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LZ.OQ - Q1 2022 LegalZoom.com Inc Earnings Call

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OVERVIEW:

LZ reported 1Q22 total GAAP revenue of $154m. Co. expects 2022 revenue to be $650-660m and 2Q22 total revenue to be $162-164m.

CORPORATE PARTICIPANTS

Daniel A. Wernikoff *LegalZoom.com, Inc. - CEO & Director*

Danny Vivier *LegalZoom.com, Inc. - Head of IR*

Noel B. Watson *LegalZoom.com, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Andrew M. Boone *JMP Securities LLC, Research Division - Director & Equity Research Analyst*

Elizabeth Mary Elliott *Morgan Stanley, Research Division - VP of Equity Research*

Matthew Charles Pfau *William Blair & Company L.L.C., Research Division - Analyst*

Nathaniel Holmes Schindler *BofA Securities, Research Division - Director in Equity Research*

Ronald Victor Josey *Citigroup Inc., Research Division - MD*

Sang-Jin Byun

Stephen D. Ju *Crédit Suisse AG, Research Division - Director*

X. Lu *Barclays Bank PLC, Research Division - Research Analyst*

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the LegalZoom First Quarter 2022 Earnings Call. (Operator Instructions) Please be advised today's conference may be recorded. (Operator Instructions) I'd now like to hand the conference over to your host today, Danny Vivier, Head of Investor Relations.

Danny Vivier - *LegalZoom.com, Inc. - Head of IR*

Thank you, operator. Hello, and welcome to LegalZoom's First Quarter 2022 Earnings Conference Call. Joining me today is Dan Wernikoff, our Chief Executive Officer; and Noel Watson, our Chief Financial Officer.

As a reminder, we will be making forward-looking statements on this call. These forward-looking statements can be identified by the use of words such as believe, expect, plan, anticipate, will, intend, and similar expressions and are not and should not be relied upon as a guarantee of future performance or results. Results could differ from those contemplated by our forward-looking statements. We caution you to review the Risk Factors section of our reports and filings with the Securities and Exchange Commission for a discussion of factors that could cause our results to differ materially. The forward-looking statements we make on this call are based on information available to us as of today's date, and we disclaim any obligation to update any forward-looking statements, except as required by law.

In addition, we will also discuss certain non-GAAP financial measures. Our CEO and CFO use these measures to make decisions regarding our business, and we believe these measures provide helpful information to investors. Reconciliations of all non-GAAP measures to the most directly comparable GAAP measures are set forth in the Investor Relations section of our website at investors.legalzoom.com. The non-GAAP financial measures are not intended to be considered in isolation or as a substitute for results prepared in accordance with GAAP.

Now I'll turn the call over to Dan.

Daniel A. Wernikoff - *LegalZoom.com, Inc. - CEO & Director*

Thanks, Danny, and good afternoon, everyone. It's been a quick turnaround since our last earnings call, so I'll keep my comments brief today.

Q1 was a strong start to the year for LegalZoom, continuing the momentum we experienced in 2021. In the first quarter of 2022, we generated $154 million of revenue, ahead of the top end of our guidance range and up 15% year-over-year despite a challenging prior year comparison. Subscription growth continued to outperform in the period, with revenues coming in at $84 million, up 29% year-over-year. The subscription strength, driven in part by LZ Tax revenue, continues to dislocate our performance from the broader market for new business formations with consensus EIN nonseasonal applications down 8% year-over-year in the period.

The census decline in the first quarter was within our expectations. We outperformed the macro in Q1 with LegalZoom business formations down just 2% versus prior year. We reported adjusted EBITDA of $1.3 million in the first quarter, ahead of our guidance of breakeven. As a reminder, there is a seasonal component to the recognition of our transaction revenue that weighs on margins in the first quarter of the year. Noel will further unpack our guidance later in the call, but we continue to feel confident in our ability to deliver our adjusted EBITDA target for the full year of 2022.

Given the current state of affairs with geopolitical concerns, inflation and other macroeconomic factors causing significant uncertainty, it's important to consider the advantages our cost structure has in responding to external factors beyond our control. First, we've reduced margins in the near term to accelerate revenue growth over the long term. We are investing across all areas of the business, but most significantly within sales and marketing, which grew from 27% of revenue in 2019 to 45% of revenue in 2021. Excluding sales and marketing, we actually saw operating leverage over that 2-year period, with non-S&M expenses declining from 50% of revenue in 2019 to 47% in 2021.

