meanings:

- 1.1. "Discretionary Services" means the items listed in Part 3 of this Schedule
- 1.2. "Estimate" means the Occupier's Proportion of the Owner's reasonable estimate of the Service Expenses to be incurred or paid during any Service Year
- 1.3. "Obligatory Services" means the items listed in Part 2 of this Schedule
- 1.4. "the Occupier's Proportion" means such fair and reasonable proportion as the Owner may attribute to the Property during any Service Year (subject always to paragraph 4 of this Schedule and so that the proportions determined for the Property and the Other Lettable Areas (whether or not let) shall together amount to 100% at all times)
- 1.5. "Service Charge" means the Occupier's Proportion of the Service Expenses in any Service Year calculated in accordance with and subject to the provisions of this Schedule
- 1.6. "Service Expenses" means the total of all reasonable costs charges commissions premiums fees interest expenses and taxes (including VAT) properly incurred or payable by the Owner in respect of and incidental to the provision of the Services in or in relation to any Service Year
- 1.7. "Service Year" means the period of 12 calendar months ending on 1 March in each year or on such other date as the Owner may from time to time notify to the Occupier
- 1.8. "Services" means both the Obligatory Services and the Discretionary Services
- 1.9. "Statement" means a statement of account certified by the Owner or its appointed managing agents (or by the Owner's auditors if the Owner so chooses) as being an accurate summary of the Service Expenses and the Service Charge payable for that Service Year and showing any sums due as a result

2. Service Charge payments

The Occupier will pay the Service Charge to the Owner at the times and in the manner set out below:

- 2.1. On or as soon as practicable after the Term commencement date the Owner will notify the Occupier of the amount of the Estimate for the Service Year in which the Term commencement date falls
 - 2.2. The Occupier's first payment of the Service Charge shall be in respect of the period from and including the Term commencement date until and including the day before the Quarter Day next following the date of this Lease (apportioned on a daily basis) and is payable within 10 Working Days of demand
 - 2.3. Thereafter the Occupier will pay the Estimate by equal quarterly instalments in advance on the Quarter Days (or an appropriate apportionment for any period less than a quarter calculated on a daily basis)
 - 2.4. On or about the end of each Service Year the Owner will notify the Occupier of the amount of the Estimate for the next Service Year and until then the Occupier is to continue to pay the Service Charge at the rate of the Estimate for the previous Service Year
 - 2.5. Once the notification of the Estimate for the next Service Year is given the remaining payments of the Estimate and any VAT on them will be adjusted to provide for payment of the whole Estimate for the Service Year to be paid during that Service Year
 - 2.6. If once the Estimate for any Service Year has been notified the Owner subsequently anticipates incurring expenditure (whether exceptional or not) which is likely in its reasonable opinion to mean the Estimate will not then be sufficient the Owner may on reasonable notice revise the Estimate and the remaining instalments of the Estimate will be adjusted so that the full amount of the revised Estimate will have been paid by the end of the relevant Service Year
 - 2.7. The Owner may revise the Estimate as many times as necessary in any Service Year
 - 2.8. The Owner may require the Estimate to be paid by direct debit or automated credit
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3. Service Charge accounts and balancing charge

- 3.1. As soon as practicable after the end of each Service Year the Owner will submit the Statement to the Occupier
- 3.2. The Statement is conclusive and binding on the Occupier except in the case of manifest error
- 3.3. If the Service Charge in the Statement is more than the Estimate actually paid by the Occupier during the Service Year the Occupier must pay the difference to the Owner within 10 Working Days of receipt of the Statement
- 3.4. If the Service Charge in the Statement is less than the Estimate actually paid by the Occupier during the Service Year the Owner will:
 - 3.4.1. allocate the difference by crediting it against future payments of the Estimate due from the Occupier and
 - 3.4.2. credit any further unallocated difference against any sums due from the Occupier to the Owner at the Determination of the Term and
 - 3.4.3. repay any further unallocated difference to the Occupier at the Determination of the Term
- 3.5. The provisions of this Schedule will continue to apply after the Determination of the Term in respect of any Service Year then current
- 3.6. The Occupier may within 6 months after the issue of a Statement give notice to the Owner that it wishes to inspect the vouchers and receipts relating to the Service Charge in which case the Owner shall arrange for the Occupier to do so at a location and time designated by the Owner (acting reasonably)

4. Adjustment of Occupier's Proportion

- 4.1. The Occupier's Proportion may not be increased or adjusted as a result of any Other Lettable Areas being vacant or occupied by the Owner or because any occupier of any Other Lettable Area defaults in paying his proportion of the Service Expenses
- 4.2. If the Estate or the properties having rights over the Common Parts are extended added to or altered in any other substantial manner or if it is otherwise reasonable to do so the Owner may recalculate the Occupier's Proportion on a fair and reasonable basis (but so that the proportions determined for the Property and the Other Lettable Areas shall together amount to 100% at all times) and the amended Occupier's Proportion will take effect from the date on which the Occupier receives notice of the recalculation

5. Service Charge Arrangements

- 5.1. The Owner may (but is not obliged to) provide all or any of the Discretionary Services as it sees fit
 - 5.2. In providing the Services and managing the Service Charge arrangements the Owner shall at all times:
 - 5.2.1. act in good faith and except where there are sound reasons for implementing alternative procedures that can be justified and explained the Owner shall have reasonable regard to the provisions and recommendations of the RICS Code of Practice for Service Charges in Commercial Property
 - 5.2.2. ensure that the Services are provided in a commercial and professional manner and that the quality and cost of the Services are regularly reviewed (and so far as practicable in accordance with the Owner's then current policy relating to responsible property investment)
 - 5.2.3. deal promptly and efficiently with any reasonable enquiry made by the Occupier relating to the Service Charge or any of the Services
 - 5.2.4. consult and communicate with the Occupier and keep the Occupier reasonably informed regarding the provision of the Services and the administration of the Service Charge
 - 5.3. The Owner may in its reasonable discretion acting in the interests of good estate management add to or withhold or vary any Services at any time so long as the Occupier's enjoyment and use of the Property are not materially impaired
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- 5.4. The Owner is not liable to the Occupier or anyone else if it fails to provide any of the Services in any of the following circumstances:
- 5.4.1. while it inspects maintains repairs or renews any of the Conduits or Services and Systems or carries out works to the Estate (which the Owner may do at any time)
 - 5.4.2. there is an unforeseen shortage of fuel water materials or labour
 - 5.4.3. there is a breakdown failure stoppage leaking bursting or defect in any of the Conduits the Services and Systems the utilities or other installations serving the Estate or in the supply of gas water electricity or lighting of the Common Parts
 - 5.4.4. there is an omission or failure by any employee contractor or agent of the Owner (save in cases of negligence)
 - 5.4.5. where damage occurs to the Estate due to an Insured Risk or an Uninsured Risk
 - 5.4.6. where it is prevented from doing so by statute
 - 5.4.7. in any circumstance which is beyond its reasonable control

Provided that the Owner shall have due regard to the Occupier's use and enjoyment of the Premises and shall use all reasonable endeavours to reinstate the Services as soon as reasonably practicable

- 5.5. If any of the events in paragraph 5.4 occurs, the Owner will use all reasonable endeavours to restore the relevant Service as soon as reasonably practicable after becoming aware of the event
- 5.6. This Schedule does not impose any obligation on the Owner to make good any damage to the Building or the Estate caused by an Insured Risk or by an Uninsured Risk
- 5.7. If the Owner carries out major works of repair maintenance and decoration or replaces major items of plant or machinery it may:
- 5.7.1. apportion the relevant expenditure over more than one Service Year and
 - 5.7.2. include in the Service Expenses interest at Base Rate on the part of the expenditure to be recovered in later Service Years
- 5.8. If the Owner recovers money in any court proceedings against or by way of settlement of any dispute with a third party employed in the construction refurbishment and/or repair of the Estate or for the remedy of a defect or otherwise or to establish preserve or defend any rights amenities or facilities used or enjoyed by any occupiers of any Other Lettable Areas where that money represents expenditure which has been or would otherwise be included in the Service Expenses the Owner will set off or credit that money against the Service Expenses accordingly
- 5.9. The Owner is not concerned with the administration of or accounting for the Service Charge on an assignment of this Lease and accordingly the Owner:
- 5.9.1. is not required to make any apportionment on such an assignment
 - 5.9.2. may deal exclusively with the Occupier in whom this Lease is for the time being vested (and for this purpose an assignment not registered under clause 4.17 is disregarded)
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6. Other provisions

