

LGM-Dairy: Livestock Gross Margin for Dairy

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PDPW – Production Management Symposium, Nov. 2008

LGM-Dairy: What is it?

- New Livestock Gross Margin for Dairy Insurance
 - Federally reinsured dairy insurance program
 - Purchased from crop insurance providers
 - Approved July 2007, available August 2008
- Protects Dairy Business against Unexpected declines in Gross Margins
 - $\text{Gross Margin} = \text{Milk Revenue} - \text{Feed Costs}$
- Revenue neutral (No subsidies)
 - Premium = Expected Indemnity

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LGM-Dairy: What impacts the premium?

- Insured milk and insured feed (selected)
- Deductible level (selected)
- Average futures prices and their volatility (market determined)

How does it work?

LGM-Dairy pays the difference, if positive, between an expected gross margin guarantee and actual gross margin, when gross margin is milk price less the feed costs per cow.

The insured margins are calculated using futures prices for milk, corn and soybean meal.

Producers need to estimate the quantity of milk to be marketed, the feed quantity to be used, a deductible level and the months to cover the gross margin.

Farmers can insure an amount of milk up to 240,000 cwt per insurance period.

Deductible level ranges between \$0 and \$2.50 of the gross margin guarantee.

Insurance coverage begins one full month after the sales closing date.

LGM-Dairy is only sold on the 3rd to last business day of every month. Sales period starts at 4 P.M. the 3rd to last business day and ends at 4 A.M. the following day.

LGM-Dairy More Information:

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Additional Information on:

http://lga.wisc.edu/extension/extension.html
http://www.wisconsin.edu/extension/extension.html
http://www.wisconsin.edu/extension/extension.html

LGM-Dairy: Livestock Gross Margin Insurance for Dairy Cattle

A New Risk Management Tool for Wisconsin Dairy Farms!

What is LGM-Dairy?

LGM-Dairy is a new insurance policy approved by the USDA Risk Management Agency available for dairy producers since August 2008.

LGM-Dairy protects producers against unexpected declines in the gross margin (milk price less feed costs).

No producer premium subsidy is available for this insurance program, although all administrative and policy adjustment are paid by the federal government.

LGM-Dairy premiums depend on producers' marketing plan, coverage selected, deductible level, futures and price volatility. Producer premiums are average of long-run expected volatilities of sign-up.

To which states is LGM-Dairy available?

States eligible to participate in the LGM-Dairy program (Dairy-Only, DMO)

What does LGM-Dairy not insure?

Risk of dairy cattle death.
Unexpected production losses.
Unexpected increase in feed costs.
Accidental declines in milk prices or increases in feed costs.
Multiple years of decline in milk prices or increases in feed costs.

What are the benefits of LGM-Dairy?

Convenience: Producers can sign-up for LGM-Dairy insurance 12 times a year over a 12-month rolling period.

Customization: LGM-Dairy can be tailored to any size farm and to any month or months of the year.

Bundled option insurance: LGM-Dairy is similar to buying both a call option to limit higher feed costs and a put option to set a floor on milk prices.

LGM-Dairy: What it covers?

Prices of:

- Any milk volume of producer's target marketing for a 10-month period (up to 240,000 cwt)
- Amount of corn and soybean meal equivalents to be fed during insurance period restricted to be in range:
 - 0.00364 – 0.02912 tons corn/cwt milk
 - 0.13 – 1.04 bu corn/cwt milk
 - 0.000805 – 0.006425 tons SBM/cwt milk
 - 1.61 – 12.85 lb SBM/cwt milk

LGM-Dairy: What it does not cover/protect?

- Production losses
- Risk of dairy cattle death
- Unexpected decrease in milk production or increase in feed use
- Multiple years of declines in milk prices or increases in feed costs
- Anticipated declines in milk prices or increases in feed costs

LGM-Dairy: What farmer needs to decide?

Three main things to consider:

- Percentage (%) of target marketings to be insured (0% to 100%)
- Level of Gross Margin Deductible or risk assumed
 - \$0 to \$1.50/cwt in \$0.1 increments
- Months to insure

LGM-Dairy: What farmer needs to provide?

Estimates of:

- Target milk marketing per insured month
- Expected feed per insured month
 - Corn and corn equivalents
 - Soybean meal and soybean meal equivalents
 - Feed Conversion software downloadable from our website
- Verifiable records should be available

LGM-Dairy: What is the insurance Period?

