



**University of Kentucky**  
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# Dairy Risk Management Tools for Producers

# OVERVIEW OF MY DISCUSSION

- Program will highlight multiple tools, all of which have merit
  - Further explore what fits best for you
- I will briefly outline
  - Livestock Gross Margin (LGM) Dairy
  - Futures and Options



# HOW CAN I COMPARE DMC AND LGM-DAIRY?



# LGM-DAIRY

- Dairy Margin Insurance Program
- “Lock in” milk price over feed cost
  - Milk price – class III milk futures
  - Feed price – corn and soybean meal futures
- Effective risk management tool
- Offerings evolve with market

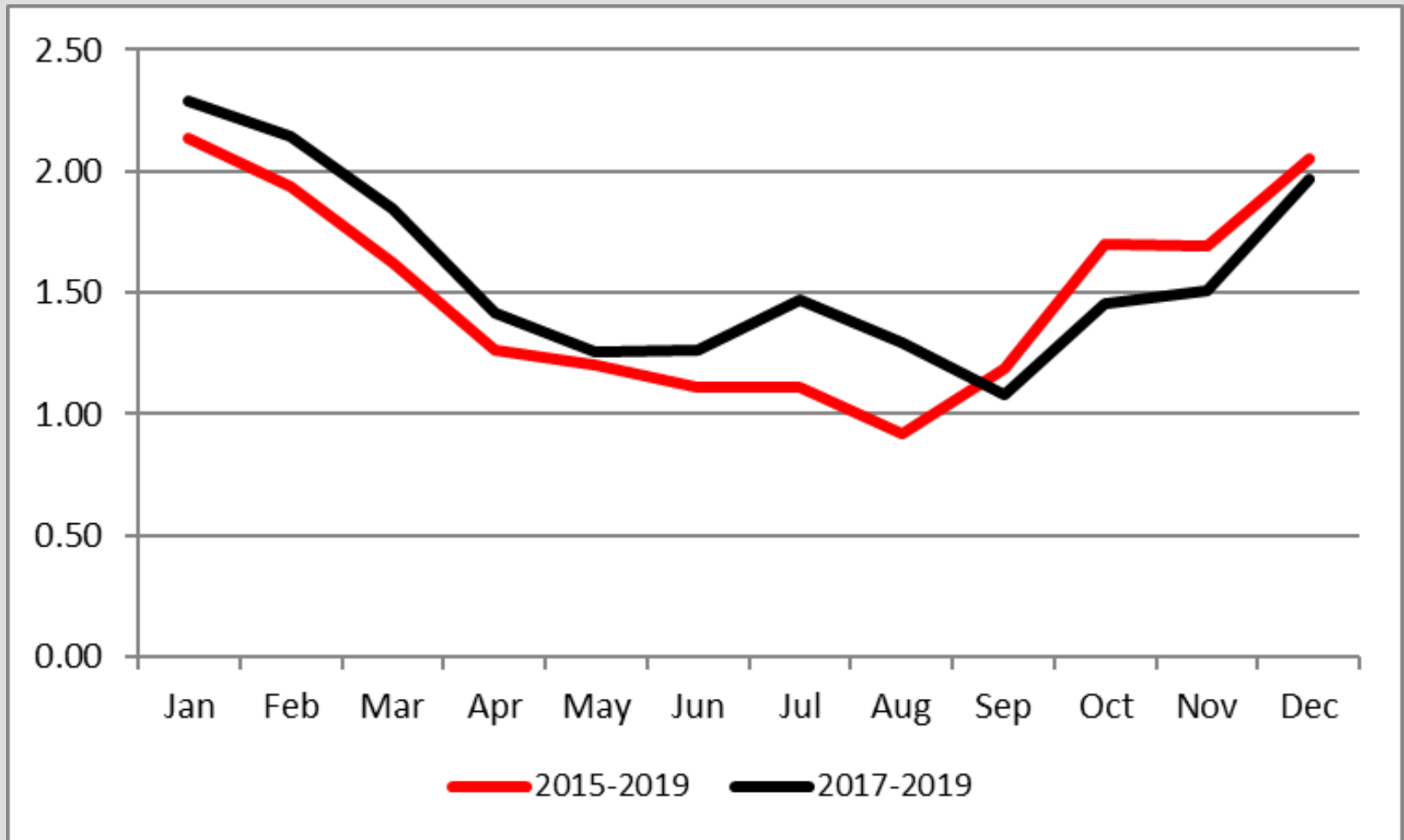
# DMC VS. LGM-DAIRY

- Milk price difference
- Feed cost component
  - LGM can be customized
- Nature of the programs

