LGM-Dairy: Livestock Gross Margin for Dairy

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Eastern Wisconsin Farm Management Update Seminar
LGM-Dairy: What is it?

• New Livestock Gross Margin for Dairy Insurance
  o Federally reinsured dairy insurance program
  o Purchased from crop insurance providers
  o Approved July 2007, available August 2008

• Protects Dairy Business against Unexpected declines in Gross Margins
  o Gross Margin = Milk Revenue – Feed Costs

• Revenue neutral (No subsidies)
  o Premium = Expected Indemnity
LGM-Dairy: Who is eligible?
Milk producers of 32 states
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)

• Any amount of corn and soybean meal to be fed during insurance period, restricted to:
  - 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
- 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:

- 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
  - [http://future.aae.wisc.edu/lgm_dairy](http://future.aae.wisc.edu/lgm_dairy)

- Verifiable records should be available
# LGM-Dairy: What is the insurance Period?

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- **LGM-Dairy:**
  - No Coverage

- **Selected Covered Months:**
  - Nov
  - Jan
  - Feb
  - May
  - Jun
  - Aug

- **Insurance Coverage:**
  - From 4 pm on 3rd to last business day to 9 am following day (17-hour period)
LGM-Dairy: How it works?

GMG
Gross Margin Guarantee

EGM
Expected Gross Margin

DL
Deductible Level

AGM
Actual Gross Margin

IND
Indemnity

PREM
Premium Cost

EMR
Expected Milk Revenue

EFC
Expected Feed Cost

AMR
Actual Milk Revenue

AFC
Actual Feed Cost

EMP
Expected Class III Price

SMB
State Milk Basis

ECC
Expected Corn Cost

ESC
Expected SBM Cost

CME
Class III Futures

SCB
State Corn Basis

CBOT
Corn Futures

CBOT
SBM Futures

TM
Target Marketings

EFQ
Expected Feed Quantity

Policy Rules

Exogenous Data

Producer Data/Decision
LGM-Dairy: What are expected prices?

Average of future prices over 3-day price discovery period:

- Class III
- CBOT - Corn
- CBOT - Soybean meal
LGM-Dairy: What are “actual” prices?

Average of settle prices over 3 days prior to last contract trading day:

- Class III
- Chicago Board of Trade (CBOT) for
  - Corn
  - Soybean meal
LGM-Dairy: What are prices basis?

State and month basis:

• Difference between All-Milk and Announced Class III price

• Difference between corn price received and historical average “actual” CBOT 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: How would it had been?

Comparison of Projected and Actual Milk Prices in 2002

+$/cwt

- March
- April
- May
- June
- July
- August
- Sept
- Oct
- Nov
- Dec

2002 Projected
2002 Actual

Extension

The University of Wisconsin
LGM-Dairy: How would it had been?

Comparison of Projected and Actual Corn Prices in 2002

- March
- April
- May
- June
- July
- August
- Sept
- Oct
- Nov
- Dec

$/cwt

2002 Projected
2002 Actual
LGM-Dairy: How would it had been?

Comparison of Projected and Actual Soymeal Prices in 2002
LGM-Dairy: How would it have been?

Comparison of Projected and Actual Margin in 2002

Would have paid: $2.52/cwt in indemnities

Would have cost: $0.60/cwt in premium
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http://www.uwex.edu/ces/dairymgt/
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UW LGM-Dairy Website:
http://future.aae.wisc.edu/lgm_dairy.html