LGM-Dairy: Livestock Gross Margin for Dairy

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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: What impacts the premium?

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

• Amount of corn and soybean meal equivalents to be fed during insurance period restricted to be in range:
  o 0.00364 – 0.02912 tons corn/cwt milk
  o 0.13 – 1.04 bu corn/cwt milk
  o 0.000805 – 0.006425 tons SBM/cwt milk
  o 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
  o Corn and corn equivalents
  o Soybean meal and soybean meal equivalents
  o Feed Conversion software downloadable from our website

■ 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

**CME**
Expected Class III Price

**AMR**
Actual Class III Price Settlement

**CBOT**
Actual Feeds Costs Settlement

**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 (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)

Premium (% GMG)

SBM Equivalents
(ton/cwt)

Corn Equivalents (ton/cwt)
LGM-Dairy: GMG and Premium (Sep 2008)
Feed Insured
CE - SBME

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)

Would have paid: $0.00/cwt in indemnities

Would have cost: $0.87/cwt in premium
LGM-Dairy: Livestock Gross Margin for Dairy
Livestock Wisconsin Farm Management Update Seminar

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