I make this comment because it points to the inherent flexibility in our operating model. Less than 1/3 of our operating spend is fixed. The vast majority is variable and can be flexed up or down dynamically as market conditions warrant. We are an asset-light business with capital expenditures running at just 2% of revenue in 2021. And despite the ramp in CAM spend, we continue to generate positive cash flow and have just under $250 million of cash and no debt on the balance sheet. We feel we are in a very strong financial position to weather a potential economic contraction while still maintaining a healthy level of investment to drive durable long-term top line growth.

I'll now transition to an update on LZ Tax, where we successfully navigated our first peak tax season. We saw a notable step-up in the number of LLC formations attaching a tax subscription in the first quarter of 2022. With taxes top of mind, it's not surprising customers were more open to the cross-sell. However, we were surprised to see a portion of these new customers have already completed their 2021 returns and were instead looking for a tax planning and bookkeeping solution for the 2022 tax year.

This learning reinforces the power of our platform. Entrepreneurs are starting new businesses all year round. And since we're often the very first third-party entrepreneurs visit when starting the business, we have the unique opportunity to grow awareness and drive product adoption off-cycle, a significant advantage to our competition, which primarily relies on new customer acquisition during peak tax season.

We're also seeing a significant opportunity to improve utilization of our tax platform. To date, our efforts have focused on cross-selling tax at the time of business formation. However, many of these new businesses are pre-revenue and are therefore less likely to require tax filing services.

These insights reinforce the importance of engaging our existing base of 1.4 million active legal suit subscriptions, many of whom are generating income and scaling operations. We've seen the power of our channel to acquire new customers and grow awareness. Our focus now is providing these customers with the right service level at the right time in their journey, which is often months after they've borne.

And finally, though it's a bit too early to interpret retention data, we continue to see that customers who engage with our tax platform and experts are really happy with the service. In our Q4 earnings call in March, I introduced our plans to conduct a series of line of tests within our core formation experience throughout 2022. We spent the better part of 2 years driving efficiencies in our fulfillment processes, improving our attorney platform and expanding our subscription ecosystem to make this testing possible.

Our thesis here is that by expanding our formations line of both up and down market, we widened the aperture of customer segments we serve, unlocking new opportunities to grow share and expand customer lifetime value. I'm pleased to report that the first segmented line-up test was launched in late April to a subset of LLC traffic in a few smaller states. The initial test includes a mix of do-it-yourself and attorney-assisted formation experiences with prices ranging from free stand-alone LLC registration to $1,149 for customers seeking a high-touch experience with an attorney.

At the high end, customers will have on-demand access to our independent attorney network for the first 3 months post-formation as well as an attorney-assisted trademark filing with an attorney staffed in our ABS Law Firm. Services include everything from reviewing a lease contract or new employee agreement up to applying for a trademark registration. This one-of-a-kind solution emulates the experience of working with the traditional law firm, but at a fraction of the price.

I'm proud of our team for standing up this new experience in short order. We've taken an agile approach to these tests with the priority being to learn, quickly iterate and expand. We're carefully monitoring user behavior in combination with business metrics such as conversion rates, AOV and subscription attach rates.

I'd also like to talk about our progress on the partner front. Just a couple of weeks ago, you likely saw the announcement of a new multiyear partnership with Wix. When integrated, entrepreneurs will soon be able to have a unified experience to legally form their business in the U.S. and build their online presence together in one place. This partnership is truly bilateral. Whether you start with LegalZoom and add a website or start by building a website and then decide to formalize your business or protect your IP, we work side-by-side to provide an integrated experience. The relationship is also built on recurring revenue model where both parties share in the economics through the life of the customer.

The Wix announcement adds yet another major brand to our growing ecosystem of best-in-class SMB enablement solutions. Other partners include Intuit, Amazon, Square and Toast. The success we've seen in attracting best-in-class SMB partners enhances our strategic moat. Few online providers come close to rivaling the scale of our third-party ecosystem. And with each successive new signed partner, we expand our competitive advantage by forging new relationships that offer integrations with more business applications and exposure to more potential customers.

We anticipate an initial launch of the integrated experience in the second half of this year, but do not expect material revenue from the partnership in 2022. It will take time to commercialize these partnerships to their full potential, but my conviction in the long-term opportunity could not be stronger.

In closing, I'm very encouraged by our results in the first quarter and the energy I've seen across our teams to start the year. Despite a dynamic and, in some ways, challenged economic backdrop, I remain optimistic about the future of small businesses, our industry and LegalZoom's position within it. We have a clear vision and plan and continue to execute against it. A solid first quarter positions us well for a strong 2022, and the foundation is continuing to be laid to enable us to continue penetrating the $50 billion legal service industry in the years beyond.

