



Understanding How the New LGM for Dairy Fits on Your Dairy

Alan Zepp

Risk Management Program Coordinator

Center for Dairy Excellence



pennsylvania

DEPARTMENT OF AGRICULTURE



CENTER FOR
Dairy EXCELLENCE

LGM for Dairy Today

- Why?
- LGM Basics
- LGM today
- LGM's Role

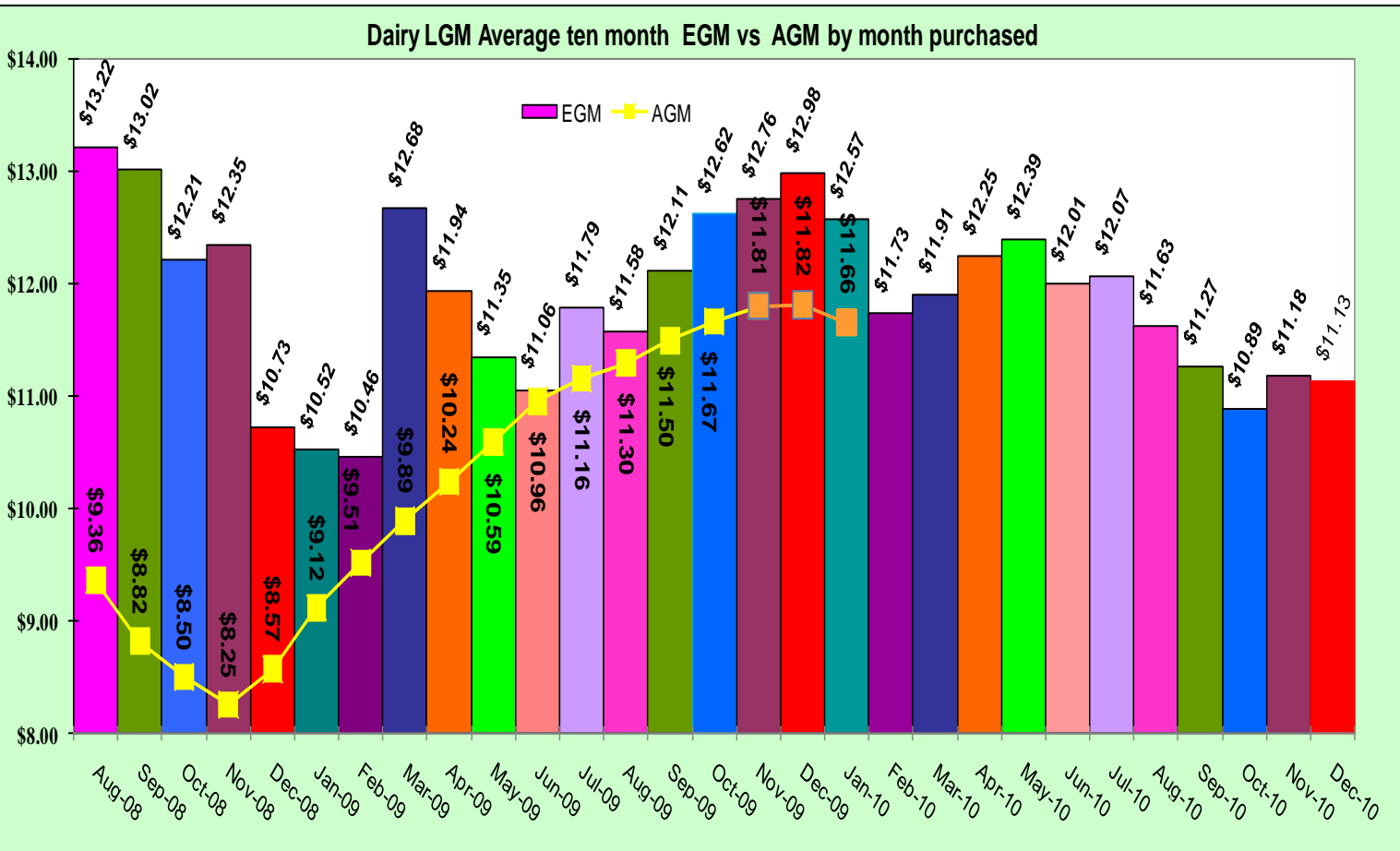


Why Manage Price Risks

- Different World
- Smaller World
- Cushion Crashes
 - Protect Profits & Your Business
- Producers - Risk Takers
- Individual responsibility
 - Time



10 Month Margins



Default Margin ?

