

# Managing & Understanding Your Business Risks

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## CDE DAIRY MARKETS & MANAGEMENT UPDATE

All prices — OCTOBER 6, 2009 — except where noted

### Risk Management

While most farmers would consider themselves risk averse, the sense of accomplishment from overcoming a challenge (risk) is one of the greatest satisfactions of farming. Dairy farmers deal with risks from disease, fire, weather, liability, injury, labor, environment, mechanical breakdown, government policy, and even price risk every day.

**AVOID** risks with a high probability of occurrence and with large negative consequences. Don't ship the milk from a treated cow. Don't put manure or chemicals directly into a stream.

**SHARE** risks with large consequences but low probability by buying insurance or sharing resources with your neighbors. Property casualty insurance, health insurance, and crop insurance are all ways to spread risks over a larger group making costs more predictable.

**MANAGE** all your risks. Keep vaccination schedules up to date, property maintain equipment, and select your correct deductible levels on insurance policies.

**ASSUME** the low impact risks that you might benefit from. These include that "new and improved" test dip and seed corn variety, as well as the used haybale that your neighbor is selling and that lovely bred heifer at the auction.

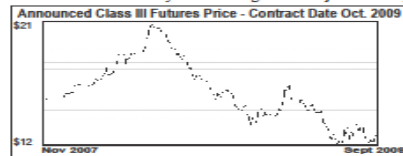
In the past, Joe Dairyman assumed the price risk because the markets were less volatile. The graph shows that the October 2009 Class III milk contract has traded from a high of \$20.80 to a low

of \$11.96. Joe may need to manage his price risk in the future. Can he assume the risk that government or industry policy will provide a profit for his business?

On Oct. 27 in Harrisburg and Oct. 28 in Clark Mills, PA, the Pennsylvania Profitability Forum will feature a keynote address from the U.S. Department of Agriculture, along with Phil Flourid from Blumling & Associates and Dr. David Galton from Cornell on marketplace issues and how to manage for profitability in turbulent times. To register, call 717-346-0949 or visit [www.centerfordairyexcellence.org](http://www.centerfordairyexcellence.org).

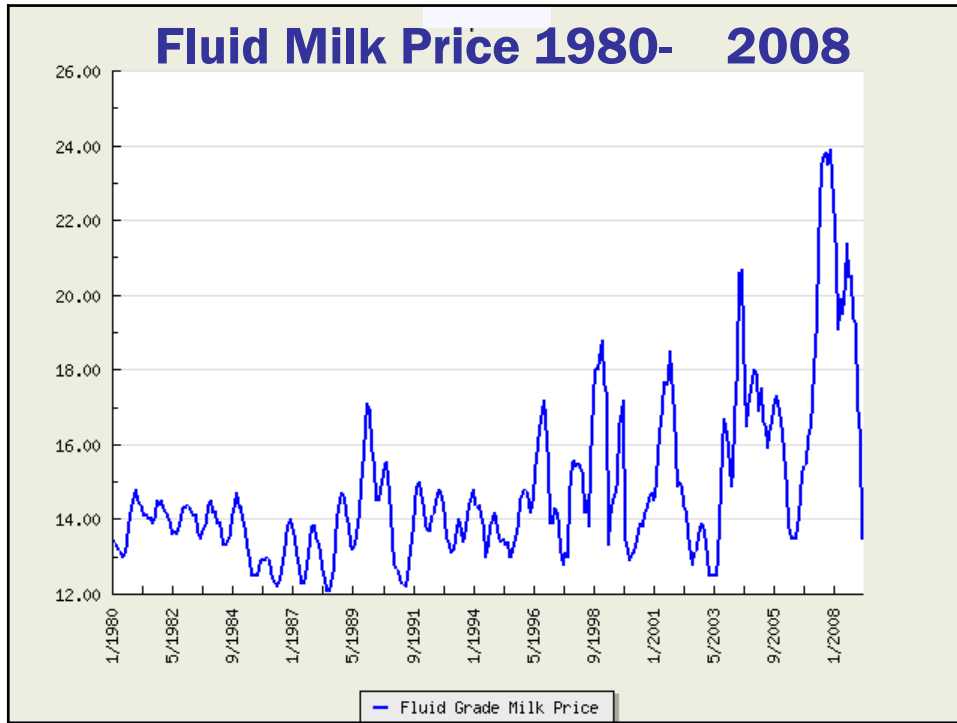


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Prices change daily. This market information is an example for informational purposes. The market data below are copyrighted weekly by Farmline using CME and USDA reports and are not to be reprinted.