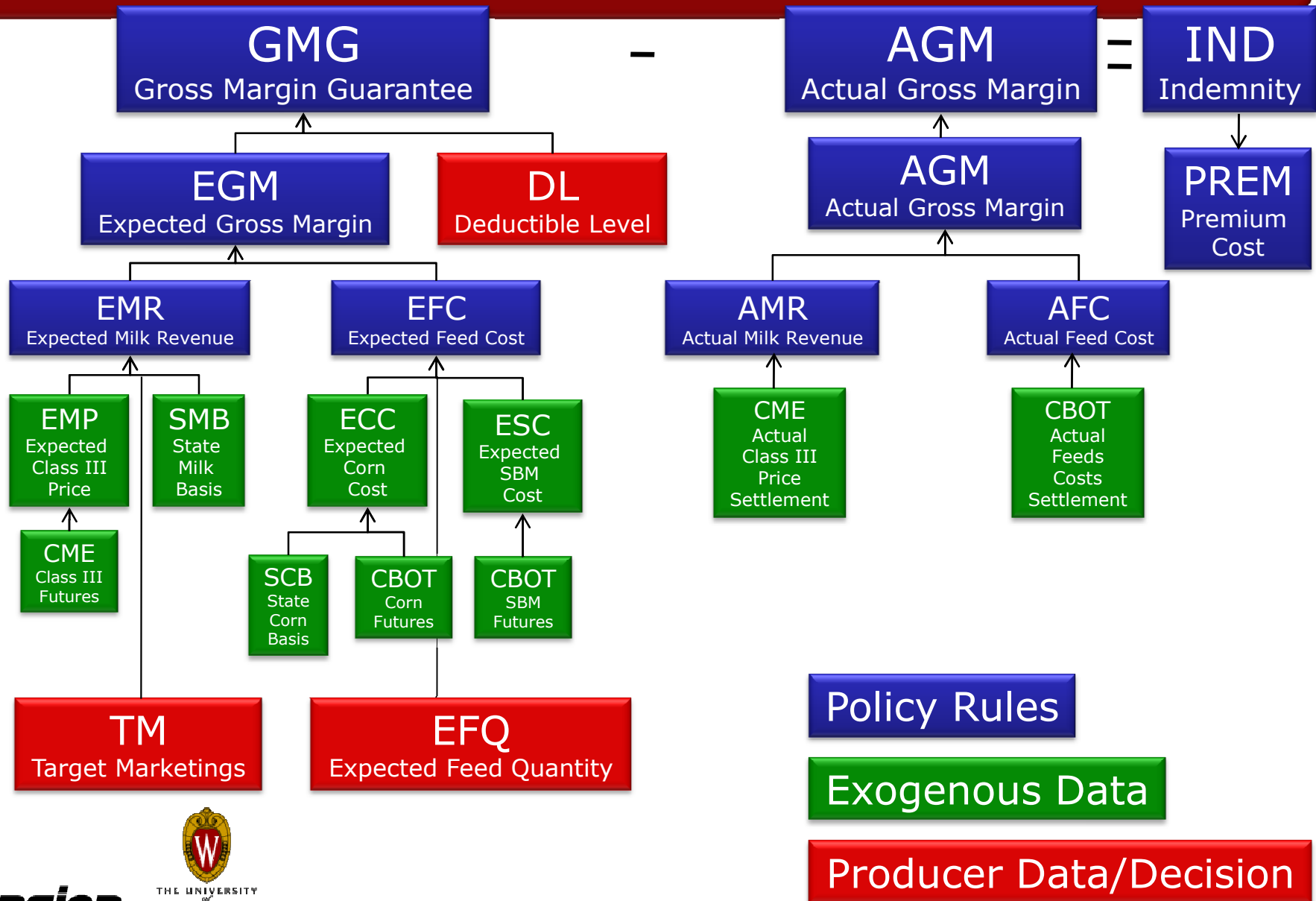
Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
		1	2	3	4	5	6	7	8	9	10
LGM-Dairy	No Coverage	Insurance Coverage									
Selected Covered Months		Nov		Jan	Feb			May	Jun		Aug



→ From 4 pm on 3rd to last business day to to 9 am following day (17-hour period)



LGM-Dairy: How it works?



LGM-Dairy: What are expected prices?

Average of future prices over 3-day price discovery period (CME/CBOT):

- Class III
- Corn
- Soybean meal

LGM-Dairy: What are “actual” prices?

Average of settle prices over 3 days prior to last futures contract trading day (CME/CBOT):

- Class III
- Corn
- Soybean meal

LGM-Dairy: What are prices basis?

State and month basis:

- Difference between All-Milk and “actual” Class III CME/CBOT futures price
- Difference between corn price received and historical average “actual” CME/CBOT futures price

LGM-Dairy: What is the premium?

Premium is the average of expected indemnities in the long-run:

- Proportional to the insured milk and insured feed
- Increases with price volatility
- Decreases with elected deductible (\$0 to \$1.5/cwt in \$0.1 increments)
- Decreases when all months insured together
- Estimates available in RMA website

LGM-Dairy: Overview

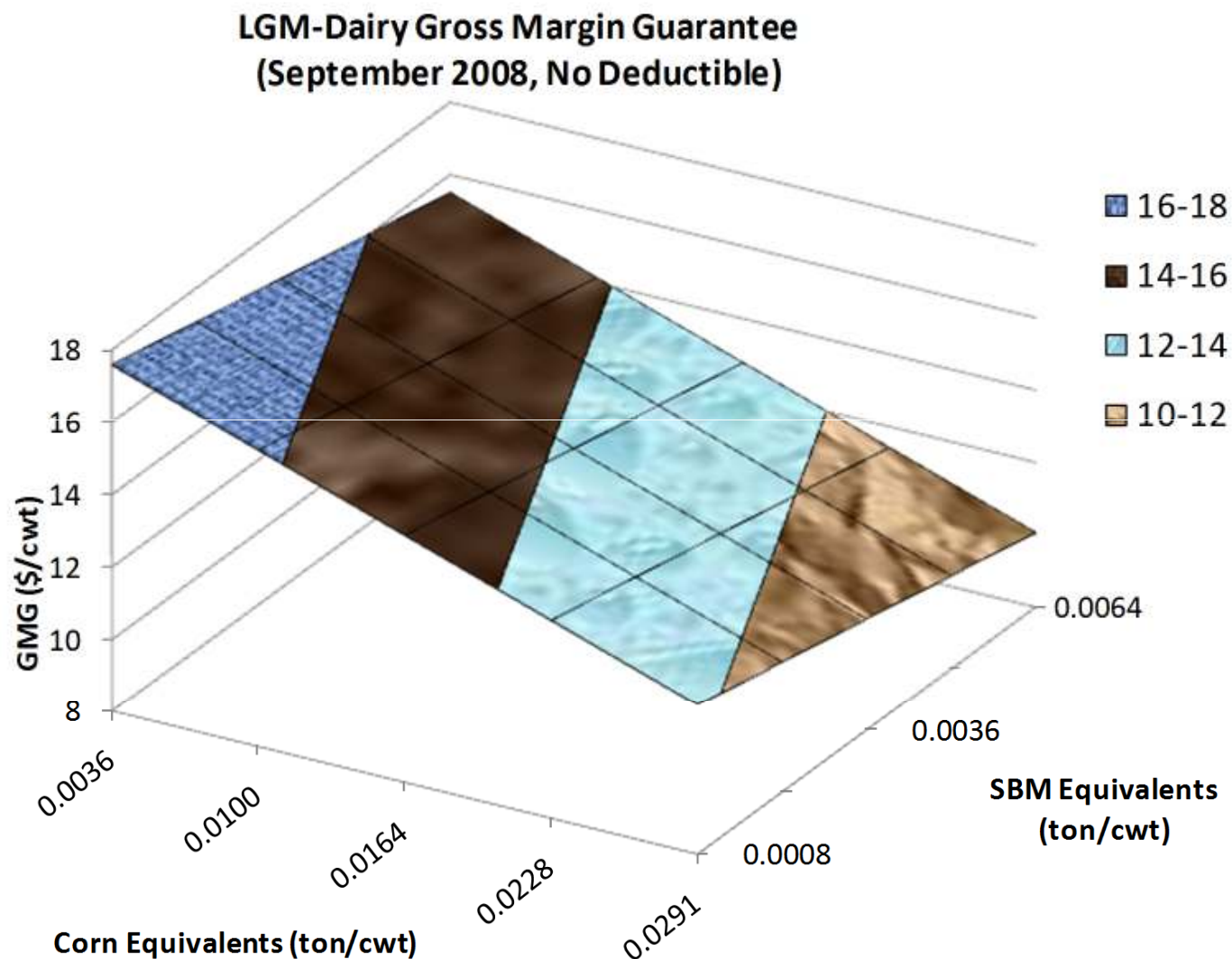
Advantages:

- Unique bundled insurance protects the margin: milk price less feed cost
- Very flexible and customizable
- Offered every month of the year

Drawbacks:

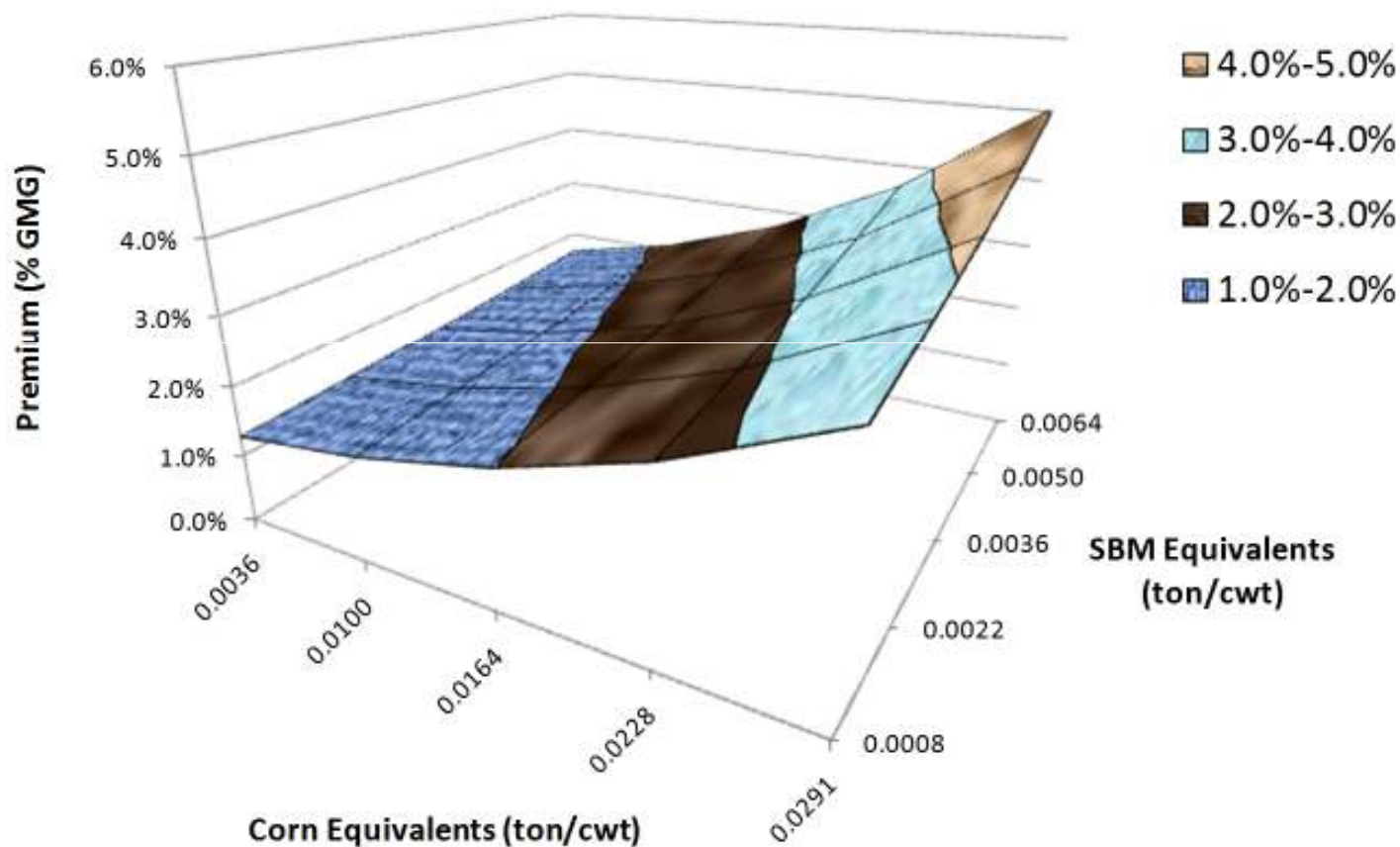
- Very short enrollment period
- Total premium due at sign-up
- No farmer subsidies available
- Limited capacity

LGM-Dairy: Aug 08 (Oct 08 – Jul 09)