100 lbs Class III Milk		\$16.00
- 1/2 bushel corn - \$6.00/ bu		-\$3.00
- 4 lbs bean meal		
	(.002 T)	\$380/T
		-\$0.76
<hr/>		
=Default LGM Margin		\$12.24



Feed Values

- Feed values have been updated based on information from the National Milk Producers Federation
 - Corn .00364 -.0381 T 7.28- 76.2 lbs
 - Soy Meal .000805- .013T 1.61 - 26 lbs
- Document Rations
- Use default values to Keep it simple!!



Margin Not Price

	NASS <u>All Milk Price</u>	PSU <u>Milk Margin</u>
• August 08	\$20.50	\$12.33
• November 08	\$19.20	\$12.31
• January 10	\$18.30	\$12.32



Dairy Gross Margin Insurance

- Crop Insurance Policy
 - <http://www3.rma.usda.gov/apps/agents/index.cfm>
 - Crop Revenue Protection for milk
 - Contact Alan Zepp for help
- Bundled option
 - Class III milk - put option
 - Corn - call option
 - Soybean meal - call option



Dairy Gross Margin Basics

- Last Friday & Saturday of each month
- Can cover any portion of expected milk
- Coverage period from 1 to 10 months
 - Stacked coverage
- Maximum milk enrollment – 240,000 Cwts / Year
- **LGM is an insurance policy**
- **No potential upside losses**



LGM Changes

- Available in all contiguous 48 states
- Deductibles – \$0- \$2 /cwt. in \$0.10/cwt. intervals
- Federal premium subsidy if milk is enrolled in at least 2 of the months available for the monthly enrollment period



Premium Subsidy

Deductible	Subsidy for Pooled Coverage	Subsidy for Unpooled Coverage
\$0.00	0.18	0.00
\$0.10	0.19	0.00
\$0.20	0.21	0.00
\$0.30	0.23	0.00
\$0.40	0.25	0.00
\$0.50	0.28	0.00
\$0.60	0.31	0.00
\$0.70	0.34	0.00
\$0.80	0.38	0.00
\$0.90	0.43	0.00
\$1.00	0.48	0.00
\$1.10	0.50	0.00
\$1.20	0.50	0.00
\$1.30	0.50	0.00
\$1.40	0.50	0.00
\$1.50	0.50	0.00
\$1.60	0.50	0.00
\$1.70	0.50	0.00
\$1.80	0.50	0.00
\$1.90	0.50	0.00
\$2.00	0.50	0.00



Margins January 21, 2011

Understanding Dairy Markets U of Wisconsin

Month	Milk Quantity (cwt)	Corn Equiv. (tons)	SBM Equiv. (tons)	Expected Milk Price (\$/cwt)	Expected Corn Price (\$/bu)	Expected SBM Price (\$/ton)	Monthly Gross Margin (\$)	Monthly Gross Margin (\$/cwt Covered Milk)
Mar-11	2000	28	4	\$15.57	\$6.51	\$382.73	\$23,098.85	\$11.55
Apr-11	2000	28	4	\$15.86	\$6.56	\$384.11	\$23,623.29	\$11.81
May-11	2000	28	4	\$16.06	\$6.61	\$385.49	\$23,967.65	\$11.98
Jun-11	2000	28	4	\$16.11	\$6.63	\$385.84	\$24,046.25	\$12.02
Jul-11	2000	28	4	\$16.32	\$6.65	\$386.18	\$24,444.81	\$12.22
Aug-11	2000	28	4	\$16.36	\$6.40	\$376.11	\$24,815.09	\$12.41
Sep-11	2000	28	4	\$16.37	\$6.15	\$365.24	\$25,128.52	\$12.56
Oct-11	2000	28	4	\$16.38	\$6.02	\$351.40	\$25,330.38	\$12.67
Nov-11	2000	28	4	\$16.27	\$5.90	\$350.35	\$25,241.12	\$12.62
Dec-11	2000	28	4	\$16.24	\$5.77	\$349.30	\$25,311.87	\$12.66