And with that, I'll hand the call over to Noel.

Noel B. Watson - *LegalZoom.com, Inc. - CFO*

Thanks, Dan, and good afternoon, everyone. I'll start today with a review of our performance in the first quarter and end with our outlook for the remainder of the year.

Total GAAP revenue came in at $154 million, up 15% year-over-year and above the top end of our guidance range. We continue to lap a challenging comparison on the transaction side of the business, with transaction revenue up 4% year-over-year at $64 million. We completed 129,000 business formations in Q1, down 2% compared to the same period last year, in line with our expectations.

As a reminder, we've made 2 small adjustments to our definition of a business formation. The first adjustment is the removal of non-U.S. formations, all of which are attributable to our small presence in the U.K. The second adjustment is the addition of doing business ads or DBA transactions. These transactions are most often completed by sole proprietors and are becoming a significant feeder into our portfolio of subscription services, particularly as we look to integrate LZ Tax into the DBA flow. Excluding these small adjustments, we would have completed 119,000 business formations in the period, also down 2% year-over-year.

Transaction units were 267,000 units in the quarter, down 3% year-over-year. Average order value came in at $240 in the first quarter. The sequential decline is typical of seasonal patterns in the business. More importantly, AOV was up 8% year-over-year, driven by ongoing efficiencies in our order fulfillment processes and growth in our attorney-led trademark solution which carries a significantly higher AOVs than the DIY solution.

Subscription revenue continued to outperform expectations, coming in at $84 million in the quarter, up 29% year-over-year. 55% of our Q1 revenue was subscription, up 600 basis points from the same period last year. We're very encouraged by the pace of this mix shift, which will drive a more predictable, higher-margin operating model.

ARPU was $244 in the first quarter, up 8% year-over-year. ARPU growth has accelerated every quarter we've reported as a public company. We view this growth as durable and driven in large part by new high ARPU services, like LZ Tax and Earth Class Mail. Partnership revenue was approximately $6 million in the first quarter, in line with expectations. We're confident Q4 of last year was a trough in this part of the business due to the transition of the legacy relationship with misaligned strategic objectives.

Now turning to expenses and margins, where all of the following metrics are on a non-GAAP basis. Gross margin came in at approximately 65% of revenue, down from 69% in Q1 of last year. We anticipated the year-over-year decline as we invested to scale our in-house CPAs ahead of the spring tax season. We expect gross margin to normalize in the second quarter and be roughly in line with Q2 of last year. Sales and marketing costs were $72 million in the first quarter or 47% of revenue. Customer acquisition spend came in at $54 million in the period, flat to Q1 of last year.

We signaled our intention to hold media spend roughly flat to 2021 levels. Our outlook here remains unchanged, but we continue to monitor our efficiencies and can adjust up or down quickly if circumstances change.

Within our non-CAM sales and marketing spend, we do expect a onetime $5 million expense in the second quarter related to the rollout of new creative assets. Technology and development spend of $13 million and G&A spend of $15 million were both up modestly on an absolute dollar basis from Q4, but remained roughly flat as a percentage of revenue. Adjusted EBITDA was $1.3 million in the quarter, ahead of our breakeven guidance, and our base of deferred revenue increased by $17 million in the period, which follows typical seasonal patterns.

In the first quarter, we began to execute on our $150 million share repurchase authorization. We repurchased a total of 79,000 shares of our common stock at an average per-share price of $14 for a total repurchase amount of $1.1 million, including commission. We have continued to repurchase shares in the second quarter. As of March 31, 2022, we had cash and cash equivalents of $248 million and no debt outstanding.

I'll now provide our guidance for the second quarter and full year '22. For the second quarter of 2022, we expect total revenue of $162 million to $164 million, 8% year-over-year growth at the midpoint. Business formation has peaked in Q2 of last year, so we are lapping the most challenging quarter for transaction growth. However, we do anticipate total revenue growth to reaccelerate in the back half of 2022.

We expect adjusted EBITDA of $10 million to $12 million in the second quarter or 7% of revenue at the midpoint. We remain optimistic about our ability to deliver strong financial results in 2022, particularly on the heels of a strong first quarter. Given the fluid economic environment and the number of variables outside of our direct control, we remain comfortable with our full year 2022 outlook provided in March.