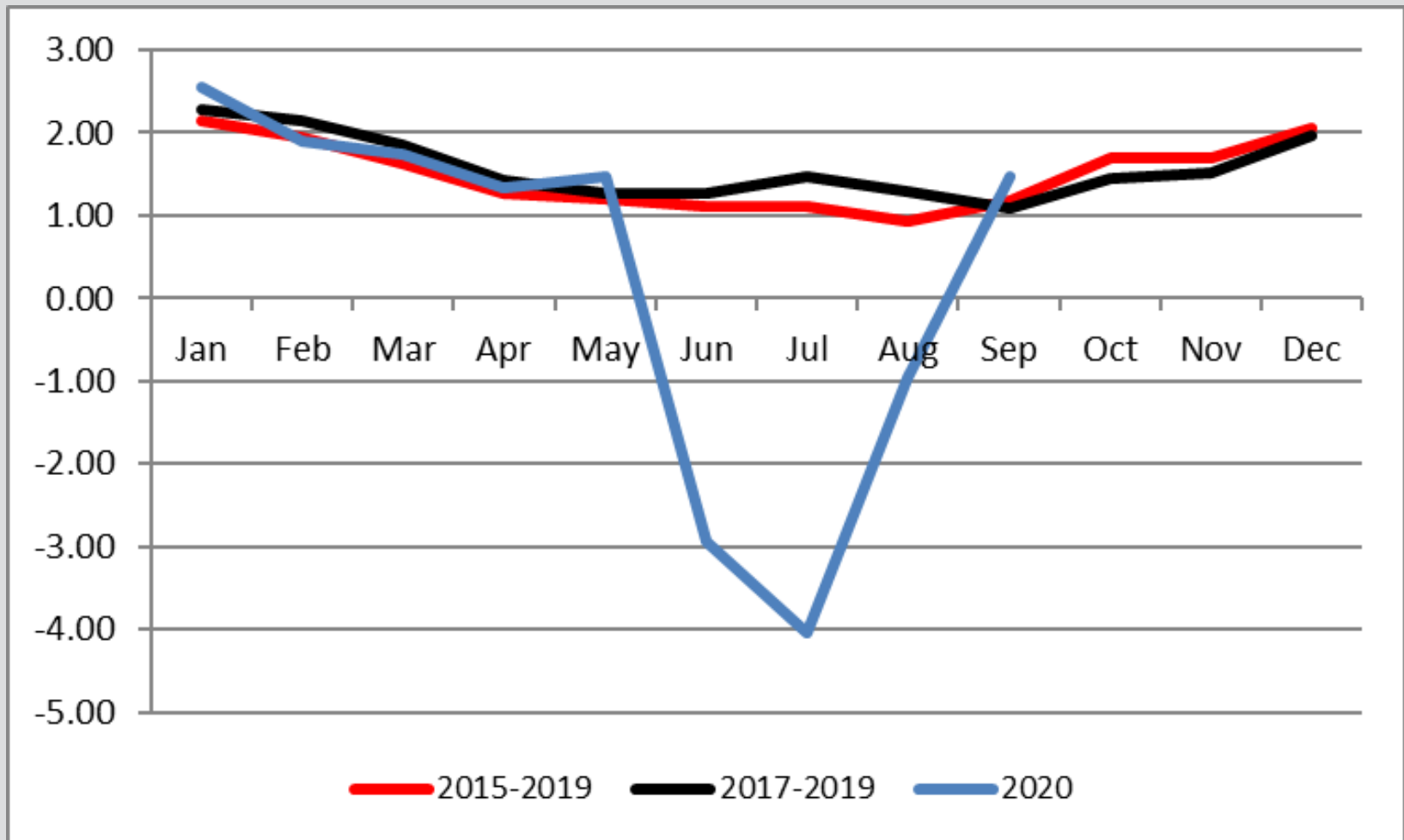
# MILK PRICE DIFFERENCES

- Margins offered can't be compared directly
  - Not apples to apples
- DMC: US All Milk
  - Includes all milk classes
- LGM-Dairy: Class III Milk Futures
- Historically, US All Milk Price has exceeded class III by about \$1.50 per cwt.

# US ALL MILK MINUS CLASS III



# US ALL MILK MINUS CLASS III





# FEED COST FACTORS / CUSTOMIZATION

- LGM-Dairy – Corn and SBM
  - Producers can match feed quantities to milk production
  - Min's and max's exist
- DMC – Corn, SBM, and Alfalfa Hay
  - “ration” is fixed for life of farm bill

# FEED COST DIFFERENCES

- LGM-Dairy – corn and SBM futures
  - Default – 28 lbs of corn, 4 lbs of SBM, can be changed
- DMC – National corn, SBM, and Alfalfa prices
  - 60.1 lbs of corn (32.1 lbs more)
  - 14.7 lbs of SBM (10.7 lbs more)
  - 27.4 lbs of Alfalfa hay (27.4 lbs more)
- Adjust for price differences, match feed quantities, subtract Alfalfa component

# FOR QUICK COMPARISON

- Set corn and soybean meal quantities in LGM to match DMC
  - Price differences will exist in feeds as well
  - Change is what matters
- Add US All milk minus class III milk
- Subtract impact of Alfalfa Hay
  - It is not included in LGM at all
- General rules of thumb
  - Default feed quantity: LGM margin needs to be \$4.50-\$5.00 higher
  - Match corn and SBM quantity: LGM needs to be \$1.50 to \$2.00 higher

# NATURE OF THE PROGRAMS

- LGM-Dairy – futures based
  - Available insurable margins evolved with market
  - Good times = good opportunities
- DMC – a bit of a throwback
  - Countercyclical – margins and premiums fixed through 2023
- LGM-Dairy – more attractive in profitable times
- DMC – likely to pay in challenging times