- 6.1. Except where expressly stated in paragraph 6.6 of this Schedule all expenditure incurred by or on behalf of the Owner in the proper and appropriate provision of services and amenities to the Estate for the benefit of the occupiers thereof (including any fees and administrative costs in connection with the provision of those services and amenities) is intended to be included as part of the Service Expenses so that even if a Service is not expressly listed in Part 2 or Part 3 of this Schedule the Occupier acknowledges that so long as the Owner has properly incurred expenditure in providing that Service (and the Service in question is for the benefit of the Estate as a whole) the Occupier's Proportion of that expenditure is recoverable under this Lease
 - 6.2. The Occupier shall co-operate with the Owner and shall respond promptly and efficiently to any reasonable enquiry made by the Owner to enable the Owner to manage the Estate and administer the Service Charge in accordance with this Schedule
 - 6.3. The Occupier shall be proactive in assisting the Owner with operating and using the Services on a value for money and quality standard basis including complying with whatever procedures the Owner reasonably requires to implement the Owner's then current policy on responsible property investment in relation to the Estate
 - 6.4. The Occupier shall not be entitled to object to any item comprised in the Service Expenses by reason that:
 - 6.4.1. the materials work or service in question might have been provided or performed at a lower cost or
 - 6.4.2. the item may or does benefit one or more other occupiers on the Estate more than it benefits the Occupier or
 - 6.4.3. the Property may not have been open for business throughout the times when the Estate has been open or
 - 6.4.4. the Owner has omitted to include any sum or liability incurred in any Service Year during the Term in the Statement or Estimate for that Service Year and has therefore charged for such sum or liability in a subsequent Service Year during the Term or in the immediately subsequent year thereafter
 - 6.5. The Service Expenses shall expressly exclude those costs:
 - 6.5.1. incurred initially by the Owner in relation to the original design and construction of the Estate and any buildings on the Estate or the Services and Systems or other set-up costs reasonably considered to be part of the original development cost of the Estate and the original provision of plant and equipment initially required for the provision of the Services
 - 6.5.2. which are matters between the Owner and an individual occupier including those relating to:
 - (a) the enforcement of covenants to pay rent or any other proceedings against any occupier of any Other Lettable Area
 - (b) the marketing letting or re-letting of any Other Lettable Areas (including any inducements offered or paid in connection with such letting)
 - (c) any consents required under leases of any Other Lettable Areas
 - (d) the review of rents for any Other Lettable Areas
 - (e) any other matter for which the Occupier or an occupier of any Other Lettable Area is exclusively responsible under the terms of their respective leases or under statute
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- 6.5.3. incurred as a result of damage to the Estate caused by an Insured Risk or an Uninsured Risk or the subsequent reinstatement of the Estate (except where the insurance policy has been vitiated or any insurance money is withheld due solely or in part to an act or omission of the Occupier or the damage was caused by an act or omission of the Occupier (including an act or omission which caused a previously Insured Risk to become an Uninsured Risk))
 - 6.5.4. relating to the replacement of any item except where that item is beyond economic repair or where the enhancement achieved by the replacement can be justified for the purposes of good estate management following an analysis of reasonable options and alternatives (in which case the Owner will provide the Occupier with reasonable evidence justifying the cost if requested)
 - 6.5.5. relating to the provision and use of car parking spaces in the Multi-Storey Car Park save for any damage caused to the Multi-Storey Car Park which will be
 - 6.5.5.1 100% recoverable from the Occupier under the Service Charge while the Occupier is the sole user of the Multi-Storey Car Park; and
 - 6.5.5.2 from such time as the Multi-Storey Car Park is used by another party or parties the cost of any such damage identified will be calculated pro rata amongst all the users of the Multi-Storey Car Park
 - 6.5.6. the remedy or removal of any Contamination to the Estate
 - 6.5.7. relating to the improvement of any item (where the cost exceeds the costs of normal maintenance repair or replacement) except where the improvement will provide the Occupier and/or any occupiers of Other Lettable Areas with a direct or discernible benefit or where the cost can otherwise be justified for the purposes of good estate management following an analysis of reasonable options and alternatives (in which case the Owner will provide the Occupier with reasonable evidence justifying the cost if requested)
 - 6.5.8. which are recovered from third parties whether pursuant to an insurance policy, guarantee, warranty or otherwise and which will be paid towards the Service Expenses
- 6.6. The Service Expenses may include:
- 6.6.1. the cost of fuel used in the provision of any of the Services
 - 6.6.2. provision for whatever expenditure the Owner (acting reasonably) considers fair and proper for the Occupier to contribute towards in any subsequent Service Year during the Term
 - 6.6.3. (where the Owner does not appoint external managing agents to manage the Estate and administer the Service Charge) a fair and reasonable fee for the management of the Estate and administration of the Service Charge by the Owner in each Service Year
- 6.7. Service Expenses for a Service Year in which the Term commencement date falls may include costs incurred by the Owner before that date but during that Service Year
- 6.8. If at the Determination of the Term the Occupier has paid money in respect of the Service Charge which has not by then been expended the Occupier is not entitled to any repayment of it save as provided under paragraph 3.4.3 of this Schedule
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PART 2
The Obligatory Services

1. Providing operating cleaning draining emptying maintaining testing repairing modifying renewing or replacing:
 - 1.1 the Services and Systems
 - 1.2 those Conduits which do not serve either the Property exclusively or one only of the Other Lettable Areas exclusively
 2. Providing reasonable lighting in the Common Parts
 3. Painting decorating washing and cleaning the Common Parts
 4. Discharging all payments of the kinds mentioned in clause 4.3 of this Lease relating to any parts of the Estate not let or intended to be let to other occupiers
 5. Discharging any sums the Owner is required to pay as contributions towards the expense of making repairing maintaining rebuilding and cleaning all accessways roads pavements sewers drains pipes watercourses party walls party structures party fences or other amenities which may belong to or be used for the Property in common with Other Land or neighbouring premises
 6. Complying with the provisions of any statute or the requirements of the insurers which apply to the use occupation and enjoyment of the Estate
 7. Providing operating cleaning decorating lighting maintaining testing repairing modifying renewing or replacing any parts of the Estate occupied or used by or on behalf of the Owner whether as control rooms storage areas or otherwise in connection with the management or administration of the Estate or the provision of the Services or security to it
 8. Providing maintaining repairing renewing and replacing all entrance and exit and traffic control barriers and equipment and notice boards notices signs and directions at the entrances to and exits from the Building and in the Common Parts
 9. Providing maintaining repairing renewing and replacing all seating ornamental features statuary and other decorative items and decorative lighting and flood-lighting and all furnishings decorations bins receptacles refuse-compactors tools appliances apparatus and other similar equipment and materials in the Common Parts
 10. Laying out planting re-planting landscaping and maintaining such landscaping in the Common Parts and keeping all Common Parts of the Estate in a neat and tidy condition
 11. Providing refuse facilities and refuse collection and disposal services at the Estate
 12. The administration and management of the Estate including making and enforcing regulations in respect of the Estate and performing the Owner's obligations in this Lease in relation to the Estate
 13. Taking all proper and reasonable steps in complying with making representations against or otherwise contesting or dealing with every notice regulation or order of any competent local or other authority in relation to the Estate
 14. Complying with the provisions of any statute or the requirements of the insurers which apply to the use occupation and enjoyment of the Estate
 15. Providing 24 hour security to the Estate
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PART 3
The Discretionary Services

1. Employing or obtaining or retaining the services of such persons as the Owner considers necessary or desirable for any purpose in connection with any of the Services including providing accommodation for them (on such terms as the Owner may reasonably determine)
 2. Borrowing money at normal commercial rates in order to pay the costs of performing any of the Services
 3. Instructing solicitors accountants surveyors valuers or other professional advisers in respect of the provision of the Services including obtaining insurance valuations and preparing and auditing the Statement (and in respect of which the Owner may make a reasonable charge for performing all or any such functions itself rather than employing a third party to do so)
 4. Employing external managing agents to manage the Estate and administer the Service Charge
 5. Carrying out any other work or doing any other thing or providing any other services or facilities which the Owner reasonably considers necessary or desirable for the purpose of maintaining the Estate or its amenities or for the benefit of the Estate and its occupiers
-

SCHEDULE 6
PART 1
Guarantor Covenants and Guarantee

1. In this Part 1 of this Schedule a "Relevant Event" means any of the following:
 - 1.1 the Occupier's liability under this Lease is disclaimed
 - 1.2 this Lease is forfeited
 - 1.3 the Occupier ceases to exist
 2. The Guarantor covenants with and guarantees to the Owner:
 - 2.1 that the Occupier will throughout the Term (or (if earlier) until the Occupier is released from the Occupier's Covenants pursuant to the 1995 Act) punctually pay the Rents and will observe and perform the Occupier's Covenants and if the Occupier defaults in paying the Rents or in observing and performing the Occupier's Covenants the Guarantor will pay the Rents and will observe and perform the covenants in respect of which the Occupier is in default and
 - 2.2 (so far as may be permitted by the 1995 Act) that throughout any period during which the Occupier is liable under any Authorised Guarantee Agreement the Occupier will observe and perform the obligations on the part of the Occupier contained in the Authorised Guarantee Agreement and if the Occupier defaults in observing and performing those obligations the Guarantor will observe and perform the obligations in respect of which the Occupier is in default
 3. The Guarantor covenants with the Owner as a separate and independent primary obligation to indemnify the Owner on demand against the Owner's Costs and all other Liability resulting from any failure by the Occupier:
 - 3.1 to pay any of the Rents or to observe or perform any of the Occupier's Covenants and
 - 3.2 to observe and perform the obligations on the part of the Occupier under any Authorised Guarantee Agreement
 4. The Guarantor covenants with the Owner to guarantee the payment of the rents and the observance and performance by the Occupier of the covenants and other obligations on the part of the Occupier under any lease entered into by the Occupier pursuant to any Authorised Guarantee Agreement
-