CME DAILY FUTURES & OPTIONS TRADING — OCTOBER 6, 2009 CLOSE												
	SEP-09	OCT-09	NOV-09	DEC-09	JAN-10	FEB-10	MAR-10	APR-10	MAY-10	JUN-10	JUL-10	AUG-10
<b>CLASS III MILK FUTURES (\$/CWT)</b>	N/A	12.84	14.21	14.65	14.58	14.53	14.67	14.53	14.75	14.75	14.90	15.18
	12.08	12.66	13.56	14.05	14.09	14.26	14.33	14.24	14.48	14.70	14.90	15.21
HIGHEST & LOWEST DAILY SETTLE PRICE OVER LIFE OF CONTRACT AND MONTH/YEAR IT OCCURRED												
	20.98 6/08	20.80 9/09	20.50 9/09	20.54 6/08	20.30 6/08	19.89 6/08	19.75 6/08	19.60 6/08	19.50 6/08	19.20 7/08	19.20 7/08	15.45 9/09
	11.10 7/09	11.96 7/09	12.80 8/09	13.00 9/09	13.23 1/09	13.31 8/09	13.41 8/09	13.58 8/09	13.82 8/09	14.49 8/09	14.75 9/09	15.00 9/09
MILK BASIS (\$/CWT) — SELECTED NORTHEAST & MID-ATLANTIC STATES (2008 Historical Reference)												
	PA	2.37	2.87	3.19	3.01	3.40	3.19	3.32	1.94	2.23	2.63	2.61
	NY	1.39	1.79	2.17	1.97	2.32	2.11	2.32	1.04	1.43	1.57	1.61
	VT	1.53	1.99	2.27	1.99	2.38	2.15	2.42	1.10	1.39	1.69	1.71
	NJ	1.17	1.67	1.99	1.81	2.20	1.99	2.12	0.74	1.03	1.43	1.41
	DE	1.79	2.29	2.61	2.43	2.82	2.61	2.74	1.36	1.65	2.05	2.03
	MD	1.75	2.25	2.57	2.39	2.78	2.57	2.70	1.32	1.61	2.01	1.99
	ALG	1.33	1.91	2.31	2.23	2.32	2.15	2.34	0.98	1.25	1.51	1.63
	AMLC	1.19	1.69	2.01	1.83	2.22	2.01	2.14	0.76	1.05	1.45	1.43
	WV	1.24	0.60	0.40	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
MILC PAYMENT (\$/CWT) FORECASTS Based on Futures as of Fri., Oct. 2, 2009												
	N/A	12.75 0.08	14.00 0.32	14.50 0.52	14.50 0.66	14.50 0.76	14.50 0.77	14.50 0.89	14.75 1.00	14.75 1.05	14.25 0.80	15.00 1.11
CLASS III MILK (\$/CWT) OPTIONS — PUTS — Daily Strike Price / Premium												
	DEC-09	MAR-10	MAY-10	JUL-10		DEC-09	JAN-10	MAR-10	MAY-10			
CORN (\$/BU) OPTIONS — CALLS												
	2.50 1.084	2.50 1.053	2.60 1.047	2.70 1.046		240 38.90	240 31.20	230 38.45	230 39.25			
	3.80 0.957	3.10 0.875	3.20 0.852	3.30 0.821		260 21.75	260 17.00	250 28.50	250 28.25			
	3.60 0.186	3.70 0.310	3.80 0.350	3.80 0.445		280 10.30	280 10.80	270 17.30	270 15.85			
	3.80 0.116	4.40 0.114	4.70 0.120	4.90 0.095		320 2.00	330 1.85	360 1.65	380 1.80			
CORN FUTURES (\$/BU)												
	DEC-09	MAR-10	MAY-10	JUL-10	SEP-10	DEC-10	MAR-11	MAY-11	JUL-11	SEP-11	DEC-11	JUL-12
	3.582	3.704	3.786	3.862	3.940	4.034	4.144	4.220	4.286	4.170	4.104	4.304