To summarize, for the full year 2022, we are expecting revenue of $650 million to $660 million or 14% growth at the midpoint. And we expect full year adjusted EBITDA of $48 million or 7% of revenue at the midpoint. As Dan mentioned, our largely variable cost structure allows us to quickly flex our EBITDA margins up or down depending on the operating environment.

We continue to favor a balanced approach to capital allocation that preserves a healthy level of operating cash flow while still providing room for organic investments to drive durable revenue growth in the out years.

And with that, let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Ron Josey with Citi.

Ronald Victor Josey - *Citigroup Inc., Research Division - MD*

I had 2. One is just on assist. Dan, thanks for the additional commentary around the testing of assist across all the different verticals and bringing all the services of traditional law firm to your clients. Just talk to us about the road map here as you're in a few states now. What's needed? What are the gating factors to expand the testing? What are you looking for before you sort of go nationwide would be question one. And then question 2, just on the macro. There are a few comments in here about more fluid results on macro. And just tell us -- if you can tell us what you're seeing from a macro basis, maybe how the quarter progressed where you're seeing in April would be very helpful?

Daniel A. Wernikoff - *LegalZoom.com, Inc. - CEO & Director*

On the first question around what we're doing with assisted, I mean it's worth going back and even just thinking about the journey here. We started by providing an assisted solution for trademarks. And the main thrust of that was just knowing that it's a more complex transaction, some customers wouldn't be comfortable not doing it on their own. We've also gone out and really started a law firm in Arizona, which is under an alternative business structure, which allows us to practice on one geography so that we can start to understand the end-to-end experience of our customers working on our platform.

And now we're really just trying to expand that and think about how we can approach customers who have typically been afraid to do these types of transactions on their own. And that all the way into doing that for our formation specifically, which is where the bulk of the volume is in our business. And so we've introduced a lineup. We're only at this point in 3 small states. Part of the objective here is running water through the pipes to making sure that we're operationally very sound and that we're thinking about the experience and starting to tweak at a lower volume.

The way we're measuring results is we're looking at 1 year bookings and trying to understand if that's accretive and also the shift from lower transactional pricing, which is likely because we're also introducing free along with more subscription bookings and understand the balance between the 2 as we start to offer a more comprehensive lineup to our customers. And then as we see results we like, we just will continue to expand it through multiple states.

And part of the thing that's happening in the background of all this is we have a pretty significant investment in automating the fulfillment of orders. And we also have an investment that we've made that's really around efficiency for our independent network of attorneys. So there's a lot of things going on at once. And actually, I've been pretty pleasantly surprised with the early testing and operationally, it was very sound. We're starting to get data in, and we'll probably be expanding it in the next quarter given what we're seeing so far. So things are going pretty well there.

On the macro side, this one is pretty clear as well. I mean, we went into the year with a pretty clear understanding that we'd see the macro decline year-over-year. In Q1, we saw the census was down 8%. We were down 2% in that period. So we gained a little bit of share. What I'd say is, as you look at April because the census just printed April, that was a little bit on the lower end of what we expected, but still within the range of what we've used to do our plan.

And we're just going to continue to watch it. It's a very dynamic environment. We do have a pretty flexible cost structure, and we think oftentimes in advance around what we're seeing from a demand perspective and dialing up or down our media spend along with it. We're also really consciously thinking about our marginal return in our TAM spend and taking some of the insights that we've been getting from media mix modeling and shifting some of our spend around right now so that we can go after a better marginal return on the last dollar spent.

So -- but there's nothing that we've seen that we didn't expect so far this year on the macro. But again, we just want to be somewhat cautious, knowing that there's a lot going on in the broader economy.

Noel B. Watson - *LegalZoom.com, Inc. - CFO*

Yes, Ron, just to build on that real quick. In terms of Dan's comments on the macro, I mean, that really largely describes why we've sort of reiterated and maintained our guidance for the full year for both top and bottom line.

Operator

Our next question comes from Elizabeth Porter with Morgan Stanley.

Elizabeth Mary Elliott - *Morgan Stanley, Research Division - VP of Equity Research*

I wanted to follow up on the comment for the outperformance information versus the broader macro. I believe last year, share gains in formations were a little bit lot lighter than what you were expecting and the guidance for this year was implying a similar rate of gains. So could you just hit on the pace of share gains versus your expectations? And especially in light of the marketing spend changes that you guys are doing.