5. None of the following or any combination of the following shall release discharge impair or in any way lessen or affect the liability of the Guarantor under this Lease:
- 5.1 any time or indulgence granted by the Owner to the Occupier or any other party
 - 5.2 any delay or forbearance of the Owner in obtaining payment of the Rents or in enforcing the observance or performance of the Occupier's Covenants or the Occupier's obligations under any Authorised Guarantee Agreement or in making any demand in respect of them
 - 5.3 any refusal by the Owner to accept the Rent tendered by or on behalf of the Occupier during a period in which the Owner is entitled or would after service of a notice under section 146 of the 1925 Act be entitled to re-enter the Property
 - 5.4 the Owner exercising any right or remedy against the Occupier for any failure to pay the Rents or to observe or perform the Occupier's Covenants or the Occupier's obligations under any Authorised Guarantee Agreement
 - 5.5 the Owner taking any action or refraining from taking any action in connection with any other security held by the Owner in respect of the Occupier's liability to pay the Rents and observe and perform the Occupier's Covenants or the Occupier's obligations under any Authorised Guarantee Agreement (including the release of any such security)
 - 5.6 (if the Guarantor comprises more than one party) a release or compromise of the liability of any one of the persons who is the Guarantor or the grant of time or concession to any one of them
 - 5.7 any surrender of part of the Property (in which case the liability of the Guarantor shall continue in respect of the part of the Property not so surrendered after making any necessary apportionments under Section 140 of the 1925 Act)
 - 5.8 subject to section 18 of the 1995 Act (so far as it applies) any variation by agreement between the Owner and the Occupier of any of the terms of this Lease or of any of the Occupier's obligations under any Authorised Guarantee Agreement whether or not:
 - 5.8.1 the variation is material or prejudicial to the Guarantor
 - 5.8.2 the variation is made in any document
 - 5.8.3 the Guarantor has consented in writing or otherwise to the variation
 - 5.9 any legal limitation immunity disability or incapacity of the Occupier or any invalidity or irregularity of any of the Occupier's Covenants (or the Occupier's obligations under any Authorised Guarantee Agreement) or any unenforceability of any of them against the Occupier
 - 5.10 any change in the constitution structure or powers of the Occupier the Guarantor or the Owner
 - 5.11 (without prejudice to paragraph 6) the occurrence of a Relevant Event
 - 5.12 any other act omission or thing by which but for this provision the Guarantor would have been released or exonerated or its liability would have been affected (other than an express release by deed given by the Owner)
-

6. The Guarantor also covenants with the Owner that:

6.1 If a Relevant Event occurs and if the Owner so requires (by giving the Guarantor notice no later than 6 months after the Owner receives notice of the Relevant Event) then the Guarantor will accept a new lease of the Property from the Owner such lease to commence on the date of the Relevant Event and to be:

6.1.1 subject to the right of any person to have this Lease vested in them by the court and to the terms on which any such court order may be made and subject to the rights of any third party existing at the date of the grant of the new lease

6.1.2 for a term equivalent to the residue of the Term which would have remained had the Relevant Event not occurred

6.1.3 at the Rent which was reserved at the date of the Relevant Event (subject to paragraph 6.2)

6.1.4 subject to the same covenants and conditions contained in this Lease (except that the Guarantor need not ensure that any other person is made a guarantor to the new lease)

and the Guarantor will promptly execute and deliver to the Owner a counterpart of the new lease and will pay the Owner's Costs in respect of it on a full indemnity basis (including any VAT)

6.2 If at the date of the Relevant Event there is a rent review pending under this Lease then the initial annual rent firstly reserved by the new lease shall be equivalent to the Rent which would have been payable from the Relevant Review Date had the rent review been settled and for the purpose of ascertaining that Rent (and only for that purpose) the rent review provisions in Schedule 7 shall apply (with the Guarantor being deemed to be the Occupier for that purpose) as if there had been no Relevant Event

6.3 If the Owner does not require the Guarantor to take a new lease of the Property in accordance with paragraph 6.1 the Guarantor will pay to the Owner on demand a sum equal to the Rents (including the reviewed Rent referred to in paragraph 6.2) and all other payments which would have been payable under this Lease had the Relevant Event not occurred until the date the Property is re-let by the Owner and becomes income-producing at a principal annual rent equal to or greater than the Rent referred to in paragraph 6.1.3 (and subject to paragraph 6.2)

7. The Guarantor's obligations in this Lease are in addition to any other security or other rights or remedies that the Owner may have in respect of the Occupier's liability under this Lease and will not merge in or be affected by any other security

8. The Owner may enforce the Guarantor's obligations:

8.1 without having first enforced the Occupier's Covenants against the Occupier

8.2 without having first had recourse to any other rights or security which the Owner may have obtained in relation to this Lease and

8.3 irrespective of whether any demands steps or proceedings are being or have been made or taken against the Occupier or any third party or whether the obligations of any other guarantor or third party are released or waived in whole or in part

9. The Guarantor is not entitled to participate in any security held by the Owner in respect of the Occupier's liability to pay the Rents and to observe and perform the Occupier's Covenants
 10. The Guarantor shall not without the Owner's consent exercise any right or remedy it may have (whether against the Occupier or any other person) in respect of any amount paid or other obligation performed by the Guarantor under this Lease unless and until all the obligations owed to the Owner by the Guarantor have been fully discharged
 11. The Guarantor shall not claim in competition with the Owner in any insolvency proceedings or arrangement of the Occupier in respect of any payment made by the Guarantor pursuant to this Lease and if the Guarantor receives any money in such proceedings or arrangement the Guarantor shall immediately pay it to the Owner to be applied towards the satisfaction of the Guarantor's obligations to the Owner until such obligations have been fully discharged
 12. The Guarantor warrants that it has not taken and covenants that it will not take any security from or over the assets of the Occupier in respect of any liability of the Occupier to the Guarantor and if the Guarantor does hold any such security it will hold such security for the benefit of the Owner
 13. Any payment or dividend that the Owner receives in connection with any insolvency proceedings or arrangement involving the Occupier will not prejudice the right of the Owner to recover from the Guarantor to the full extent of the Guarantor's obligations in this Lease
 14. Any sum payable by the Guarantor under this Lease is to be paid without any deduction counterclaim or set-off
 15. The Guarantor shall at the Owner's request join in and consent to the terms of any variation consent approval or other document that may be entered into by the Occupier in connection with this Lease
 16. The Guarantor shall promptly give written notice to the Owner of any change:
 - 16.1 (in the case of a company) to the registered office address
 - 16.2 (in the case of an individual) to the addressof the Guarantor and shall keep the Owner indemnified against all Liability resulting from the Guarantor's failure to give such notice
-

SCHEDULE 7
Rent Review

1. The Rent shall be reviewed on the Review Date and as from and including the Review Date the reviewed Rent (ascertained in accordance with this Schedule) shall become payable
 2. The reviewed Rent shall be One Million Eight Hundred and Fifty Two Thousand Five Hundred Pounds (£1,852,500) (£19.50 x 95,000 sq. ft)
 3. No Guarantor shall have any right to participate in the review of the Rent
 4. Immediately following the Review Date the Owner will prepare a memorandum in duplicate recording the new Rent which shall be signed by or on behalf of both parties and in respect of which each party shall bear their own costs
-

Executed as a deed by HYDE PARK GP LIMITED acting by, a director,) /s/ RJ Gates
in the presence of:)

RS Campling) RJ Gates

Witness Signature /s/ RS Campling
Director

Witness Address

Witness Occupation Chartered Surveyor

Executed as a deed by HYDE PARK NOMINEE LIMITED acting by, a)
director, in the presence of:)

RS Campling)
Witness Signature /s/ RS Campling) /s/

Witness Signature /s/ RS Campling
Director

Witness Address

Witness Occupation Chartered Surveyor

EXECUTED as a DEED by RACKSPACE LIMITED acting by two)
directors or one director and the company secretary:)

) /s/ Brian Thomson
.....
Director

/s/ TE Lathe
.....
Director/Secretary

DATED 14 June 2010

(1) RACKSPACE LIMITED
(2) DAVID KELLY

DIRECTOR'S SERVICE AGREEMENT

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THIS AGREEMENT is made on 14 day of June 2010.
BETWEEN

- (1) RACKSPACE LIMITED (registered number 03897010) a company incorporated in England and Wales whose registered office is at 4 The Square, Stockley Park, Uxbridge, Middlesex, UB11 1BA ("Company"); and
(2) David Kelly of Fulmer Dell, Off Windmill Road, Fulmer, Bucks, SL3 6HF (the "Executive").