## The CDE Risk Management Profile

- A Resource for Your Dairy
- A Spreadsheet That Walks Producers Through Analysis of Their Risks

**RISK  
MANAGEMENT  
PROFILE**

**Risk Management Checklist:**

**AVOID**

- Antibiotics in milk/meat
- Manure & chemicals in stream

**TRANSFER**

- Large consequences – low probabilities
- Insurance-



**RISK  
MANAGEMENT  
PROFILE**

**Risk Management Checklist:**

**MANAGE**

- Vaccination Schedules
- Maintain equipment
- Price

**ASSUME**

- Low impact risks
- New products
- Price



**RISK  
MANAGEMENT  
PROFILE**

**Marketing/Pro  
duction**

- Have you reviewed your vaccination schedule with your veterinarian, and is it up to date?
- Do you have a nutrient mngmt. plan?
- Is your crop insurance protection adequate to cover a severe crop loss?
- Do you have a hedging account with a broker or cooperative?
- Do you grow & store most forage?



**RISK  
MANAGEMENT  
PROFILE**

**Financial**

- Do you have up-to-date balance sheet and income statements?
- Do you consult a professional (lender, accountant, insurance agent) when making major financial decisions?
- Do you use enterprise analysis?
- Do you know your cost of production?
- Have you investigated all of your potential financing options?



**RISK  
MANAGEMENT  
PROFILE**

**Legal**

- Are you in compliance with all regulations?
- Can your farmer owners' policy guarantee you can recover from a disaster in six months?
- Do you understand all of the provisions of your contracts, leases and loans?
- Will your existing business need to be upgraded or replaced?



**RISK  
MANAGEMENT  
PROFILE**

**Transition**

- Do you have an independent retirement fund available?
- Is your will up to date?
- Do you have a living will?
- Do family members know the location of your will?
- Do you have adequate life insurance to cover your wishes and debts at current values?



## RISK MANAGEMENT PROFILE

### Human

- Do you have adequate medical insurance?
- Have you investigated other production methods?
- Have you conveyed business goals to your family?
- Are standard operating procedures in place?
- Do you review employees at least yearly?



### Dairy Gross Margin

- Purchase end of month
- Coverage period from 1 to 10 months
- **LGM is an insurance policy**
- **No potential upside losses**