Deductibles

Deductible (\$/cwt)	Net Prem/cwt of Farm Milk (\$/cwt)	GMG/cwt of Farm Milk (\$/cwt)	Net GMG/cwt of Farm Milk (\$/cwt)	Net Prem/cwt of Covered Milk (\$/cwt)	GMG/cwt of Covered Milk (\$/cwt)	Net GMG/cwt of Covered Milk (\$/cwt)
\$0.00	\$0.69	\$12.25	\$11.56	\$0.69	\$12.25	\$11.56
\$0.10	\$0.64	\$12.15	\$11.51	\$0.64	\$12.15	\$11.51
\$0.20	\$0.58	\$12.05	\$11.47	\$0.58	\$12.05	\$11.47
\$0.30	\$0.53	\$11.95	\$11.42	\$0.53	\$11.95	\$11.42
\$0.40	\$0.48	\$11.85	\$11.37	\$0.48	\$11.85	\$11.37
\$0.50	\$0.43	\$11.75	\$11.32	\$0.43	\$11.75	\$11.32
\$0.60	\$0.38	\$11.65	\$11.27	\$0.38	\$11.65	\$11.27
\$0.70	\$0.34	\$11.55	\$11.21	\$0.34	\$11.55	\$11.21
\$0.80	\$0.30	\$11.45	\$11.15	\$0.30	\$11.45	\$11.15
\$0.90	\$0.27	\$11.35	\$11.09	\$0.27	\$11.35	\$11.09
\$1.00	\$0.21	\$11.25	\$11.04	\$0.21	\$11.25	\$11.04
\$1.10	\$0.19	\$11.15	\$10.96	\$0.19	\$11.15	\$10.96
\$1.20	\$0.17	\$11.05	\$10.88	\$0.17	\$11.05	\$10.88
\$1.30	\$0.16	\$10.95	\$10.79	\$0.16	\$10.95	\$10.79
\$1.40	\$0.15	\$10.85	\$10.71	\$0.15	\$10.85	\$10.71
\$1.50	\$0.13	\$10.75	\$10.62	\$0.13	\$10.75	\$10.62
\$1.60	\$0.12	\$10.65	\$10.53	\$0.12	\$10.65	\$10.53
\$1.70	\$0.11	\$10.55	\$10.44	\$0.11	\$10.55	\$10.44
\$1.80	\$0.10	\$10.45	\$10.35	\$0.10	\$10.45	\$10.35
\$1.90	\$0.09	\$10.35	\$10.26	\$0.09	\$10.35	\$10.26
\$2.00	\$0.08	\$10.25	\$10.17	\$0.08	\$10.25	\$10.17