IT IS AGREED AS FOLLOWS

1 DEFINITIONS AND INTERPRETATION

1.1 In this Agreement (including the Schedule), unless expressly stated to the contrary, the following expressions have the following meanings:	
Board	the Board of Directors of the Company from time to time, and any committee of the Board duly convened by it;
CEO	the Chief Executive Officer of the Group Company from time to time;
Competitor	any business which sells or provides (or will sell or provide once operational), products or services in competition with the Products or Services;
Confidential Information	Includes but is not limited to: (a) unpublished price sensitive information relating to securities listed on a stock exchange (including details of business development projects, proposed acquisitions, sales, joint ventures or disposals involving the Company or any Group Company); (b) lists and contact details of customers, and details of contracts with customers and/or of their requirements; (c) business plans and policies, marketing strategies, sales reports and research results; (d) lists and contact details of suppliers, and details of contracts with suppliers; (e) financial reports, budgets, trading statements and pricing lists, pricing structures and/or pricing strategies; (f) technical information and know-how relating to the processes and operations devised, owned or used by the Company and/or its Group Companies which is not in the public domain including, but not limited to, unpublished inventions, designs, computer programmes, research activities, formulae and ideas; (g) source codes and computer systems; (h) personnel information, including the identity of employees, officers, and consultants employed or engaged by the Company or any Group Company, or any other professional information regarding such personnel; and (i) any document marked "confidential" (or similar), or any information which the Executive has been told is confidential or which he might reasonably expect the Company (or any Group Company) would regard as confidential;
Customer	any person, firm or company who at any time within the period of 12 months immediately preceding the Termination Date was a customer or client of the Company or any Relevant Group Company, being a person, firm or company with whom the Executive dealt personally on behalf of the Company or any Relevant Group Company; or for whose account the Executive had overall responsibility during the said period of 12 months
Group Company	any company which from time to time is a parent or holding company of the Company or a subsidiary of the Company (both as defined by section 736 of the Companies Act 1985) or a subsidiary of a holding company (as defined), or any company where not less than 25% of its ordinary share capital is owned by the Company;
Handbook	the Company's Employee Policy and Procedure Handbook from time to time;
Immediate Relatives	wife, common law spouse or civil partner, children, brothers, sisters, cousins, aunts, uncles, parents, grandparents and those same relatives by marriage;

Intellectual Property	all intellectual and industrial property rights, including patents, rights in registered and unregistered trade marks (including domain names), rights in registered and unregistered designs, utility models, trade or business names, confidential information, know-how, database rights, topography rights, passing-off rights, and copyright (including moral rights), performer protection rights or other industrial, intellectual or commercial rights (including rights in any invention, discovery or process), and applications for registration of any of the foregoing, and the right to apply therefore, in each case in any part of the world;
Intellectual Property Rights	all present and future right title and interest whatsoever whether legal or beneficial anywhere in the world in any and all Intellectual Property;
Key Person	a person who is or was at any time during the 12 months immediately preceding the Termination Date: <ul style="list-style-type: none"> (a) an employee, director or consultant of the Company or a Relevant Group Company; and (b) a person with whom the Executive personally dealt; and (c) employed in the capacity of manager or in a more senior capacity, or engaged as a consultant in an equivalent capacity;
Personal Data	any data which relates to the Executive who can be identified from that data and other information in the possession of or likely to come into the possession of the Company and any Group Company and includes any expression of opinion about the Executive, and any indications of intention of the Company or any Group Company or a third party concerning the Executive;
Processing	obtaining, recording or holding Personal Data or carrying out any operation and includes organising, adapting or altering Personal Data, retrieving, using or consulting Personal Data, disclosing Personal Data by transmission, dissemination or otherwise making the data available or destroying the Personal Data;

Products or Services	any products or services of a kind sold or supplied by the Company or by any Relevant Group Company within the period of 12 months immediately preceding the Termination Date, and with which the Executive was substantially concerned or for which he was responsible at any time during the said period of 12 months;
Prospective Customer	any person, firm or company who has been engaged in negotiations with the Company or any Relevant Group Company with a view to purchasing or contracting in relation to products or services supplied by the Company or Relevant Group Company within the period of 12 months immediately preceding the Termination Date, being a person, firm or company with whom the Executive personally dealt or for whom he was responsible on behalf of the Company or any Relevant Group Company during the said period of 12 months;
Relevant Group Company	a Group Company to which the Executive has rendered substantial services in the period of 24 months immediately preceding the Termination Date;
Restricted Area	any territory or country: (a) in which the Company or any Group Company has operated in the period of 12 months immediately preceding the Termination Date and continues to operate as at the Termination Date, and in which the Executive has been concerned or active on behalf of the Company during the period of 12 months immediately preceding the Termination Date; or (b) in relation to which the Company or any Group Company with a view to commencing operations in that country or territory, has prepared a business plan in the period of 12 months immediately preceding the Termination Date and where the Executive has been responsible for or involved in the preparation of such plan during such period;
the Regulations	the Working Time Regulations 1998;
Sensitive Personal Data	information concerning the Executive's race, ethnic origin, political opinion, religious beliefs or beliefs of a similar nature, sexual life, physical or mental health or condition, trade union involvement or the commission or alleged commission by the Executive of any offence and any proceedings relating to that offence or alleged offence;
Termination Date	the date on which the Executive's employment with the Company terminates.
	<p>1.2 References to statutes or statutory provisions shall be construed to include references to those statutes or provisions as amended or re-enacted (whether with or without modification) from time to time or as their application is modified by other provisions (whether before or after the date of this Agreement) and shall include any statute or provision of which they are re-enactments (whether with or without modification) and shall also include any orders, regulations, instruments or other subordinate legislation under the relevant statute or statutory provision.</p> <p>1.3 The headings in this Agreement are for ease of reference only and shall not in any way affect its construction or interpretation.</p> <p>1.4 The Schedule forms part of this Agreement and shall be construed and have the same full force and effect as if expressly set out in the main body of this Agreement.</p> <p>1.5 Unless expressly stated to the contrary in this Agreement, the words and phrases "other", "including" and "in particular" shall not limit the generality of any preceding words or be construed as being limited to the same class as the preceding words where a wider construction is possible.</p>
	<p>2 EMPLOYMENT CAPACITY</p> <p>The Company shall employ the Executive and the Executive agrees to serve the Company upon and subject to the provisions of this Agreement in the capacity of Senior Vice President International or in such other capacity or office as the Company may from time to time reasonably direct, reporting directly to the CEO.</p>
	<p>3 COMMENCEMENT AND CONTINUITY OF EMPLOYMENT</p> <p>3.1 The Executive's employment under this Agreement will commence on 14th June 2010 ("the Commencement Date")</p> <p>3.2 No previous employment of the Executive shall count as part of the Executive's period of continuous employment with the Company.</p> <p>3.3 The date of the start of the Executive's period of continuous employment with the Company is the Commencement Date.</p>

4 PERIOD OF EMPLOYMENT

- 4.1 Subject to clause [23](#), either party may terminate the Executive's employment by giving to the other not less than six months' notice in writing.
- 4.2 The Company may at its absolute discretion terminate the Executive's employment with immediate effect by paying basic salary, bonus and all benefits in lieu of notice. The Company may elect to pay any monies under this clause in one lump sum or in instalments (without interest) on those days which the Executive would have received his salary pursuant to clause 9 had he remained in employment for the duration of his notice period.

5 DUTIES

- 5.1 During his employment the Executive shall (alone or jointly with such others as the Board may from time to time appoint with the Executive's consent not to be unreasonably withheld, delayed or conditioned):
 - 5.1.1 hold office as director of the Company;
 - 5.1.2 perform those duties assigned to him or vested in him by the Board, the Company or any Group Company;
 - 5.1.3 comply with all reasonable and lawful requests and instructions of the Board (whether given by or with the authority of the Board), and with all the Company's rules, regulations, policies and procedures and those of any Group Company from time to time in force; and
 - 5.1.4 faithfully and loyally serve the Company or any Group Company to the best of his ability and use his best endeavours to promote the Company's and the Group Company's interests.
- 5.2 The Company reserves the right to assign to the Executive duties of a different nature, either additional to, or instead of, those referred to in clause [5.1](#), it being understood that he will not be assigned duties which he cannot reasonably perform or which is not consistent with his position with the Company.
- 5.3 The Executive may be required to perform services not only for the Company but also for any Group Company, and without further remuneration (except as otherwise agreed), to accept any such office or position in or with any Group Company which is consistent with his position with the Company, as the Board or the Company may from time to time reasonably require. The Company may, at its sole discretion, assign the Executive's employment to any Group Company on the same terms and conditions as set out in this Agreement.
- 5.4 The Executive shall keep the CEO promptly and fully informed (in writing if so required) of his conduct of the business and give to the CEO such information relating to the affairs of the Company or of any of the Group Companies to which his duties relate as he may from time to time request.
- 5.5 Subject to clause [5.6](#), the Company shall not be under any obligation to assign any, or any particular, duties to the Executive, and the Company may, in its discretion, exercise its rights pursuant to clause [21](#) below during any period when no duties are assigned to the Executive.
- 5.6 The Company shall continue to pay the Executive his full basic salary and to make available to him and pay all other benefits to which he is entitled under this Agreement during any period where no duties are assigned to the Executive.