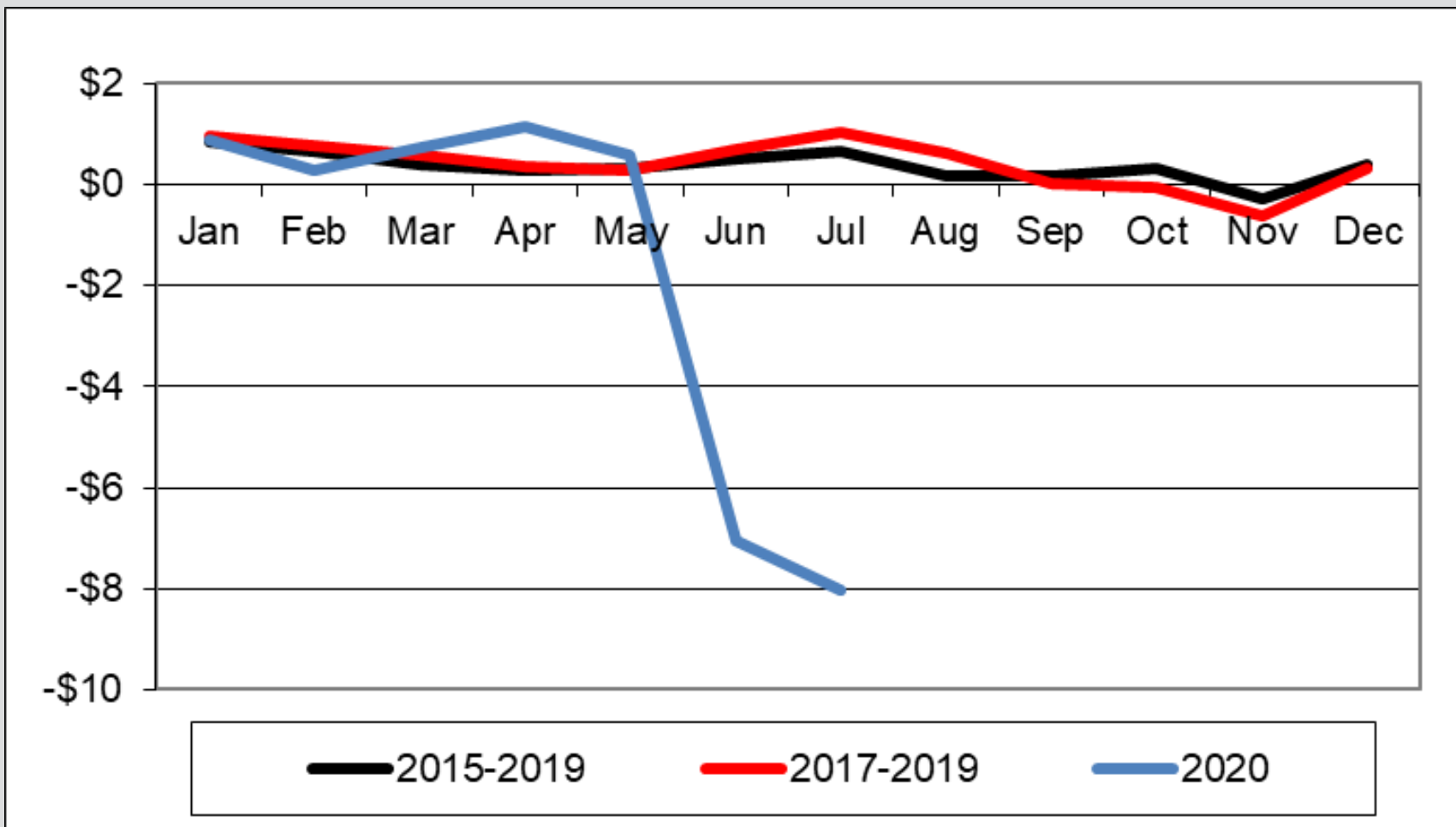
WHAT ABOUT FUTURES / OPTIONS?



# CME© MILK FUTURES

- Class III and class IV milk
- Settled based on USDA price for that class
- 200,000 lbs of milk
  - Limits ability for many to use
- Available 24 months out – but thinly traded
- Class III or IV differs from your milk check - basis

# OHIO MILK BASIS – CLASS III MINUS BLEND



# HEDGING THROUGH FUTURES

- Sell a class III futures contract for the month you wish to cover milk
  - I.e: February 2021
- Class III milk futures decrease – gain on futures, offset decrease in your milk price
- Class III milk futures increase – lose on futures, gain on your milk price



# PRICE FLOORS THROUGH PUT OPTIONS

- Buy put option – right to sell – milk futures at predetermined “strike” price
  - I.e: February class III at \$16.50, buy \$15.50 strike
- If milk futures fall below \$15.50, you gain on put
- Self-insure first \$1 drop
- Price “floor” in place
- Can still capitalize on rising milk prices

# FINAL THOUGHTS ON LGM AND FUTURES

- Understand the tools that are out there
  - Including DMC and Dairy-RP
- LGM and futures allow you to capitalize on existing market conditions
  - LGM has customizable feed cost component
- Understand futures / options for market signaling
  - Good way to evaluate forward contracting opportunities
  - Consider for risk management

# CONTACT INFORMATION

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