Daniel A. Wernikoff - *LegalZoom.com, Inc. - CEO & Director*

Sure. Thanks for the question, Elizabeth. Yes, I mean, I just -- I mentioned -- I mean, we -- the macro is down 8%. We were down to -- it's roughly 5% share gain, which I think isn't that far out of line. And in fact, you should see on a quarter-to-quarter basis, it's not going to be entirely linear. There are things that we are doing in terms of shifting our marketing spend and part of this shift started at the end of the quarter and is actually happening currently.

And we're -- whenever you do this, a shift in media mix, oftentimes, there's different durations in payback of that media mix. And we're starting to dial down in some of the areas where you have a media payback and what you're starting to see is us putting it into some different channels that have paybacks that could be 2, 4, 6 weeks. So there's -- it's not going to be a linear share gain all throughout the year. It's going to be something where it's going to be -- there's going to be some variance quarter-to-quarter.

The other thing I'd mention is as we start to do more premium deployment. You probably will begin to see us look to accelerate share gains. If we -- if it's working, you will see us start to take more share because we're going after the price-sensitive customers. And again, we'll only do that if we feel like it's a net positive on a 1-year bookings basis. But that may mean that we're -- we're giving it a little bit on the AOV in order to really push harder on continuing to accelerate the subscription bookings.

Noel B. Watson - *LegalZoom.com, Inc. - CFO*

Yes. And just to further highlight that last sentiment. So subscription has been an ongoing focus for us. And you saw that we had 29% revenue growth in subscriptions for the quarter. So I think our focus and investment around building out that ecosystem further helps to sort of dislocate us from the macro.

Elizabeth Mary Elliott - *Morgan Stanley, Research Division - VP of Equity Research*

Great. And then following up on subscriptions. In terms of the units added in the quarter, it looked lighter than what you did on average in 2021. So how should we think about the balance between kind of the unit volume and the ARPU for the remainder of the year, especially after -- as you go after some of the higher value units and tax?

Daniel A. Wernikoff - *LegalZoom.com, Inc. - CEO & Director*

Yes. I mean one of the things that is a reality of our business model is there is a coupling between the transactional growth and the subscription units. And so when you think about the beginning of this year when we're lapping some of those comps from prior year, it certainly will impact some of the unit growth. What's also interesting, too, as you think about this year, as you get to the back half of the year, there is a seasonal component to our business as well with LZ Tax. And so I would expect that to start to decelerate a little bit.

And then the thing that's a bit of an unknown or an opportunity to the good side though is that we haven't really marketed LZ Tax to the broader base. We now have virtual mail through our Class Mail acquisition, and we have the opportunity to market that as well, where it's not penetrated into the base. And then again, the piece on premium is really interesting because with the free solution, we have the opportunity to go out to price-sensitive customers.

And just to remind everybody, those customers as they may form a business for free, it would probably be a paid solution as you talk about RA and compliance. So we hope that, that would be accelerating our subscription growth in the back half of the year as well. So there's a little bit of a reality in the front half of the year on transaction growth lapping, but we have a lot of levers that we're currently testing and looking to sort of offset that in the back half.

Noel B. Watson - *LegalZoom.com, Inc. - CFO*

And then just further on that, as you were alluding to Elizabeth, in terms of -- you do have to look at subscription unit growth and ARPU growth in coordination because we're more than willing to make a trade-off if the LTV is right for higher ARPU subscriptions. And as we mentioned in our prepared remarks, we expect durable ARPU gains kind of consistent with the year-over-year growth that we saw in Q1 moving forward, in part driven by the focus on tax and the integration of ECM.

Daniel A. Wernikoff - *LegalZoom.com, Inc. - CEO & Director*

The 8% ARPU growth year-over-year is just a reflection of that mix shift. And again, there's less units coming from tax than we have from compliance, but at a higher price.

Operator

Our next question comes from Andrew Boone with JMP Securities.

Andrew M. Boone - *JMP Securities LLC, Research Division - Director & Equity Research Analyst*

Dan, as we think about a premium offering as well as a loan offering coming to market, can you frame just the overall product offering in a more comprehensive way as we start to think about 2023? What does that start to look like? And how do we think about share gains as well as pricing as well as just overall growth as we put those pieces together? And then secondly, now that you're kind of through your first tax season with LZ Tax, I'd love to hear how that went and what you need to do to improve on the experience for next year?

Daniel A. Wernikoff - *LegalZoom.com, Inc. - CEO & Director*

Great. Yes, there is a premium offering, and this is more early innings, to be honest, because we know how we want to approach a free solution for customers where it's really free filing with the state but then lots of add-on services and products. And so that piece is pretty straightforward. The premium piece is a little bit different in that there's going to take some experimentation to get this right. One of the things that we had believed last year was that customers wanted assistance as they were forming their business right at the moment of formation, meaning like I want to know what entity I should be.