6 DEVOTION TO DUTIES

- 6.1 Save where the Company has assigned no duties to the Executive, the Executive shall devote the whole of his time, attention and abilities at such times as the Board, the Company, any Group Company or his duties may reasonably require to the business and affairs of the Company or Group Companies, unless prevented by ill-health.
- 6.2 The Executive shall not during this Agreement, and whether or not he has had any duties assigned to him by the Company either on his own account or for any other person, firm, company or association, in any capacity whatsoever, be engaged or concerned in, or provide services to, any business or engagement other than that of the Company or any Group Company, except with the prior consent in writing of the Board, but the Executive may hold up to 5% of any securities which are quoted on a recognised investment exchange.
- 6.3 The Executive confirms that he has disclosed fully to the Company all circumstances in respect of which there is, or might be, a conflict of interest between the Company or any Group Company, and the Executive or his Immediate Relatives, and he agrees to disclose fully to the Company any such circumstances which may arise during employment.
- 6.4 The Executive shall not without the consent of the CEO during his employment communicate to the press or other media any comment, opinion or information whatsoever regarding the Company or any Group Company.
- 6.5 Notwithstanding clauses 6.1, and 6.2, and provided that there is no conflict of interest, the Board acknowledges and consents to the Executive's continued non-executive directorship and shareholding in By Design (UK) Limited, a private limited company trading as "MyDeco", as well as his non-executive directorship in Holiday Extras Limited, a private limited company, subject to the Executive spending no more than 12 days per annum discharging such non-executive duties. Any further directorships will require formal consent of the Board, pursuant to clause 6.2.

7 PLACE OF WORK

- 7.1 The Executive will work at the offices of the Company currently at 4 The Square, Stockley Park, Uxbridge, UB11 1ET, the Company's new offices at 11 Millington Road, Hayes, Middlesex, UB3 4AZ or shall work at such other place or places as the Company may reasonably require within commuting distance of the Executive's home address (as at the date of this Agreement) for the proper performance of his duties. The Executive will also be required to travel both within and outside the United Kingdom in order to fulfil his duties, including travel to the Group Company's headquarters in Texas on at least a quarterly basis.
- 7.2 The Executive may be required to work outside the United Kingdom for continuous periods of up to 30 calendar days from time to time, travelling throughout Africa, Asia, Australasia, Europe, the Middle East and the US. The Executive's terms and conditions of employment will remain the same during such periods.
- 7.3 The Executive shall not be required to reside in other parts of the world.

8 HOURS OF WORK

- 8.1 There are no normal working hours associated with the Executive's position, the parties acknowledging that the senior status of the Executive and his autonomous decision-making powers mean that he is free to determine the hours which he works, provided that he fulfils his duties under this Agreement, and that the Executive is therefore covered by Regulation 20(1) of the Regulations.
- 8.2 Without prejudice to clause [8.1](#), if, in fact, the Executive is not covered by Regulation 20(1) of the Regulations, the Executive agrees that the maximum weekly working time limit provided for in Regulation 4(1) of the Regulations shall not apply to him, and he specifically waives that limit by signing this Agreement. The Executive has the right to terminate the agreement in this sub-clause by providing three months' written notice. The exercise of that right shall not in any way affect the operation of any other provision in this Agreement.

9 REMUNERATION

- 9.1 The Executive shall receive a basic salary accruing from day to day at the rate of £200,000 per annum, to be paid by equal monthly instalments on or about the 25th day of each calendar month by credit transfer. This basic salary shall (unless otherwise agreed in writing by the Company) be inclusive of all fees and other remuneration which the Executive may receive for his services (whether as employee or office-holder) from the Company or any Group Company.
- 9.2 The Company may deduct from the Executive's basic salary, sum in lieu of pension contributions and/or bonus any sums owing to the Company or any Group Company by the Executive from time to time.
- 9.3 The Executive's salary shall be reviewed by the Board during the first quarter of each calendar year. The Board shall be under no obligation to award the Executive any increase, whether or not the Executive may reasonably expect to be awarded one.

10 BONUS

- 10.1 In addition to his basic salary the Executive is eligible to participate in the discretionary corporate incentive bonus plan from time to time in force in respect of each financial year of the Company. Subject to the Group Company and the Executive achieving performance objectives as established by the Board, the on target bonus opportunity will be 70% of basic salary. For the avoidance of doubt, the on target bonus earnings for the first financial year are £140,000 and the 70% bonus calculation will be based on the basic salary only. Any bonus will be paid in accordance with bonus payment policy in effect for all other executives and no less often than annually.
- 10.2 Any bonus awarded by the Company implies no expectation nor creates any precedent for the awarding of any subsequent bonus.
- 10.3 In the event that the Executive is employed for part only of any Financial Year, the bonus payable shall be calculated pro rata in respect of that Financial Year and paid at the normal time. For the purpose of this clause [10](#), earnings shall be deemed to accrue without fluctuation from day to day and shall be apportioned on a daily basis (calculated by reference to 261 working days in each Financial Year).
- 10.4 If the Company exercises its right pursuant to clause [4.2](#), the calculation of the payment shall include any bonus payment relating to any period of notice which the Executive has not worked or not been allowed to work.

11 TELEPHONE

The Company shall provide the Executive with a mobile telephone and shall discharge all maintenance, rental costs and reasonable related charges incurred by the Executive.

12 EXPENSES

- 12.1 The Executive shall be reimbursed all reasonable travel, hotel and entertainment expenses properly and necessarily incurred by him in the performance of his duties, subject to the Company's rules and policies relating to expenses. The Executive shall produce valid receipts in respect of such expenses before any reimbursement is made.
- 12.2 Should the Executive be provided with Company credit cards, he shall comply with any conditions for the time being laid down by the Company as to their use.

13 PENSION

- 13.1 Although, the Executive is eligible to join the Company's Pension Scheme, the Executive has exercised his right not to join, and the Company has agreed to pay the Executive a sum equivalent to 10% of his basic salary per annum in lieu of such benefit, to be paid by equal monthly instalments on or about the 25th day of each calendar month by credit transfer. This sum shall be in addition to the basic salary set out in clause 9.1, but shall not form part of the bonus calculation set out at clause 10.1. For the avoidance of doubt, the sum payable for the first financial year will be £20,000.
- 13.2 As the Executive has decided not to join the Company's Pension Scheme then:
- 13.2.1 the Company will not be under any obligation to make any pension provision for the Executive or his dependants; and
- 13.2.2 the Executive will be permitted to join such scheme only at the discretion of the Company and the trustees of the scheme.
- 13.3 If pursuant to clause 13.2.2, the Executive subsequently joins the Pension Scheme (or any comparable substituted scheme), then the sum payable in lieu of such benefit will no longer be paid directly to the Executive, but will be paid directly into the Company's Pension Scheme. If the Executive subsequently elects to leave such scheme at any time thereafter then:
- 13.3.1 the Company will not be under any obligation to make any further pension provision for the Executive or his dependants;
- 13.3.2 the Company will revert to paying the sum in lieu of such benefit directly to the Executive; and
- 13.3.3 the Executive will be permitted to rejoin such scheme (or to join any other pension scheme established by the Company) only at the discretion of the Company and the trustees of the scheme.

14 INSURANCE BENEFITS

- 14.1 During his employment and subject to clause [14.2](#) the Executive shall be entitled at the Company's expense, and in accordance with the terms and conditions of the policies from time to time in force, including any applicable restrictions:
- 14.1.1 to become a member of the Company's private medical insurance scheme in respect of himself, his spouse/civil partner and children under the age of 18;
- 14.1.2 to participate in the Company's permanent health insurance scheme and income protection scheme;
- 14.1.3 to participate in the Company's life assurance scheme at four times the Executive's basic salary;
- 14.1.4 to participate in the Company's business travel insurance scheme;
- Details of the above policies are available from the HR Director EMEA.
- From time to time the Company may, in its absolute discretion, amend, alter or substitute the terms of the above benefits, or replace them wholly.
- 14.2 Neither any outstanding or prospective entitlement to the benefits referred to in clauses [14.1](#) (other than the permanent health insurance scheme) nor any actual or prospective loss of entitlement to those benefits, shall preclude the Company from exercising any right to terminate the Executive's employment under this Agreement.
- 14.3 If any benefits provider (including but not limited to any insurance company) refuses for any reason to provide any benefits to the Executive, the Company shall not be liable to provide any such benefits itself, or to pay any compensation in lieu.
- 14.4 Upon request, the Company may agree to pay the Executive a sum up to £2000 per annum in lieu of the medical benefit set out in clause 14.1.1 in order that the Executive may continue participating in his existing medical insurance scheme, provided that the Executive provides evidence of his payments into such scheme of his choice.