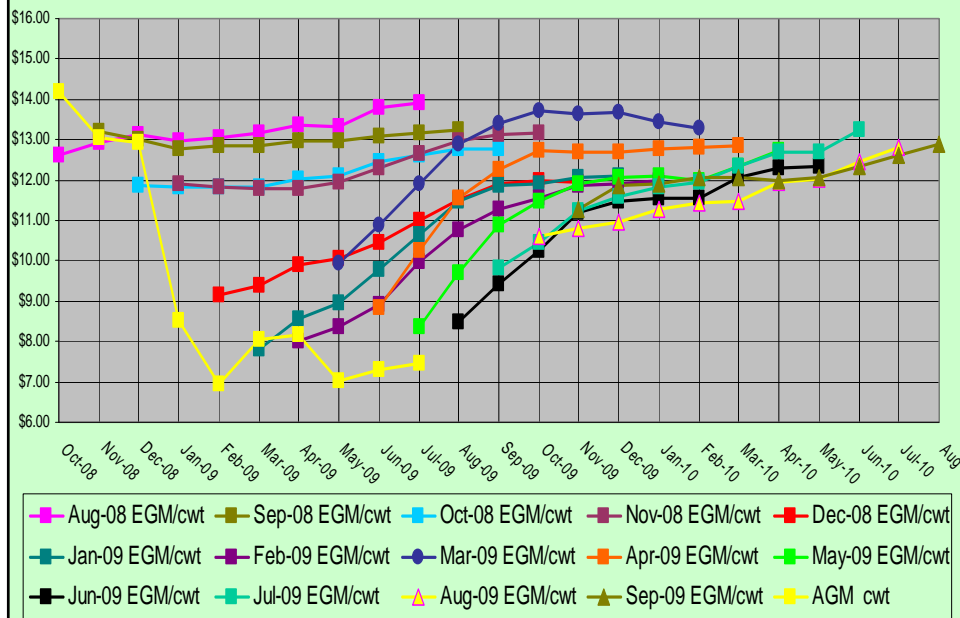


## LGM for Dairy

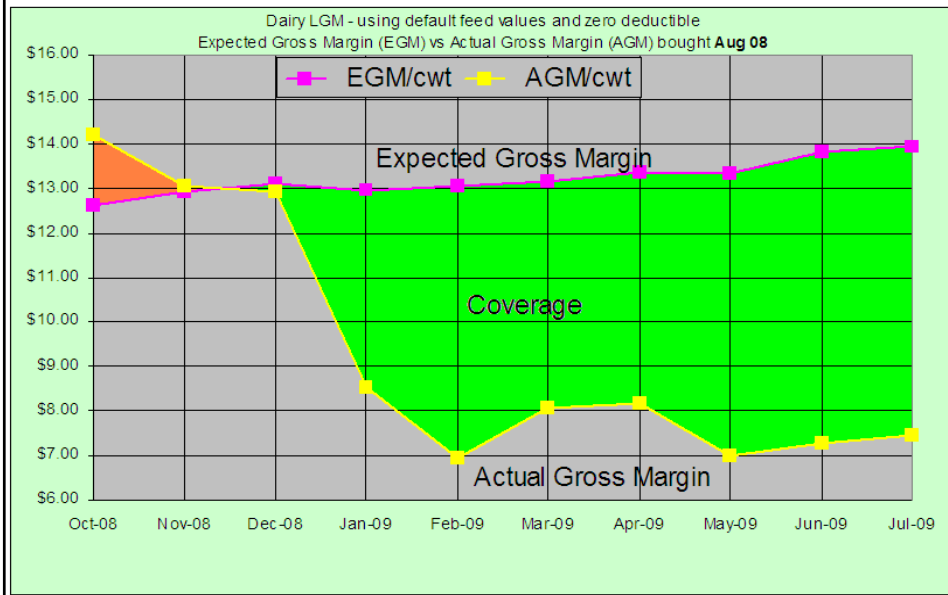
- Offered through crop insurance agents
- Class III milk - put option
- Corn - call option
- Soybean meal - call option



Expected Gross Margin (EGM) by enrollment period vs Actual Gross Margin (AGM) with zero deductible



## Performance during most recent enrollment cycle (purchase 8/08 for 10/08 through 7/09)



**Rough Estimates For Educational Purposes**

The data is derived from futures and options prices from dates: 2009-10-05, 2009-10-06, 2009-10-07

Insured Months	Covered Production (cwt)	Est. Gross Margin Guarantee, 0 Deductible (income over feed costs)		Avg. Milk Futures	Avg. Corn Futures	Avg. Soybean Meal Futures	Covered Corn Equiv (Tons)	Covered Soybean Equiv (Tons)
		Total \$	\$/cwt	(\$/cwt)	(\$/bu)	(\$/ton)		
Dec-09	1	12.27	12.27	14.53	3.44	271.93	0.014	0.002
Jan-10	1	12.22	12.22	14.50	3.48	269.23	0.014	0.002
Feb-10	1	12.19	12.19	14.49	3.53	267.90	0.014	0.002
Mar-10	1	12.31	12.31	14.63	3.57	266.57	0.014	0.002
Apr-10	1	12.18	12.18	14.52	3.62	265.29	0.014	0.002
May-10	1	12.35	12.35	14.71	3.66	264.00	0.014	0.002
Jun-10	1	12.36	12.36	14.74	3.70	264.32	0.014	0.002
Jul-10	1	12.49	12.49	14.89	3.74	264.63	0.014	0.002
Aug-10	1	12.80	12.80	15.22	3.78	265.43	0.014	0.002
Sep-10	1	12.94	12.94	15.38	3.82	264.87	0.014	0.002
<b>Total</b>	<b>10</b>	<b>12.41</b>	<b>12.41</b>	<b>Avg. for 10 month period</b>				

Default feed amounts used to calculation (corn: .014T.=1/2 bu, soymeal: .002T.=4 lbs. to produce 1 cwt, of milk)

The above estimated information is from the homepage of the University of Wisconsin Dairy Marketing and Risk Management Program and is maintained by Prof. Brian W. Gould of the Dept. of Agric. and Applied Economics. It is recommended that you use the browsers: Internet Explorer (V7), Firefox, or Safari set at their medium or normal text size. [http://future.aae.wisc.edu/lgm\\_premium/](http://future.aae.wisc.edu/lgm_premium/)



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