And what we've realized is actually one of the bigger problems is customers don't know what to do once they form and they start to have real challenges when they hire their first employee, or they have to sign a lease or they have their first contract. And so we've really structured this initially to be more comprehensive and having access on demand to an attorney for 3 months post-formation. Now that also includes the ability to amend your formation and do other things that are sort of tied to the entity selection, but it's much more comprehensive.

There's 2 SKUs right now that we're testing. One is just the formation itself and having access to the attorney. The other one then also adds a trademark because we know that most of our customers that you buy trademark, do it within 6 months of forming their business. So there's an obvious bundling opportunity there as well. We started with price points that were premium price points, and we have a lot of flexibility to try and test and learn what the right price point is here as well. And we will have a lot to learn on how we commercialize it, how we talk about it.

If you think about it today, we're not doing anything at the top of the funnel. So most of the people who come to LegalZoom are coming for a DIY solution. You must have to reframe that we have this hybrid-assisted solution as well. And so there's some work to do even at the top of the funnel that we'll start to do it at the later parts of this year. Anything you'd add there, Noel, before I jump into the tax season?

Noel B. Watson - *LegalZoom.com, Inc. - CFO*

No, I think you got it.

Daniel A. Wernikoff - *LegalZoom.com, Inc. - CEO & Director*

Okay. Tax season. So this was a really interesting tax season. This is, I will say, the first time I've worked on a tax season that's been very specific for small businesses. I would say we learned quite a bit. We went into the season, by the way, not trying to optimize operationally but really focus on the customer experience. And we created a very broad offering. So they weren't like segmented offerings that weren't really well targeted. And we wanted to learn as much as we could during season so that we could start to tune the offering for next year.

And I think we discovered quite a few interesting things. So the first off is that our customers are very simple filers. The majority of them being 1040 with Schedule Cs versus the more complex like 1120 corporate filers. Service delivery was much more spread out than we thought it would be. We went in thinking that it would be very peaky and the reality is we ended up not seeing the peaks as high at the end of the tax season, the filing deadlines and instead saw a lot of people doing extensions.

We also saw our customers overweighting on advice because they were so early on their journey as a business. So a lot of them weren't in operations yet. We're paying for a comprehensive service but really just wanted access to an accountant. And so it speaks a little bit to the opportunity that we have around how do we commercialize that product as well, so that there's sort of a low-end product and then a very premium product. And then I'd say the last piece is we learned a lot about how to operationalize this business.

Like I said, we hired into the season very specifically to make sure we left no customers behind. And now we have a better sense of the actual filing curve and how we're going to approach efficiently supporting those customers for next season.

Operator

Our next question comes from Matt Pfau with William Blair.

Matthew Charles Pfau - *William Blair & Company L.L.C., Research Division - Analyst*

Wanted to just first hit on retention and if you could give us any updated commentary on what you're seeing with retention within your subscriber base and then how we should think about that in the recession environment where we perhaps see an uptick in business failures?

Daniel A. Wernikoff - *LegalZoom.com, Inc. - CEO & Director*

Yes. So I'll hit on recession primarily on the core products, the core compliance products. It's harder to talk about retention just yet on things like LZ Tax or Virtual mailings. We haven't really lapped the acquisition of those customers. Not much has changed here. I mean we did see a weakness in the customers acquired during COVID. And as we look back at the data, there were 2 things that would distinguish them. Some of those businesses were designed to be somewhat ephemeral like in reaction to COVID. And then we also saw a higher mix of first-time businesses.

So we have typically a mix of people who form multiple LLCs and then we have people who are trying it for the first time, that mix actually went up pretty materially and we attribute that to a higher level of a failure as well. That's already started to normalize. And the other thing I'd point out, though, is that every other cohort, so as you get into the 25 and the 37 months and different age cohorts, we were seeing improvements in our retention.

As it relates to recession, I wouldn't say that we're -- I don't know if anybody can say they're a completely recession-proof business, but as we lived through the Great Recession, did see that formation volume went down roughly 10%, during the great Recession. And we actually accelerated through that. As it relates to business failures, you should expect a little bit more from business failures. Typically, though, again, it's going to be the ones that have less of a track record. It's going to be the -- like the cohorts that are being acquired as you go into the recession versus more of the age cohorts.