15 STOCK OPTIONS & RSU

Subject to final approval of the Group Company's Compensation Committee which is expected to be within 90 days of the Commencement Date, and to any restrictions from time to time imposed by law the Executive will be eligible to receive:

- 15.1 Options to purchase 70,000 shares of Common Stock in the Company's parent corporation, Rackspace Hosting, Inc., with an exercise price equal to the closing price as of the date on which the Compensation Committee grants the options in accordance with its equity award policy. The Options will be issued pursuant to the Rackspace Hosting, Inc. 2007 Long Term Incentive Plan and its standard form of Stock Option Agreement and will vest over four years in annual installments.
- 15.2 50,000 Restricted Stock Units (RSU's) in the Company's parent corporation, Rackspace Hosting, Inc, in accordance with its equity award policy. The RSU's will be issued pursuant to the Rackspace Hosting, Inc. 2007 Long Term Incentive Plan and will vest over four years in annual installments.

16 HOLIDAYS

- 16.1 In addition to normal public holidays the Executive is entitled to 25 working days paid holiday during each holiday year. Holiday entitlement shall accrue pro-rata throughout the holiday year. A "holiday year" means the period from 1 January in one year to the next following 31 December.
- 16.2 The Executive may not take more than 10 working days' holiday at any one time without the prior approval of the CEO.
- 16.3 Any holiday entitlement remaining at the end of each holiday year shall lapse unless otherwise approved by the CEO.
- 16.4 Subject to clause 16.5 below the Executive will be entitled to payment in lieu of any accrued but untaken holiday entitlement at the date of termination. For these purposes one day's holiday entitlement shall accrue at the rate of 1/261 basic annual salary.
- 16.5 On the termination of his employment pursuant to clause 23.1 the Executive will only be entitled to payment in lieu of unused holiday entitlement calculated in accordance with the Regulations and for these purposes all holiday entitlement in the relevant holiday year shall be holiday entitlement calculated in accordance with the Regulations.
- 16.6 In all cases, if the Executive has taken more than his accrued entitlement at the date of termination, the Company shall make an appropriate deduction from the Executive's final payment. For these purposes one day's holiday entitlement shall accrue at the rate of 1 /261 basic annual salary.
- 16.7 Where notice of termination is given by either party the Executive may be required to use any accrued but untaken holiday entitlement prior to the termination of employment.

17 SICKNESS OR INJURY

- 17.1 The Executive must comply with the Company's Policy and Rules from time to time in force regarding sickness notification and doctor's certificates, details of which can be obtained from the HR Director, EMEA.
- 17.2 Subject to compliance with clause 17.1, the Executive shall receive:
 - 17.2.1 his basic salary and all benefits, less normal deductions for an aggregate absence of up to 20 working days in any period of 12 months during his first two years of employment;
 - 17.2.2 his basic salary and all benefits, less normal deductions for an aggregate absence of up to 20 working days in any period of 12 months and half his basic salary, less normal deductions for any further absence of up to in aggregate 45 working days in any period of 12 months after 2 years of employment; and
 - 17.2.3 his basic salary and all benefits, less normal deductions for an aggregate absence of up to 40 working days in any period of 12 months and half his basic salary, less normal deductions for any further absence of up to in aggregate 90 working days in any period of 12 months after 5 years of employment.These payments will include any entitlement to Statutory Sick Pay, and when this is exhausted shall be reduced by the amount of any state sickness benefit(s) which may be recoverable by the Executive (whether or not recovered). Qualifying days for the purposes of Statutory Sick Pay are Monday to Friday inclusive. In the event that the Executive becomes eligible to receive benefits under the Company's permanent health insurance scheme (pursuant to clause 14.1.2) or his own scheme (if applicable pursuant to clause 14.4) the Company shall not have any obligation to make any, or any further payments (as applicable) to the Executive under this clause 17.2.
- 17.3 During any period where the Executive is unable to work as a result of ill-health, injury or other medical incapacity, the Company may appoint a further executive director or employee to perform the Executive's duties temporarily, until such time as the Executive is able to fully resume the performance of his duties to the Company's satisfaction.
- 17.4 If the Executive exhausts his entitlement to sick pay under clause 17.2, the Board may, in its discretion, agree to make further payments to the Executive, provided that if such further payments are made, they may be discontinued or reduced in amount at any time in the CEO's absolute discretion.
- 17.5 The Company reserves the right to require the Executive to undergo a medical examination at the Company's expense by a doctor nominated by the Company at any time during or following a period of sickness absence. The Executive authorises the doctor to disclose the results of such examination to the Company.
- 17.6 If the absence of the Executive is due to injuries, actionable negligence or nuisance caused by, or on account of a breach of any statutory duty by, any third party, all payments made to him by the Company under this clause 17 shall, to the extent that compensation is recovered from that third party, constitute loans by the Company to the Executive which shall be repaid by the Executive when and to the extent that the Company requests such repayment.

18 INTELLECTUAL PROPERTY

- 18.1 The Executive acknowledges that all Intellectual Property Rights in respect of all Intellectual Property made, originated or developed by him at any time in the course of his employment with the Company shall belong to and vest in the Company absolutely to the fullest extent permitted by law.
- 18.2 The Executive:
- 18.2.1 acknowledges for the purposes of Section 39 Patents Act 1977 that because of the nature of his duties, and the particular responsibilities arising from those duties, he has, and at all times during his employment will have, a special obligation to further the interests of the businesses of the Company;
 - 18.2.2 undertakes to notify and disclose the Company in writing full details of all Intellectual Property made, originated or developed by him at any time during his employment with the Company immediately upon the creation of the same (and whether or not in material form), and promptly whenever requested by the Company and in any event upon the termination of his employment, to deliver up to the Company all such Intellectual Property and all related correspondence, documents, papers and records and all copies of any such Intellectual Property in his possession or control;
 - 18.2.3 undertakes to hold upon trust for the benefit of the Company all Intellectual Property Rights in respect of all Intellectual Property made, originated or developed by him during his employment by the Company, until the same are vested absolutely in the Company;
 - 18.2.4 assigns absolutely with full title guarantee by way of present assignment of present and future rights, all Intellectual Property Rights in any Intellectual Property made, originated or developed now or in the future by him in the course of his employment;
 - 18.2.5 acknowledges that, other than as provided by law, no further remuneration or compensation other than that set out in this Agreement is or may become due to the Executive in respect of the performance of his obligations under this clause [18](#);
 - 18.2.6 undertakes at the expense of the Company to execute all such documents, make such applications, give such assistance and do such acts and things as may in the opinion of the CEO be necessary or desirable to vest in and register or obtain letters patent or any other registrable rights in the name of the Company or its nominee, and otherwise to protect and maintain any Intellectual Property made, originated or developed by the Executive and all related Intellectual Property Rights; and waives any moral rights (as provided for by Chapter IV Copyright Designs & Patents Act 1988 ("the 1988 Act") or any similar provisions of law in any jurisdiction) in any Intellectual Property made, originated, developed or produced by him in the course of his employment and agrees not to institute, support, maintain or permit any action or claim to the effect that any treatment, exploitation or use of such Intellectual Property infringes the Executive's moral rights, including (but without limitation) the right to be identified, the right of integrity and the right against false attribution provided for in the 1988 Act.

19 CONFIDENTIAL INFORMATION

- 19.1 During his employment with the Company and after its termination (however this occurs) the Executive must not (other than in the proper course of his employment with the Company):
- 19.1.1 use for his own purposes or those of any other person, firm, company, association or other organisation whatsoever; or
 - 19.1.2 disclose to any person, firm, company, association or other organisation whatsoever any Confidential Information of or belonging to the Company or any Group Company or to any third party (which includes customers, suppliers, employees and officers of the Company or any Group Company) which was learnt or disclosed to the Executive in confidence in the course of his employment.
- 19.2 Clause [19.1](#) does not prevent the Executive from using or disclosing Confidential Information if he is ordered to do so by a court of competent jurisdiction, or if authorised by the Company in writing to do so or if such information has become public otherwise than by default of the Executive.

20 DATA PROTECTION AND ELECTRONIC COMMUNICATIONS

20.1 By signing this Agreement the Executive consents:

- 20.1.1 to the Company and any Group Company where applicable Processing Personal Data and Sensitive Personal Data during his employment and for a reasonable period afterwards for the purposes of administration and management of his employment and/or the Company's and any Group Company's business. Examples of the purposes for which Personal Data may be processed are (but are not limited to) the following:
- (a) recruitment activities;
 - (b) administration of absence records, including sick leave and sick pay, monitoring attendance, sickness absences and state of health;
 - (c) administration and maintenance of personnel records, payroll pensions and other benefits;
 - (d) administration of holiday and other absence records such as, adoption leave, parental leave, paternity leave and time off for dependants;
 - (e) equal opportunities matters including the operation of the Company's and any Group Company's equal opportunities policy;
 - (f) monitoring of performance and carrying out performance appraisals and development reviews;
 - (g) disclosure of information to prospective employers in response to a reference enquiry;
 - (h) the pursuit of disciplinary and grievance matters;
 - (i) detection or prevention of the commission or alleged commission of fraud or any offence;
 - (j) the provision of information to any government body or agency or public authority for legitimate purposes including social security and income tax;
 - (k) promotion of the Company's or any Group Company's business activities and/or the Executive's contribution to the Company's or any Group Company's business;
 - (l) monitoring the use of internet email or other IT systems or the use of telephone or fax;
 - (m) for the purpose of or in connection with any legal proceedings (including prospective legal proceedings) for the purposes of obtaining legal advice or otherwise establishing exercising or defending legal rights; and
 - (n) compliance with any legal obligation.