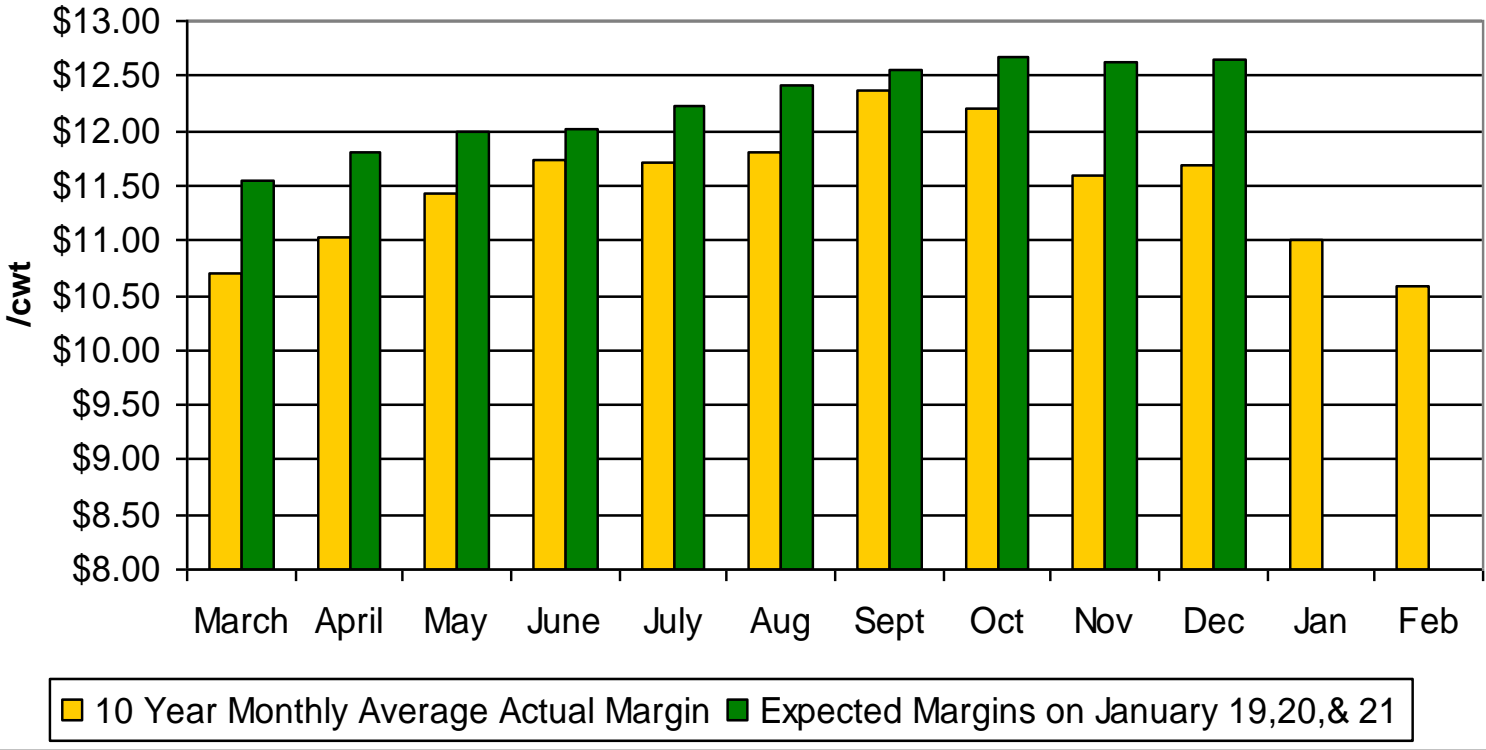
Premium Payment Example

- January 2011 bought a policy for June and July
- December 2011 end of insurance period
- First business day after end of insurance period January 1, 2012

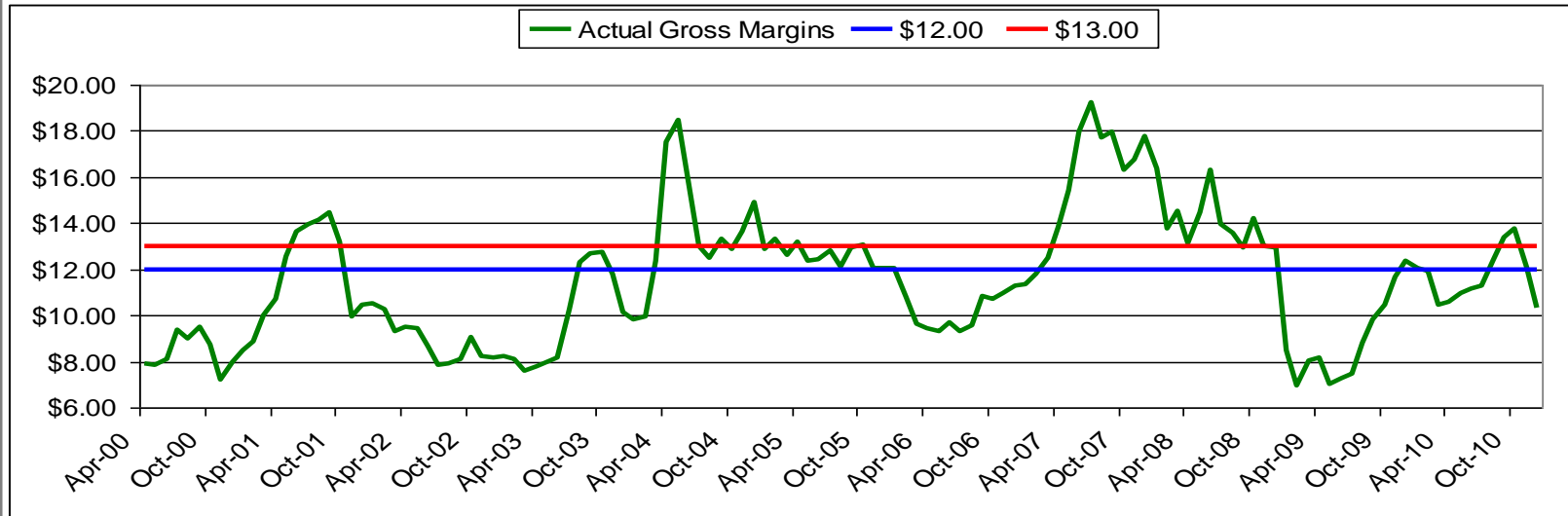


Current vs Historical Margins

Expected Margins on January 19,20,&21
vs 10 Year Average of Actual Margins



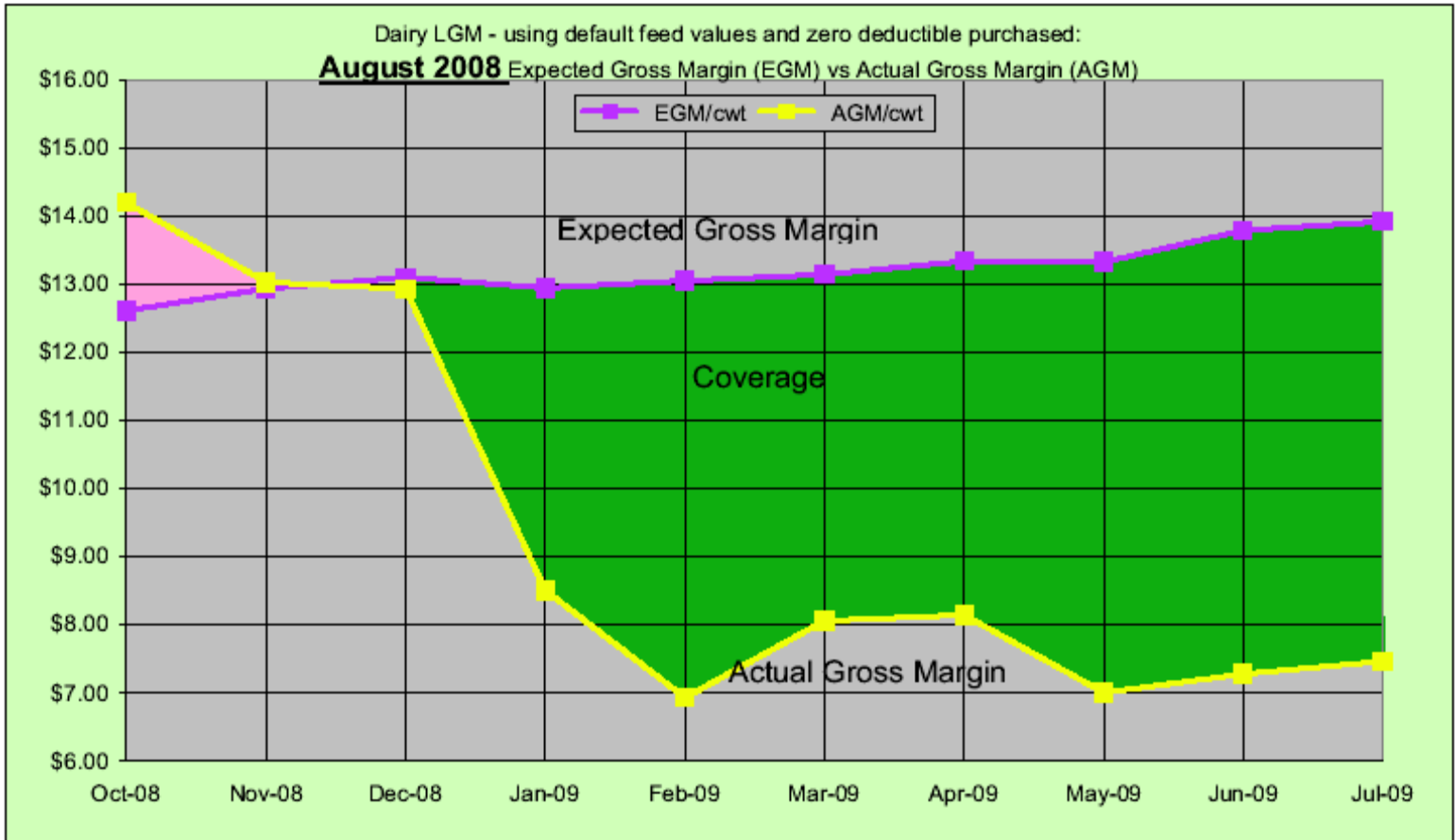
LGM Actual Margins



- 10 year average \$11.51
- 5 year Average \$12.14
- Highest \$19.21 July 2007
- Lowest \$ 6.93 February 2009



August 2008



LGM Sales

State	Commodity	Ins Plans	# Policies sold Dec. 17-18, 2010	# Policies sold July-Dec. 2010	# Policies sold July-Nov., 2010
CALIFORNIA	DAIRY CATTLE	Livestock Gross Margin	4	8	4
DELAWARE	DAIRY CATTLE	Livestock Gross Margin	0	2	2
IOWA	DAIRY CATTLE	Livestock Gross Margin	5	6	1
IDAHO	DAIRY CATTLE	Livestock Gross Margin	12	17	5
ILLINOIS	DAIRY CATTLE	Livestock Gross Margin	2	2	
KANSAS	DAIRY CATTLE	Livestock Gross Margin	0	1	1
MASSACHUSETTS	DAIRY CATTLE	Livestock Gross Margin	1	1	
MARYLAND	DAIRY CATTLE	Livestock Gross Margin	8	14	6
MICHIGAN	DAIRY CATTLE	Livestock Gross Margin	5	24	19
MINNESOTA	DAIRY CATTLE	Livestock Gross Margin	12	24	12
NEW YORK	DAIRY CATTLE	Livestock Gross Margin	11	15	4
OHIO	DAIRY CATTLE	Livestock Gross Margin	1	1	
OKLAHOMA	DAIRY CATTLE	Livestock Gross Margin	0	1	1
OREGON	DAIRY CATTLE	Livestock Gross Margin	1	1	
PENNSYLVANIA	DAIRY CATTLE	Livestock Gross Margin	25	58	33
SOUTH DAKOTA	DAIRY CATTLE	Livestock Gross Margin	3	8	5
TEXAS	DAIRY CATTLE	Livestock Gross Margin	2	2	
UTAH	DAIRY CATTLE	Livestock Gross Margin	3	11	8
VIRGINIA	DAIRY CATTLE	Livestock Gross Margin	1	6	5
VERMONT	DAIRY CATTLE	Livestock Gross Margin	21	23	2
WASHINGTON	DAIRY CATTLE	Livestock Gross Margin	13	13	
WISCONSIN	DAIRY CATTLE	Livestock Gross Margin	22	135	113
WYOMING	DAIRY CATTLE	Livestock Gross Margin	2	2	
Grand Total:			154	375	221



Where does LGM fit?

- Cost of Production?
- Dairy Policy ?
- Cash Flow Insurance
- Base for a marketing plan
- Beat the market?



Cash Flow Insurance

Snapshot of Three Enrollment Patterns

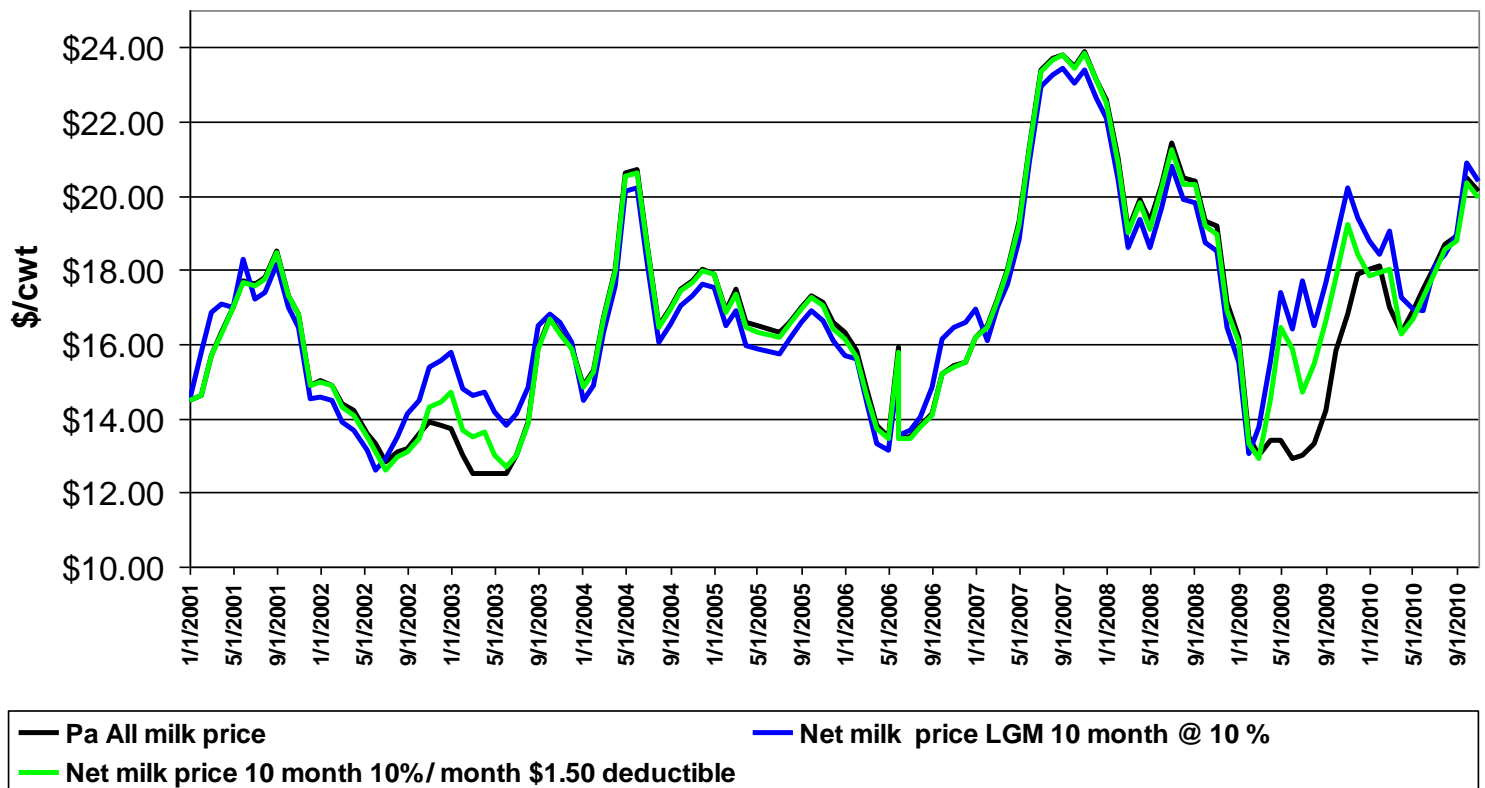
Scenario I Months 4, 5, 6 33% each month	Scenario II Months 7, 8, 9, 10 25% each month	Scenario III Months 1 through 10 10% each month
Benefit to cost ratio at zero deductible		
1.33/1.00	1.40/1.00	1.50/1.00
Benefit to cost ratio at \$1.50 deductible		
3.26/1.00	2.99/1.00	3.84/1.00

Using consistent milk enrollment amounts and selected monthly patterns each enrollment period

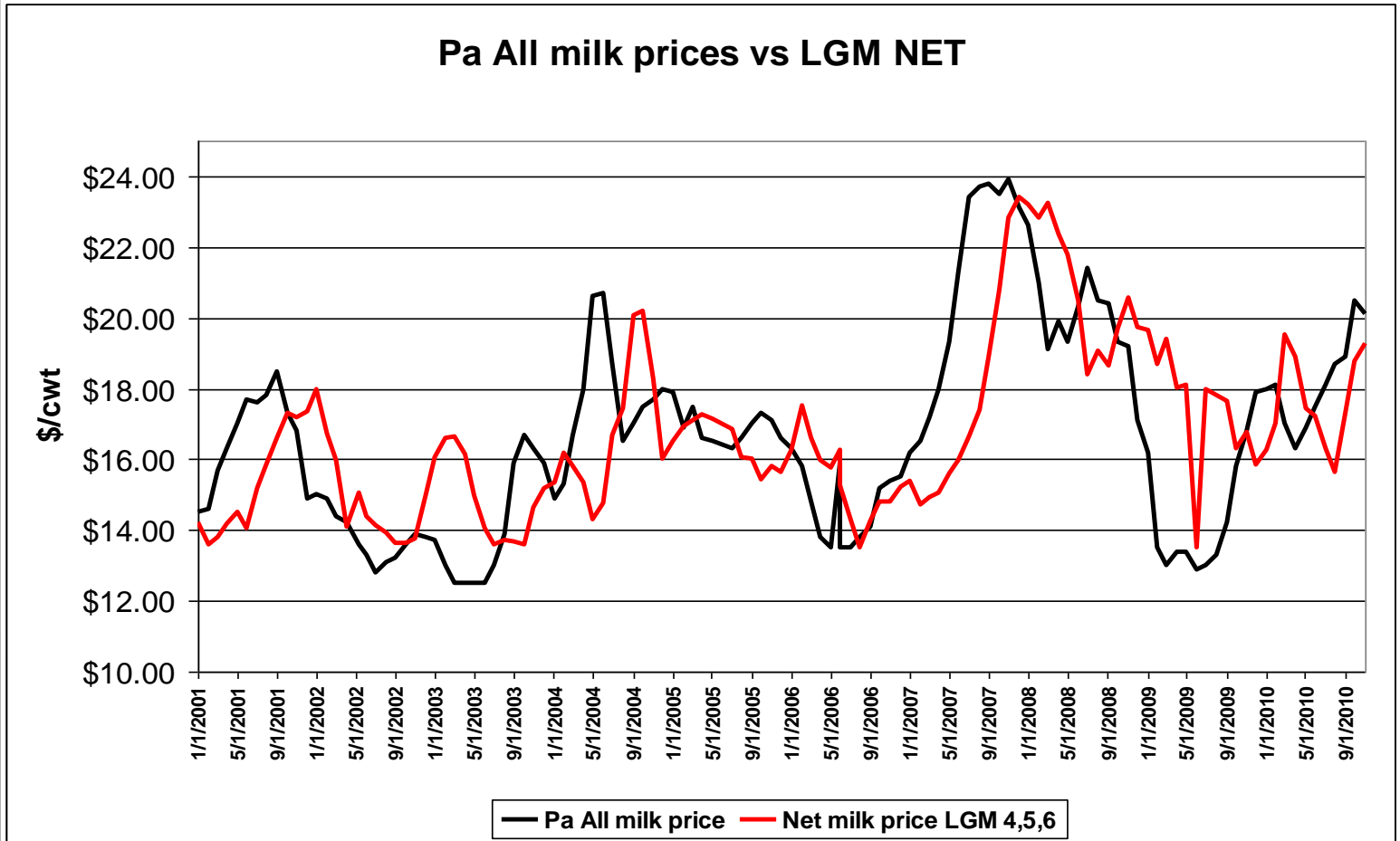


10% per Month All 10 Months

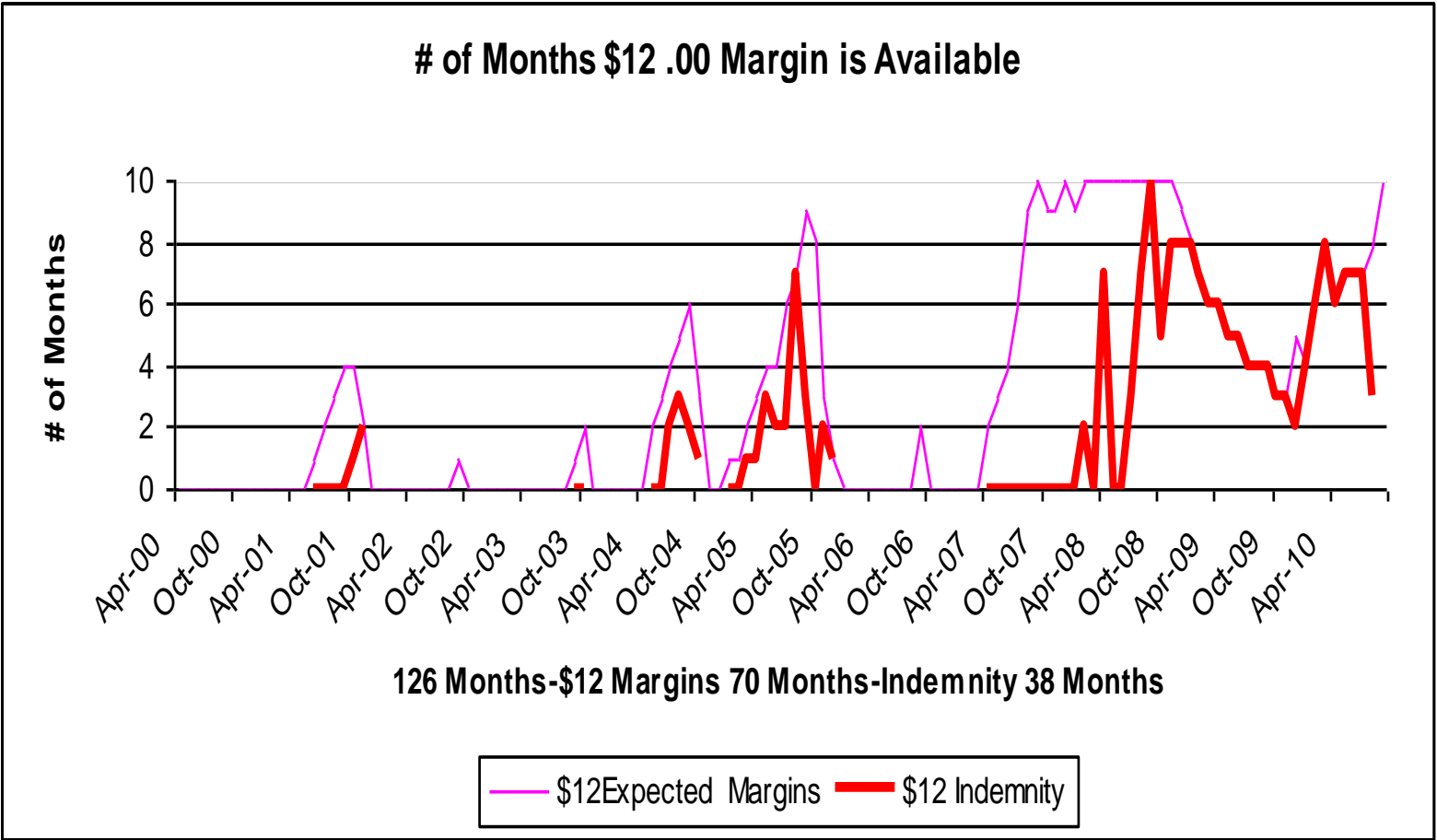
Pa All milk prices vs LGM NET



33% per Month in Months 4,5,&6



\$12.00 Margins



How much coverage do I need?

- Debt obligations
- Risk Tolerance
- Other Tools
- Expected Margins Available
 - Higher Margins & Volatility
 - Use higher deductibles to lower cost
 - Smaller Margins & Less Volatility
 - Lower deductibles cost less



Dairy Gross Margin Insurance

- Convenient
 - 1 sales period/ month
 - Milk – Feed Cost
- Flexible
 - All types of Dairy farms
 - Insure 1 or 10 Months
 - Default or Actual Feed Values
 - Cash Flow Friendly
 - No potential upside losses





Alan Zepp

Risk Management Program Coordinator

azepp@centerfordairyexcellence.org

717-420-7448

717-346-0849



pennsylvania

DEPARTMENT OF AGRICULTURE



CENTER FOR
Dairy EXCELLENCE