Matthew Charles Pfau - *William Blair & Company L.L.C., Research Division - Analyst*

Really, really helpful. And then I wanted to hit on just how you're thinking about marketing and perhaps CAM spend, maybe this year and into next. So you have a lot of new products that you're working on, whether it be the free filing product or the premium one and LZ Tax, which hasn't been perhaps broadly marketed yet. Is it possible we would see a big uptick as these products start to gain traction and you want to take them out more broadly? Or how should we think about that?

Daniel A. Wernikoff - *LegalZoom.com, Inc. - CEO & Director*

It's almost the opposite. We really want to have a singular message for customers, and we do have a brand campaign that's actually launching this weekend where it's just a singular message around, we are the place to go to form your business. And what we want to do is to have the product work as the channel for all the services but we know that there's still a pretty big opportunity to get the product knowledge that LegalZoom stands for small business formation versus the consumer side.

So the brand campaign itself is all about forming your business. And then, again, we have opportunities in the product. I'd say none of us are happy right now with how sophisticated we are in targeting and really knowing our customer and making sure that we're marketing to them the right solutions. So this is a big area of focus for us as well. So I'll give you an example. If you came into our platform and you are pre-revenue, you really don't need a tax filing solution. Right now, we're marketing it.

And those customers, some of them would select it for the tax advice when we -- you'll see us coming out of the season have something very specific for customers who are not or pre-revenue and looking for help making tax strategies part of their formation process. And I think there's other things like that as well where we really -- we know a lot about these customers and haven't been as sophisticated in targeting them as we should be.

Operator

Our next question comes from Mario Lu with Barclays.

X. Lu - *Barclays Bank PLC, Research Division - Research Analyst*

The first one is on the Wix partnership. You mentioned it's going to roll out sometime in the second half of the year. So I was just hoping if you could help us frame the long-term opportunity with regards to this partnership? And I guess, how does that compare to the ones you currently have with others like Brex or Square?

Daniel A. Wernikoff - *LegalZoom.com, Inc. - CEO & Director*

Yes. Great question. Thanks, Mario. The -- so we're really excited about this one. I think this one is -- it's definitely a win for LegalZoom. I think it's a big win for Wix, and it's a really big win for customers. So 80% of the customers that form with us today don't yet have a website, which is pretty incredible because we also know that 70% of them intend to get one. And so what we're really trying to do here is build an extremely tight integration. This is not one of these kind of affiliate relationships, but this is one where there's a material cost investment on both ends so that we can integrate their experience into the formation experience.

So we also know that Wix acquires more customers than we do from a small business standpoint, and we also only have 10% share. So there's a pretty material acquisition opportunity going the other direction. And the team there is great. I mean they really think partner first and -- they've built a pretty compelling platform. And we have lots of ideas of how we can integrate our products into their solution. Not just on formations, by the way, but these are customers who are very focused on identity as well. And so things like IP and trademark, they're really interesting opportunities when you start thinking about their base.

This is one where we're starting with testing where the integration won't be as deep. And I'm happy to say that, that will happen much sooner than in the back half of the year, and we'll start to get real learnings about what's resonating with customers. But the deep product investment would be happening towards the back half of this year. We think it will be material, and this is the type of thing that we'll do in terms of the types of partnerships that we have going forward, just not in this fiscal year, and we'll start to see the impact next year. First, you'll see it in customer growth. And then you'll start to see the buildup in that recurring revenue.

X. Lu - *Barclays Bank PLC, Research Division - Research Analyst*

Got it. Super helpful. And then just one for Noel in terms of the gross margin this quarter. I believe it came a little bit lower than expected and versus historical. So I guess, what were the main drivers here? And how should we think about the gross margins for the rest of the year?

Noel B. Watson - *LegalZoom.com, Inc. - CFO*

Yes. Thanks, Mario. So as we mentioned in our remarks, it was really in support of tax season, and we've said a few times that we were going to scale up pretty aggressively to make sure that we could support our first tax season. We do expect gross margin percentage to normalize in Q2, as we also mentioned and really just start to see some slight leverage from that kind of sequentially throughout the back half of the year.

Operator

Our next question comes from Nat Schindler with Bank of America.

Nathaniel Holmes Schindler - *BofA Securities, Research Division - Director in Equity Research*

Just quickly to just really pile on the macro side. Just wondering, has there been any historical evidence, particularly around business formation that shows a trend, particularly people have talked about potentially there being a early slowdown in front of recession and then an early expansion business formations as you come through a recession? Is that at all an accurate statement? Or have you seen evidence that suggest that?