20.1.2 where reasonably necessary to the transfer of the Executive's Personal Data (including Sensitive Personal Data) to any Group Company based either in the United States of America or inside or outside the European Economic Area for the purposes of managing his employment with the Company and/or any Group Company and or the Company's or any Group Company's business.

20.1.3 The above provisions are without prejudice to any additional rights to process Personal Data which exist for the Company and/or any Group Company pursuant to and in accordance with the Data Protection Act 1998.

20.2 The Executive agrees to comply with all policies and procedures implemented by the Company or any relevant Group Company to ensure the Company's compliance with prevailing data protection laws and Handbook.

20.3 Without prejudice to any other rights it may have, the Company reserves the right to intercept and/or monitor and/or record and/or view, as appropriate, the Executive's use of its or any Group Company's electronic communication systems including telephone, pc, remote access via a laptop or other means for the purpose of ensuring that its or any Group Company's systems:

- 20.3.1 are used primarily to further the business of the Company or any Group Company;
- 20.3.2 are not used for inappropriate or unlawful purposes, such as accessing or circulating material containing nudity, pornography, racist terminology or other offensive material or for telephoning premium-rate lines;
- 20.3.3 are used in compliance with the Handbook and any other relevant policies and procedures of the Company or any Group Company;
- 20.3.4 have sufficient capacity for the needs of the business.

By signing this Agreement the Executive understands and agrees that the content of his communications and access to the Company's or any Group Company's systems can be accessed and hereby consents to any such interception, monitoring, viewing and/or recording taking place.

21 PERIOD AWAY FROM WORK

21.1 The Company may, at its absolute discretion, require the Executive at any time and for the whole or any part or parts of the contractual notice (whether notice is given by the Company or the Executive, or if the Executive seeks to resign without giving notice other than in circumstances where he is entitled to resign and claim constructive dismissal):

- 21.1.1 not to attend any of his places of work or any other premises of the Company or any Group Company;
- 21.1.2 not to carry out some or all of his duties under this Agreement or to substitute his then current duties and carry out other duties or special project work instead;
- 21.1.3 to resign immediately from all offices he may hold in the Company, and in any Group Company and from all other appointments or offices which he holds as nominee or representative of the Company and its Group Companies;
- 21.1.4 to return to the Company all documents and other property (including computer hardware and software) belonging to the Company and any Group Company including but not limited to Confidential Information;
- 21.1.5 not to communicate with customers or suppliers of the Company and any Group Company; and

not to communicate with employees or officers of the Company and any Group Company in relation to his employment or the circumstances surrounding its termination save in respect of those individuals whose names are notified to the Executive provided that the Company shall continue to pay the Executive his full basic salary and to make available to him all other benefits to which he is entitled under this Agreement during any such period. Any holiday entitlement which has accrued to the Executive as at the commencement of any period away from work pursuant to this clause [21](#), and any holiday entitlement which continues to accrue, shall be deemed to be taken by the Executive during such period.

21.2 Should the Company require the Executive to do all or any of the things set out in clause [21.1](#) the other terms of this Agreement shall nevertheless remain in full force and effect save as varied by this clause [21](#) and, for the avoidance of doubt, the Executive's duty of good faith shall continue.

22 DISCIPLINARY AND GRIEVANCE PROCEDURE

- 22.1 The Executive should refer any grievance relating to his employment (other than one relating to a disciplinary decision) to the CEO.
- 22.2 The disciplinary procedure is a policy document only and does not form part of the Executive's contract of employment. A copy of the disciplinary procedure is available from the HR Director EMEA. If the Executive is dissatisfied with any disciplinary decision taken in relation to him, he may refer the decision to the Board for review, whose decision shall be final.
- 22.3 In order to investigate any disciplinary matter or grievance involving the Executive the Company is entitled to suspend him on full pay and benefits for so long as is reasonably considered necessary by the Company.

23 TERMINATION

- 23.1 Notwithstanding any other provision of this Agreement the Company may terminate the Executive's employment with immediate effect (without notice or any payment in lieu of notice), where:
- 23.1.1 the Company believes that the Executive has:
- (a) committed any act of fraud or serious dishonesty, or other gross misconduct, or gross incompetence or gross neglect of duty; or
 - (b) after written warning committed a second or subsequent breach of any express or implied obligation under this Agreement, or of any of the Company's policies and procedures or those of any Group Company from time to time applicable (which for the avoidance of doubt need not be of the same nature or type); or
 - (c) committed any act which in the reasonable opinion of the Board brings him, the Company, or any Group Company into disrepute, or prejudices the interests of the Company or any Group Company;
- (where any reference in this sub-clause to an act shall be interpreted as including a reference to an omission); or where:
- 23.1.2 the Executive is convicted of any criminal offence other than an offence under the road traffic legislation in the United Kingdom for which the Executive is not sentenced to any term of imprisonment, whether immediate or suspended; or
- 23.1.3 the Executive becomes bankrupt or makes any arrangement or composition with his creditors generally; or
- 23.1.4 the Executive is or becomes of unsound mind or a patient for the purpose of any statute relating to mental health. The Executive accepts that, in such circumstances, no adjustment could reasonably be made to enable him properly to perform his duties; or
- 23.1.5 the Executive becomes prohibited by law from being a director; or
- 23.1.6 the Executive resigns his office as director of the Company or any Group Company without the prior agreement of the Board.
- 23.2 The Executive's employment with the Company shall automatically terminate on the date of the Executive's 65th birthday subject to the Company's obligations under The Employment Equality (Age) Regulations 2006 as amended and updated from time to time.

24 RETURN OF PROPERTY AND DOCUMENTS

Whenever requested to do so by the Company the Executive shall immediately return to the Company in accordance with its instructions all records, papers, correspondence, customer files, equipment (including computer equipment), mobile telephone, software, notes, reports or property of whatsoever nature (including keys, books, materials and credit cards) which may be in his possession or control and which relate in any way to the business or affairs of the Company and any Group Company, and no copies, notes or abridgements of any of the above shall be retained by him.

25 RESIGNATION OF OFFICES

After termination of his employment, however it occurs, the Executive shall immediately upon the request of the Company resign from all offices held by him in the Company and in any Group Company without claim for compensation, and should he fail to do so the Company and any applicable Group Company may act as the Executive's attorney pursuant to clause [30.2](#) to give effect to such resignation(s).