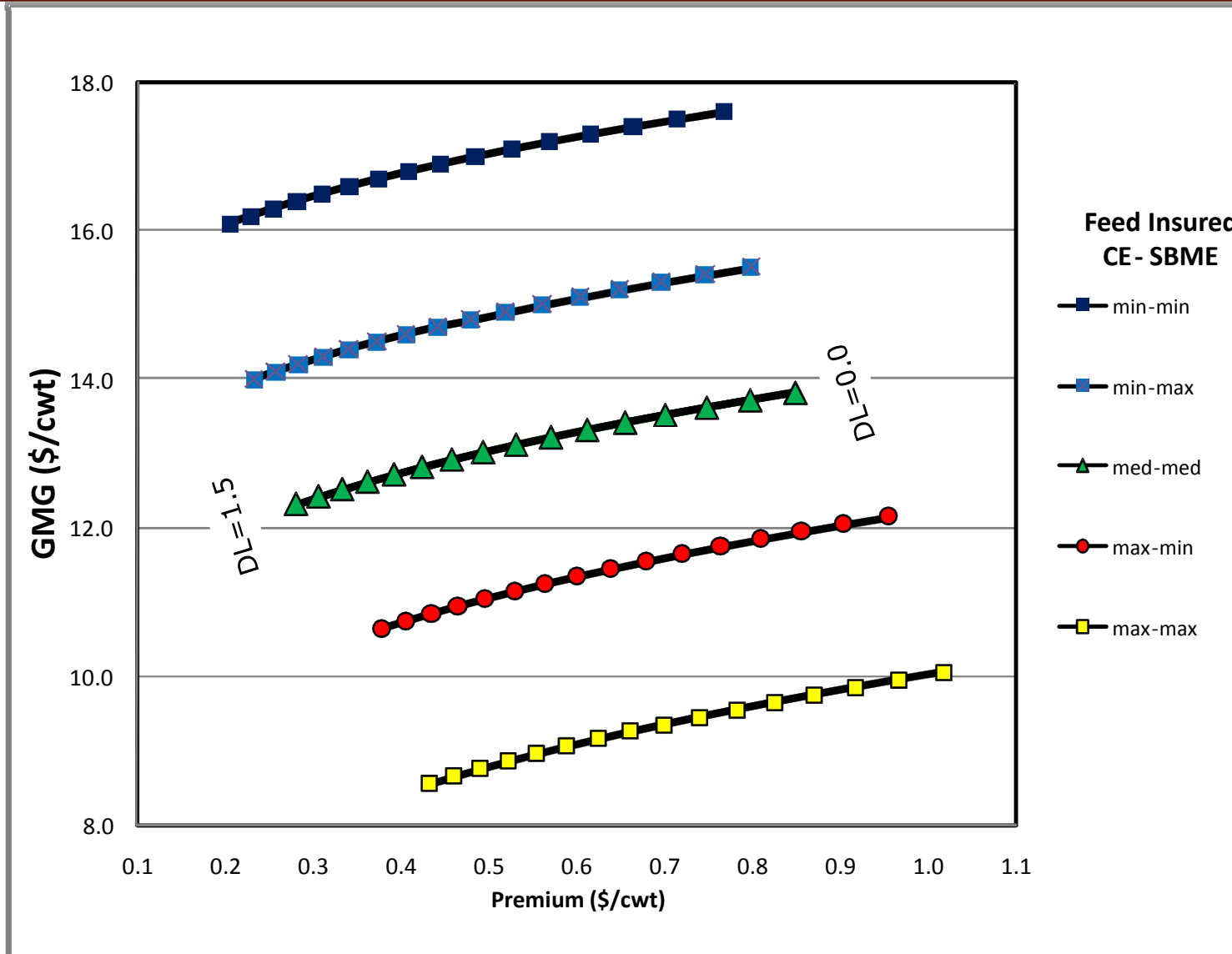


LGM-Dairy: Aug 08 (Oct 08 – Jul 09)

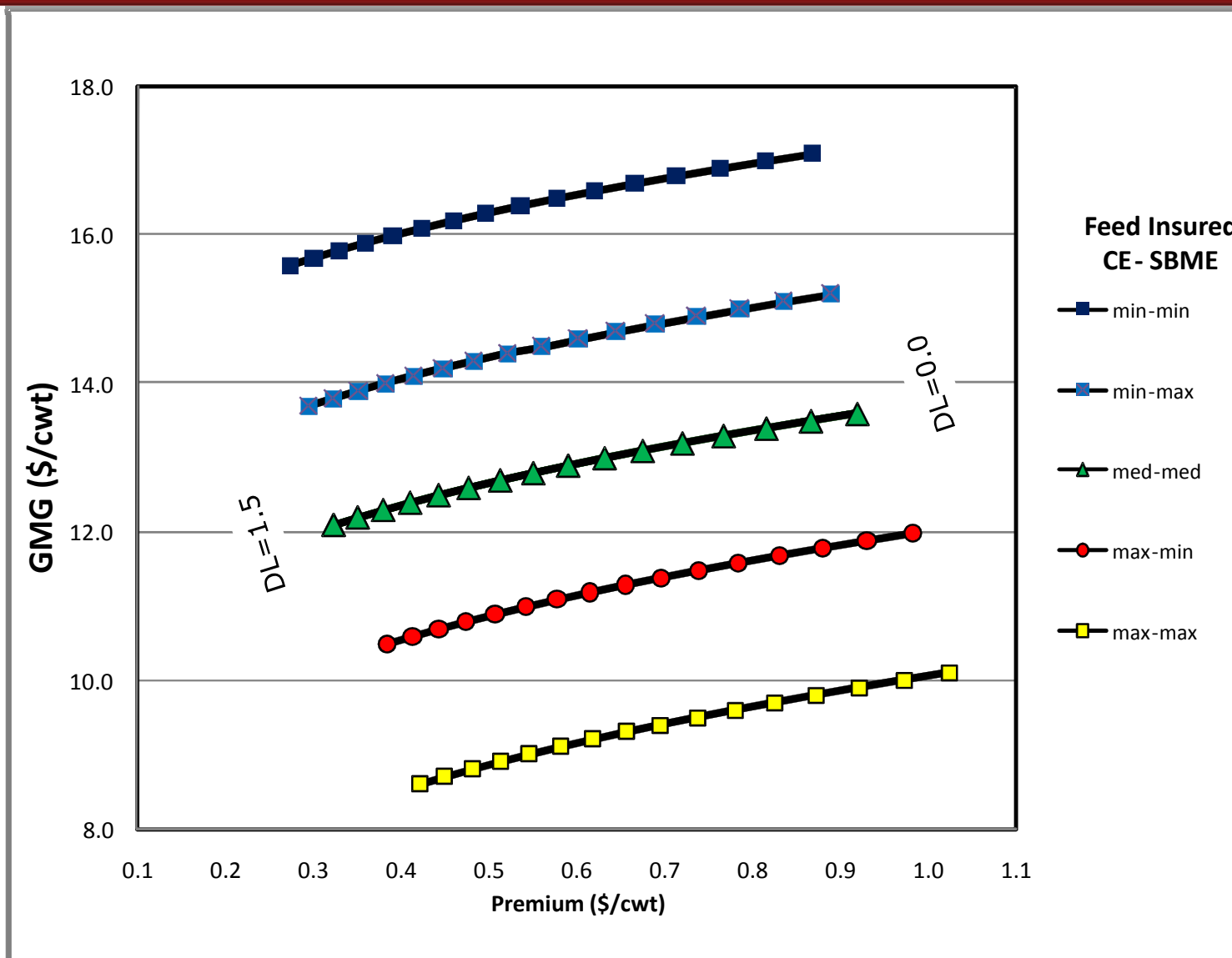
LGM-Dairy Gross Margin Guarantee
(September 2008, \$1.5/cwt deductible)



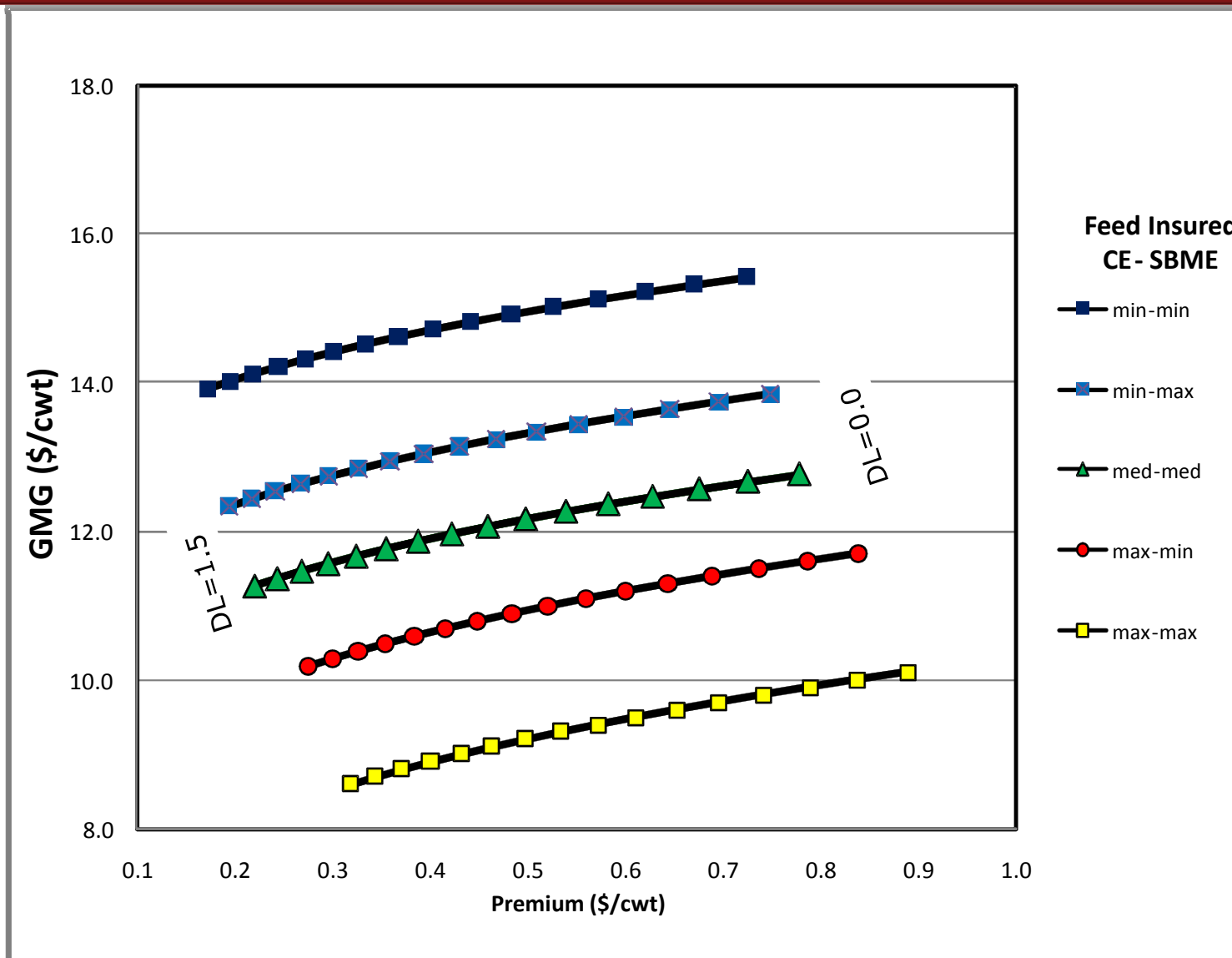
LGM-Dairy: GMG and Premium (Aug 2008)



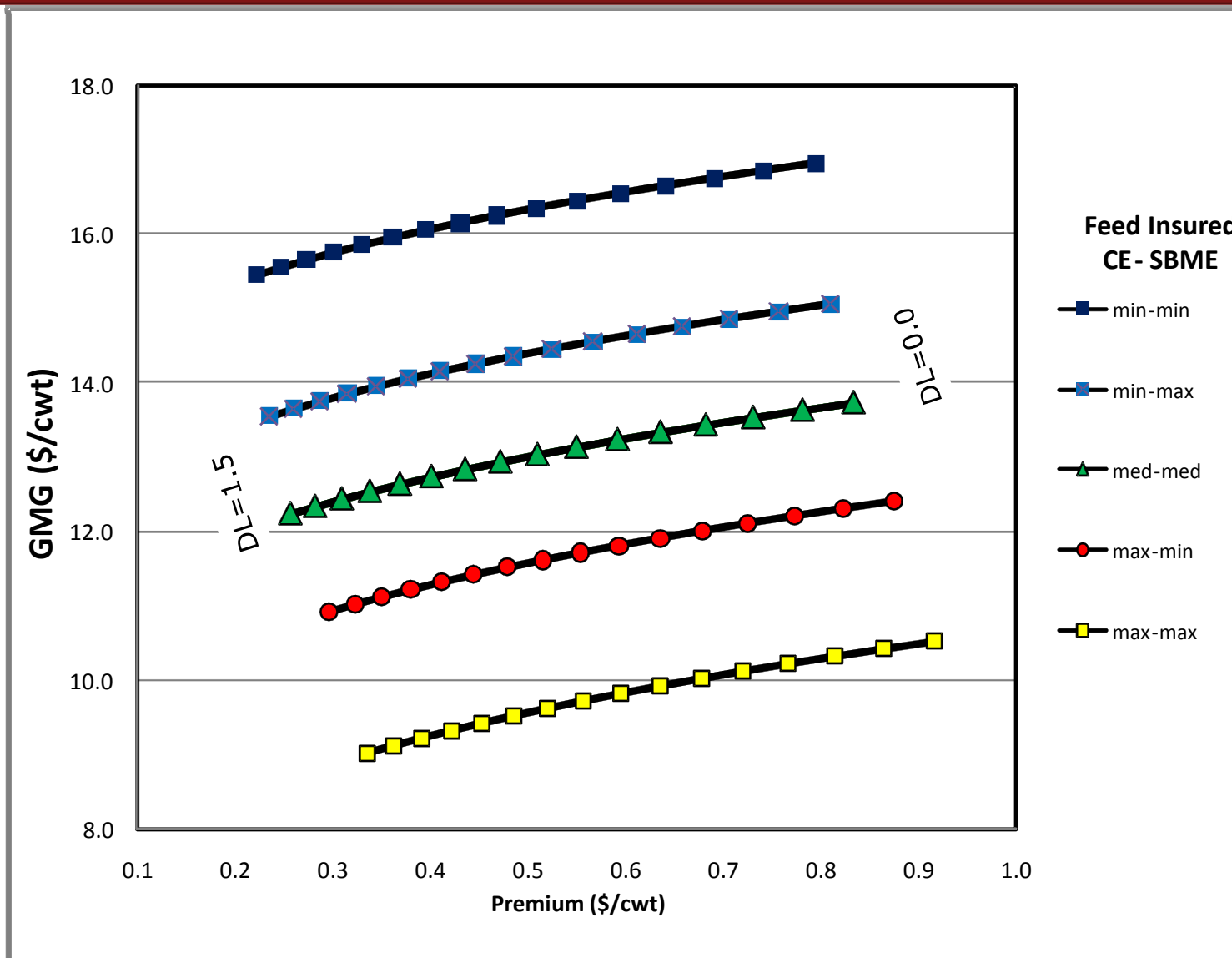
LGM-Dairy: GMG and Premium (Sep 2008)



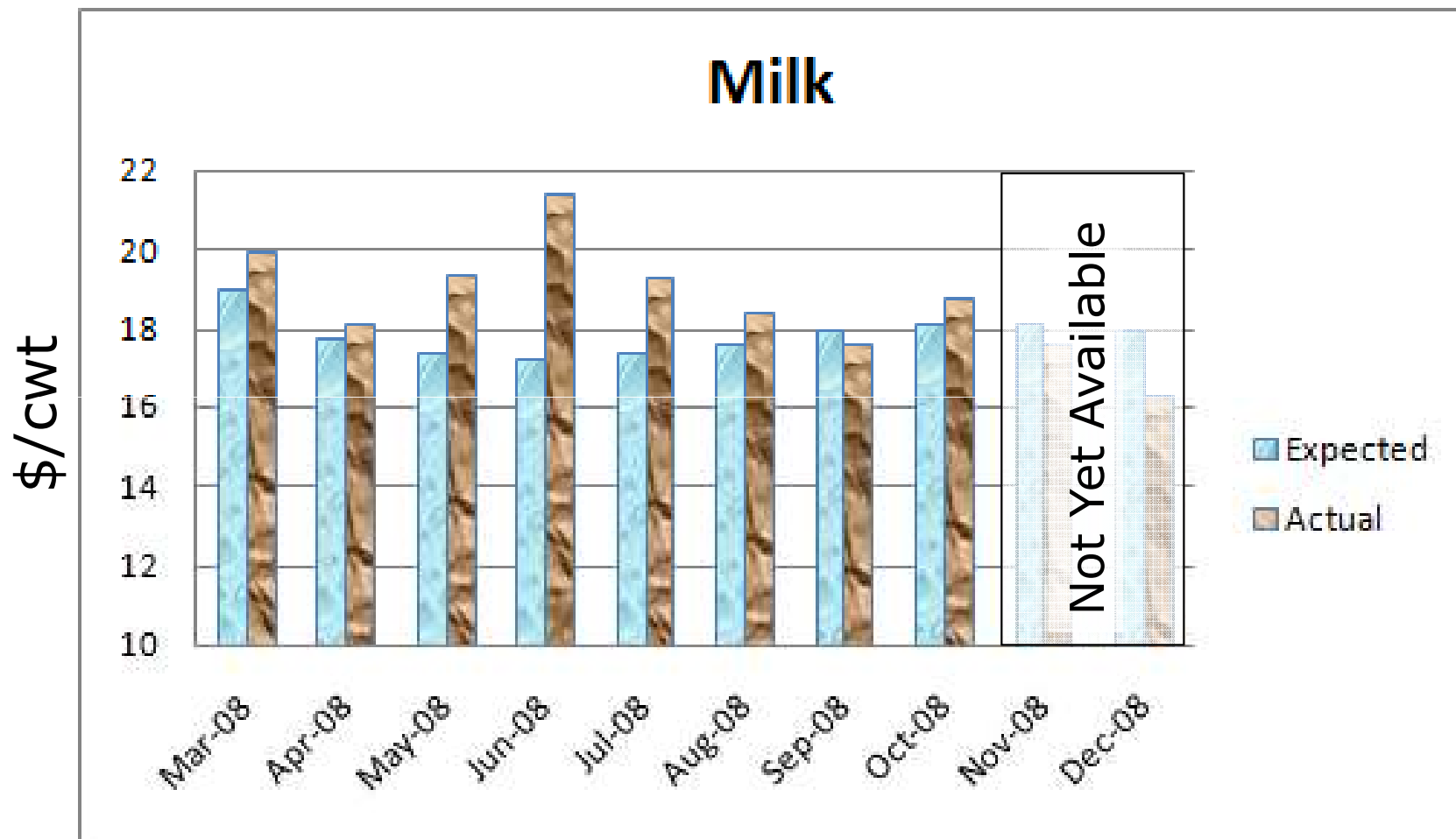
LGM-Dairy: GMG and Premium (Oct 2008)



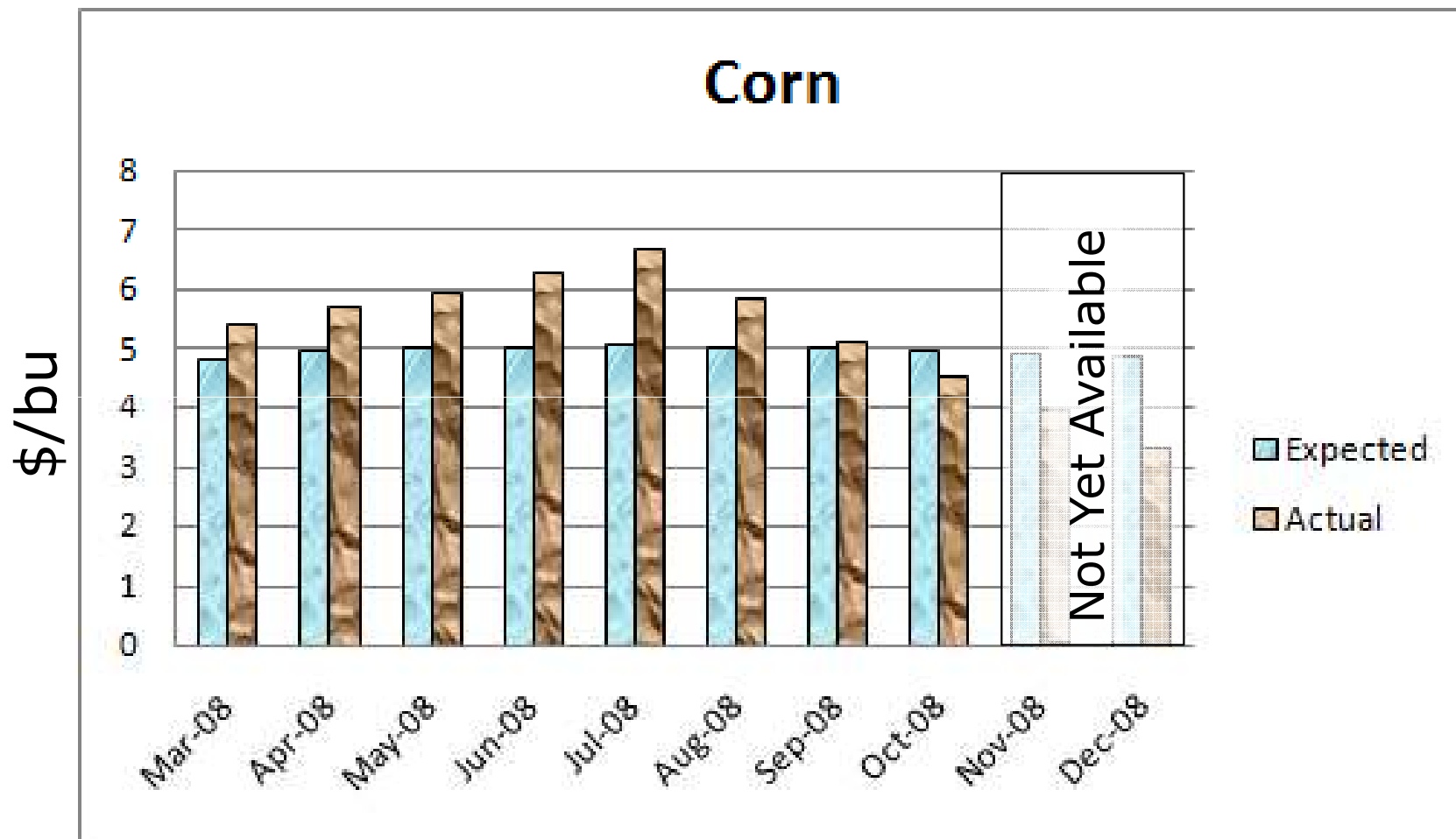
LGM-Dairy: GMG and Premium (Jan 2008)



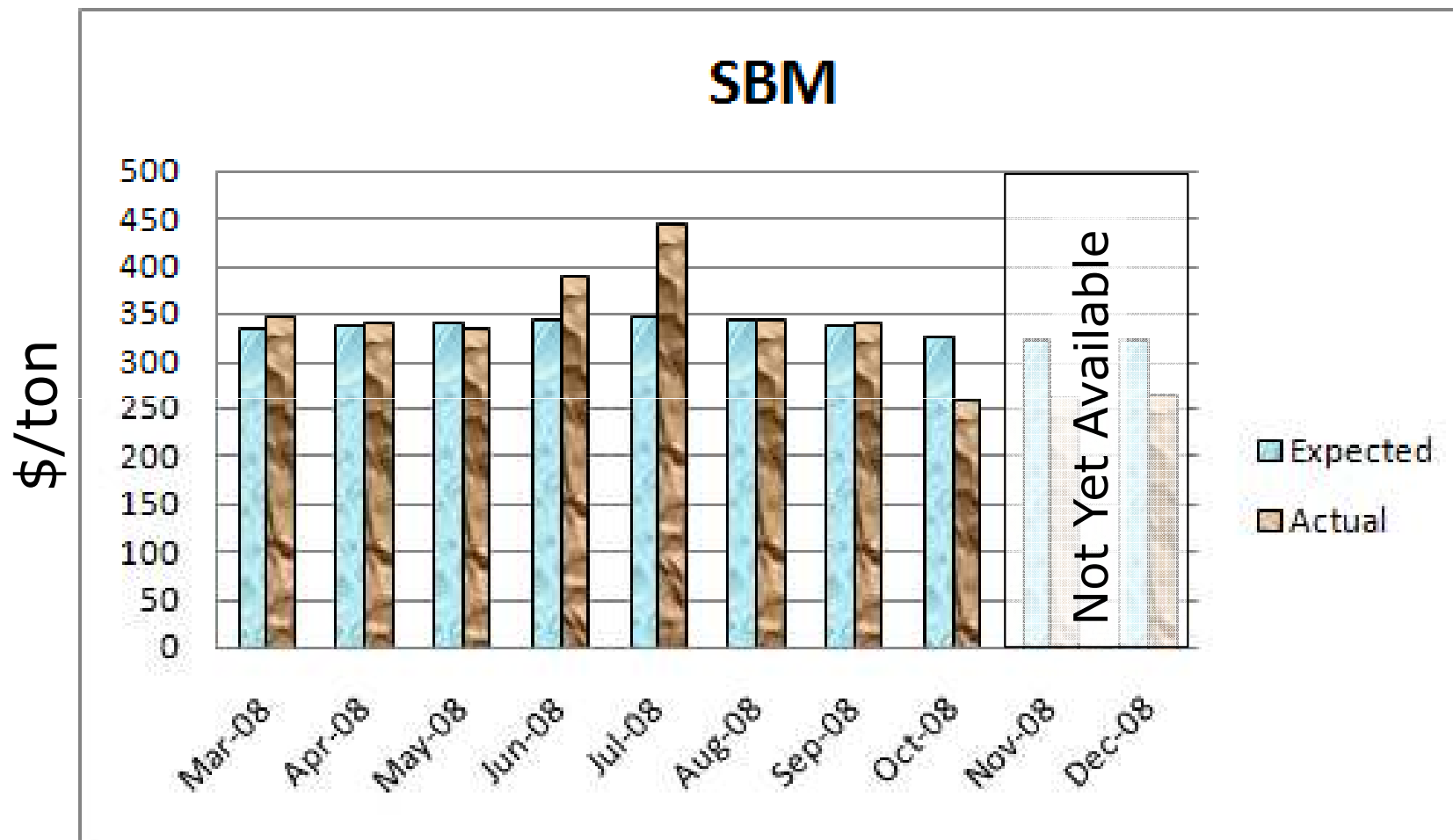
Wisconsin Expected and Actual (Jan 2008)



Wisconsin Expected and Actual (Jan 2008)

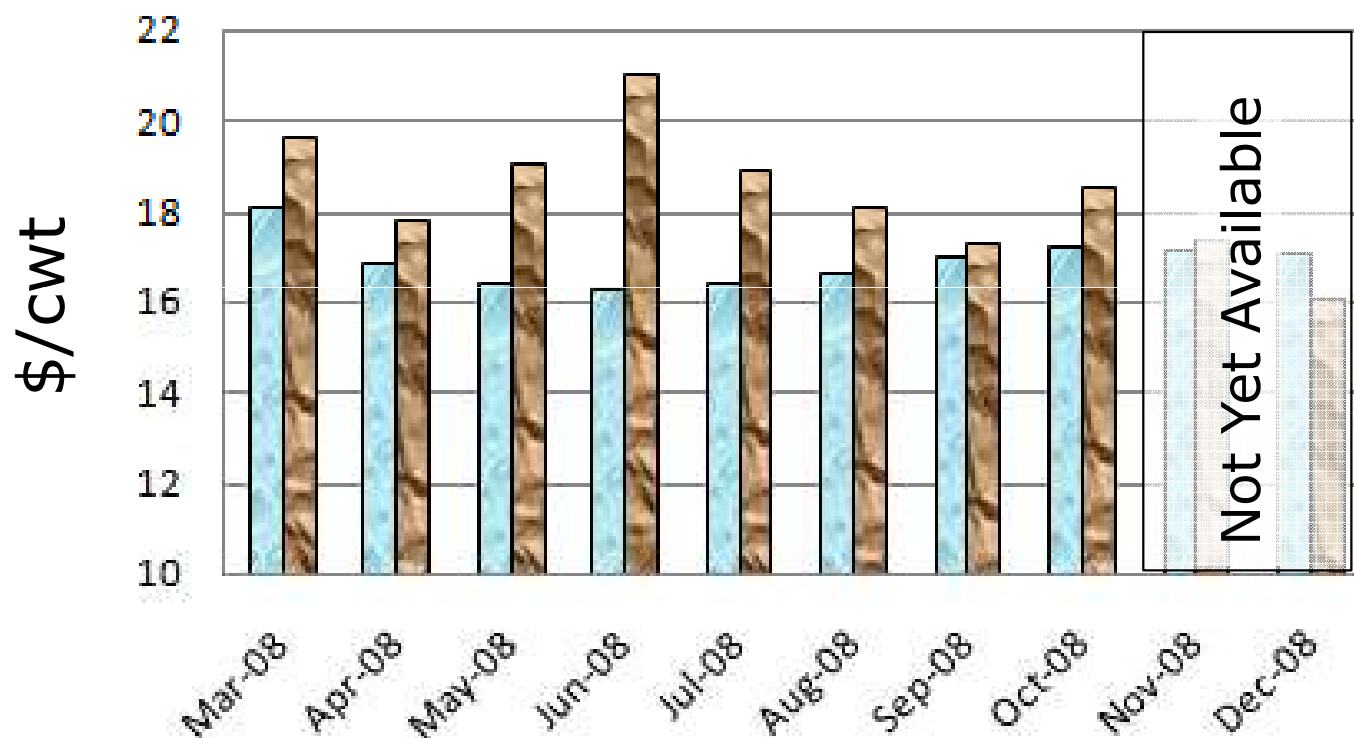


Wisconsin Expected and Actual (Jan 2008)



Wisconsin Expected and Actual (Jan 2008)

Gross Margin



Would have paid:
\$0.00/cwt in indemnities

Expected
Actual

Would have cost:
\$0.87/cwt in premium

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Livestock Wisconsin Farm Management Update Seminar

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<http://www.uwex.edu/ces/dairymgt/dairy.cfm> <http://future.aae.wisc.edu/>

UW LGM-Dairy Website:
http://future.aae.wisc.edu/lgm_dairy.html