Daniel A. Wernikoff - *LegalZoom.com, Inc. - CEO & Director*

That's one I'd probably have to go back and study closer. I mean when you look at census data, you do see there is a 10% reduction and then a 5% reduction over the 2 years of the Great Recession. And then an acceleration coming out. But like try and understand the timing of that finite level is I'd have to be looking on a month-over-month basis. And I haven't looked at that back at 2008, 2009.

Operator

Our next question comes from John Byun with Jefferies.

Sang-Jin Byun

This is John in for Brent Thill. I have 2. On the -- we're almost halfway through the quarter. I'm just wondering if you could share a little bit more about the trends you're seeing April, May across the different segments? And then second, on LZ Tax, wondering if you could provide a little bit more color as to the profile of customers you're attracting? You mentioned many of them had already done their taxes. So are they typically coming from a DIY-type profile? Or did they use like a CPA or a tax store and was there any difference in terms of attracting them in April versus earlier this year?

Daniel A. Wernikoff - *LegalZoom.com, Inc. - CEO & Director*

Yes. Thanks for the question, John. I think the -- on the April and May performance, we really don't like to get into the forward performance and there's a lot of the quarter to still play out. The one thing I'll again point you to is the census data, which did get printed for April, it showed a 13% decline in formations. But that's something that I don't think was that far out of our expectation. On the LT tax side, I'd say the profile of the customer is, like I mentioned before, meaning much more towards micro-businesses, side businesses, more personal filers in a way.

And when we think about -- what that means, in some cases, it means their actually current provider is really a personal tax provider, and this is adding on a Schedule C to that filing. A lot of them is interesting. We saw some people who didn't fully understand that doing a Schedule C filing is a personal filing. And so some people had actually come to us and bought the service. And filed a personal return, and then we went back and amended that personal return to make sure that we put the Schedule C filing on it as well.

So it just gives you a sense of how early they are in the cycle of their business. But at the same time, we have everything in our base. So we have corporate customers as well. People are incorporating, and you'll see 1120 filers. We have nonprofit filers. We have pretty complex filing returns as well. I think that's the big opportunity for us, by the way, because if you look at how we commercialize the product this year, it was more based off behavior versus forms. And we know that forms are a really good way to segment customers because it shows the complexity of their business. And so that's a place where I know we'll do a lot more next year.

Operator

(Operator Instructions) Our next question comes from Stephen Ju with Credit Suisse.

Stephen D. Ju - *Crédit Suisse AG, Research Division - Director*

As a follow-up to one of the earlier questions around the partnerships. Can you talk generally about how these will appear on the P&L, I mean, recognizing every one of these deals may be different, but presumably, there will be some sort of exchange in economics. So will there be some sort of expense recognized or finder's fee or lead gen fee or maybe a contra revenue item? And as you think about the cost of the customers acquired through these partnerships, is this more efficient versus your typical direct marketing campaign?

Noel B. Watson - *LegalZoom.com, Inc. - CFO*

Stephen, this is Noel. Thanks for the question. So first, I'll go back to some of Dan's comments, just mentioning strategically, this fits into our sweet spot in terms of the relationship being bilateral and recurring revenue. And so part of it will be, will flow through our sort of core streams in terms of it will be formations that are driven through the relationship with Wix. And we'll fulfill them as we normally would.

And you'll see other -- the other part of the stream is where we're presenting Wix offerings to our customers. And that will flow through our partnerships revenue with a contra revenue for the rev share.

Daniel A. Wernikoff - *LegalZoom.com, Inc. - CEO & Director*

Yes. From an economic standpoint on the cost of acquisition, these partnerships are early, and we're working with the partners in the case of like Wix, where it's bilateral. It's very clear we both come into this with an expectation and an understanding of what our cost to acquire and other channels are. And so we've pretty much set the economics somewhere near that. And I'm sure that will be something that we also continue to learn from. But we -- the interesting part here again is that we actually feel like this just increases the overall size of the pie, of people that we can access because these are existing businesses that in the case of Wix, for instance, spend a considerable amount of time in that application. I mean that's where they run their business.

And so you can almost think of this as not just an acquisition play but also a brand player like really helping people understand what LegalZoom does. And same thing on their side that the moment you're forming a business we're introducing you to what we think is an amazing brand of Wix. And so these are both pretty economical ways to approach acquisition of our customers.

Operator

I'm showing no further questions in queue at this time. This concludes today's conference call. Thank you for participating. You may now disconnect.