26 PREVENTION OF UNFAIR COMPETITION

- 26.1 After the termination of his employment under this Agreement for any reason the Executive shall not, without the prior written approval of the CEO or the Board, whether directly or indirectly, and whether on his own behalf, or on behalf of any other person, firm, company or association, and whether as an employee, director, principal, agent, consultant or in any other capacity whatsoever:
- 26.1.1 at any time during the period of 6 months immediately following the Termination Date, within the Restricted Area:
- (a) seek employment from, accept employment with, or offer to provide services to; or
 - (b) carry on or assist with, or otherwise be concerned or interested in, any Competitor, provided that this restriction shall not apply if the Executive's duties and responsibilities for any such Competitor do not involve him in the, sale or provision of any goods or services which are similar to or competitive with the Products or Services; or
- 26.1.2 at any time during the period of 9 months immediately following the Termination Date for the benefit of a business in competition with any business of the Company or any Relevant Group Company:
- (a) offer employment to or employ or offer or conclude any contract for services with, or solicit or entice the employment or engagement of, or enter into partnership with; or
 - (b) procure or assist any third party so to offer, employ, engage, solicit or entice any Key Person (whether or not such person would commit any breach of his or her contract with the Company or any Relevant Group Company) unless such Key Person had ceased to be employed or engaged by the Company or Relevant Group Company (as the case may be) more than three months previously; or
- 26.1.3 at any time during the period of 9 months immediately following the Termination Date for the benefit of a business in competition with any business of the Company or any Relevant Group Company:
- (a) canvass or solicit the custom of (or procure or assist with the same); or
 - (b) transact or otherwise deal with (or procure or assist with the same) any Customer or Prospective Customer in respect of Products or Services, provided that this clause [26.1.3](#) shall not prohibit general advertising in the press or other media by the Executive (or by any person, firm, company or association on his behalf), which is not specifically targeted at or sent to Customers or Prospective Customers.
- 26.2 After the termination of the Executive's employment, however it occurs, he shall not:
- 26.2.1 represent to any person, firm, company or association or otherwise lead them to believe that he is still employed by the Company or any Group Company or is in any way connected with or otherwise associated with the business of the Company or any Group Company; or
- 26.2.2 make any derogatory or untrue remarks about the Company, any Group Company, any of its or their employees, officers or customers, or any of its or their services or products.
- 26.3 The Executive acknowledges:
- 26.3.1 that each of the foregoing sub-clauses of this clause [26](#) constitutes an entirely separate and independent restriction on him; and
- 26.3.2 if any of the restrictions shall be adjudged to be void or ineffective for whatever reason but would be adjudged to be valid and effective if it or another restriction were deleted in whole or in part then such restriction shall apply with such deletions as may be necessary to make it valid and effective.
- 26.4 The Executive agrees that he will, at the request and cost of the Company, enter into a direct agreement or undertaking with any Relevant Group Company whereby he will accept restrictions corresponding to those set out at clause [26.1](#) (or such of them as may be appropriate in the circumstances).
- 26.5 Nothing in this clause [26](#) shall prevent the Executive after the termination of his employment with the Company from holding in his own name or jointly or being beneficially interested in any securities of any company or corporation for the time being quoted or listed on any recognised stock exchange, but so that in the case of a Competitor the amount of any one class of securities so held or in which the Executive's beneficial interest exists shall not exceed 5 per cent of the nominal amount of the issued securities of that class during the period specified in clause [26.1.1](#) above.
- 26.6 The Executive agrees that if he receives an offer of employment or engagement (whether oral or written and whether accepted or not) from any person either during this Agreement or during the continuance of restrictions contained in this clause [26](#) he shall immediately inform the Board of the identity of the offer and its terms if the acceptance of such offer would involve him in the breach of clauses [6](#), [19](#), [21](#), and [26](#). Without prejudice to the Executive's obligations concerning confidentiality the Executive will provide the offer with details of the substance of the restrictions contained in clause [19](#) and this clause [26](#).

27 RECONSTRUCTION OR AMALGAMATION

If the Executive's employment is terminated by reason of the liquidation of the Company for the purpose of reconstruction or amalgamation, and the Executive is offered employment with any concern or undertaking resulting from such reconstruction or amalgamation on terms and conditions which, taken as a whole, are not substantially less favourable than the terms of this Agreement, the Executive shall have no claim against the Company in respect of the termination of his employment.

28 PRIOR RIGHTS AND DELAY

- 28.1 The termination of the Executive's employment shall be without prejudice to any right that the Company may have in respect of any breach by the Executive of any of the provisions of this Agreement which may have occurred prior to termination.
- 28.2 Any failure to exercise or delay by the Company or any Group Company in exercising a right or remedy arising in connection with this Agreement or by law shall not constitute a waiver of such right or remedy or of any other rights or remedies. No waiver shall be effective unless in writing and signed by the Company or the relevant Group Company or on the Company's or the relevant Group Company's behalf by a duly authorised representative. A waiver of a right or remedy on one occasion shall not constitute a waiver of the same right or remedy in the future.

29 NOTICES

- 29.1 Any notices under this Agreement shall be in writing and signed by or on behalf of the party giving it.
- 29.2 Any such notice may be served by delivering it personally or by sending it by pre-paid recorded delivery post, in the case of the Company, at or to its registered office for the time being, and in the case of the Executive, at or to his last known address or, in the case of either party, at or to any other address in England which that party may from time to time notify in writing to the other.
- 29.3 Any such notice delivered personally shall be deemed to be received when delivered (or, if delivered otherwise than between 9.00am and 5.00pm on a business day, at 9.00am on the next business day); any notice sent by pre-paid recorded delivery post shall be deemed to be received 2 days after posting and in proving the time of despatch it shall be sufficient to show that the envelope containing such notice was properly addressed, stamped and posted.

30 GENERAL

- 30.1 The Executive warrants that:
- 30.1.1 by entering into this Agreement he will not be in breach of any agreements with or obligations owed to any third party;
 - 30.1.2 the particulars contained in any curriculum vitae/resume supplied and of his qualifications and all other representations (whether verbal or in writing) made to the Company in relation to his employment by the Company or in connection with this Agreement are true and not misleading; and
 - 30.1.3 he has the appropriate qualifications and experience as are necessary to fulfil his duties pursuant to this Agreement.
- 30.2 The Executive hereby irrevocably and by way of security appoints the Company and each Group Company now or in the future existing to be his attorney to act in his name and on his behalf, and as his attorney to sign, execute and do all acts, things and documents which he is obliged to execute and do under the provisions of this Agreement.

31 PRIOR AGREEMENTS AND ENTIRE AGREEMENT

- 31.1 This Agreement constitutes the entire agreement and understanding of the parties and supersedes any previous agreement or understanding between the parties with respect to the arrangements contemplated by or referred to in it.
- 31.2 The Executive acknowledges and agrees that:
- 31.2.1 for the avoidance of doubt, no provision of the Company's Articles of Association, as may be amended from time to time, which confers or purports to confer rights in favour of directors or other officers of the Company is intended to form part of the terms of this Agreement, save to the extent that such rights are set out expressly in this Agreement;
 - 31.2.2 in entering into this Agreement he does not rely on, and shall have no remedy in respect of, any statement, representation, warranty (in each case whether negligently or innocently made) or understanding of any person (whether party to this Agreement or not) which is not expressly set out in this Agreement; and
 - 31.2.3 the only remedy available to it for breach of any statement, representation, warranty or other term which is expressly set out in this Agreement shall be for breach of contract under the terms of this Agreement
- 31.3 Nothing in this clause [31](#) shall, however, operate to limit or exclude any liability for fraud or fraudulent misrepresentation.

32 MISCELLANEOUS STATUTORY PROVISIONS

- 32.1 This Agreement is not a temporary or fixed term contract but is of indefinite duration subject to its terms.
- 32.2 There are no collective agreements in force relating to the Executive's employment under this Agreement.

33 THIRD PARTY RIGHTS

No provision of this Agreement shall be enforceable by any person who is not a party to it pursuant to the Contracts (Rights of Third Parties) Act 1999 but this does not affect any right or remedy of a third party which exists or is available independently of that Act.

34 GOVERNING LAW AND JURISDICTION

This Agreement shall be governed by and construed in accordance with the laws of England and the parties hereto irrevocably submit to the non-exclusive jurisdiction of the Courts of England for the determination of all disputes or claims which may arise out of or in connection with this Agreement.

IN WITNESS WHEREOF the Company has signed this Agreement under the hand of its duly authorised representative and the Executive has executed this Agreement as a deed the date first above written

SCHEDULE

STATEMENT OF INITIAL EMPLOYMENT PARTICULARS

The Employer: Rackspace Limited
The Executive: David Kelly
Job title: (Clause 2) Senior Vice President International
Commencement date: (Clause 3) 14 June 2010
Term: (Clause 4) Indefinite
Notice Period: (Clause 4) 6 months
Start of continuous employment: (Clause 3) 14 June 2010. No prior period of employment
Place of work: (Clause 7) 4 the Square, Stockley Park, Uxbridge, Middlesex, UB11 1ET or 11 Millington Road, Hayes, Middlesex, UB3 4AZ or such other place within commuting distance of Executive's home address

Overseas employment: (Clause 7) Not more than 30 consecutive calendar days
Hours of work: (Clause 8) There are no normal working hours associated with the Executive's position, the parties acknowledging that the senior status of the Executive and his autonomous decision-making powers mean that he is free to determine the hours which he works, provided that he fulfils his duties under this Agreement

Basic Salary: (Clause 9.1) £200,000 per annum to be paid monthly
Bonus: (Clause 10.1) 70% of Basic Salary to be paid no less than annually
Pension and other benefits: (Clauses 13 and 14) No Pension. 10% of Basic Salary to be paid in lieu of company contribution into pension scheme.
Stock Options/RSUs: (Clause 15) Private medical, permanent health & life assurance offered.
70,000 Options & 50,000 Restricted Stock Units in accordance with terms and subject to compensation committee approval.

Holiday entitlement: (Clause 16) 25 working days per holiday year
Period of holiday year: (Clause 16) 1 January – 31 December
Sick pay: (Clause 17) Up to 20 working days full pay in any 12 month period during the first 2 years of employment, increasing to 20 working days full pay and 45 working days at half pay in any 12 month period after 2 years' employment and, after 5 years' employment, increasing to 40 working days full pay and 90 working days at half pay in any 12 month period.

Disciplinary rules: (Clause 22) See Handbook
Person to whom a grievance should be brought in the first place: CEO
(Clause 22)
Person to whom a complaint about a disciplinary decision should be made: The Board
(Clause 22)
Collective agreements: (Clause 32) not applicable

Signed by Brian Thomson, for and on behalf of RACKSPACE) /s/ Brian Thomson
LIMITED

EXECUTED as a DEED by the said in the presence of:

Signed by David Kelly) /s/ David Kelly
EXECUTED as a DEED by the said in the presence of: