



What is LGM Dairy Insurance?

- LGM Dairy is a federally backed program,
 - run by the Risk Management Agency (RMA).
 - Administered through insurance agencies.

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How LGM Dairy Works

- The LGM Dairy program allows producers to set a floor on their milk price and a ceiling on their feed prices. If the margin (income-feed cost) decreases, an indemnity is collected.
- If the margin increases, the premium paid is left on the table, and higher prices or lower costs are reflected in the milk check.

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How does LGM Dairy Work?

- On the third to the last business day of each month, a producer may elect to purchase insurance for 1-11 months. He/she then chooses the amount of feed and the amount of milk to sign up.
- This must be done by 9:00am the following day. NO EXCEPTIONS

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How Does LGM Dairy Work?

- A producer can sign up for one contract each month. The contracts can range from 1-10 months, or any combination of months.
- The contract expires at the end of the last month which was signed up.
- If an indemnity is due, it will be paid after the respective corn contracts settle. (see chart)

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Purchasing an Array of months has its advantages and disadvantages.

An Array will be discounted based on how many months are combined. It ranges from 3% to 17%.

The longer the Array, the more time the market has to offset any losses. The contract settles at the end of the last contract period

(See Array Analysis Chart)

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How is the expected milk price determined?

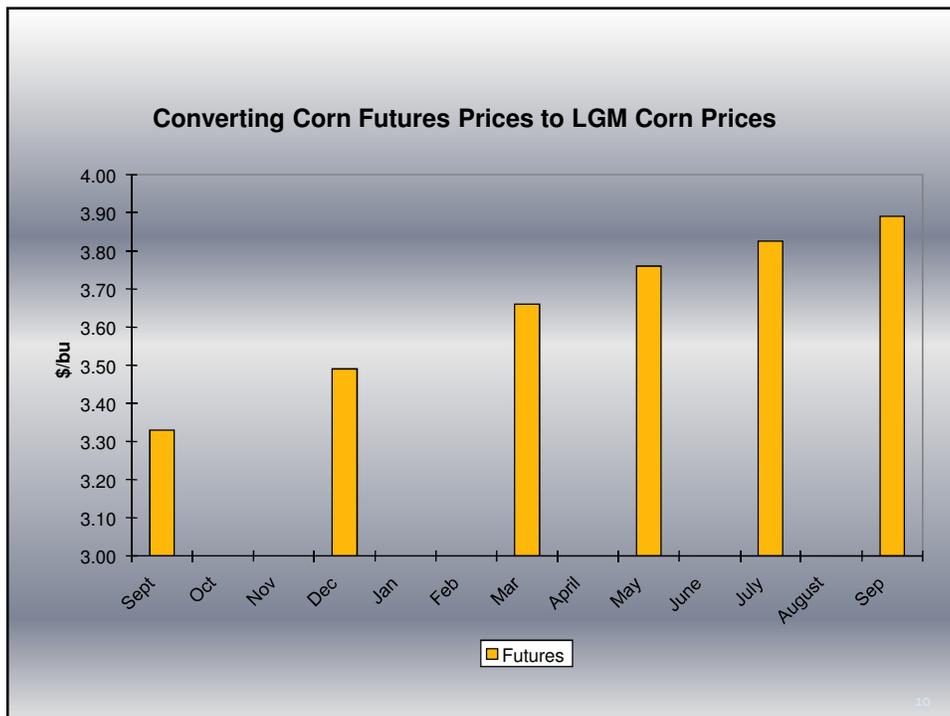
- The simple average of the three days prior to the 9:00am sales closing day off the CME for class III milk for the respective month.
 - Example: Third to last business day in June 2009 is June 26th. Sales closing is 9:00am on June 27th. Thus, the expected milk price for June is the average of the closes for June Class III milk on June 26th, 25th, & 24th.

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What is the Expected Corn Price?

- Expected corn prices for months are determined using three-day average settlement prices on CBOT corn futures contracts and a basis adjustment that varies by month and state.
 - Example: for a sales closing date of June 26th the expected corn price for June in Wisconsin equals $\frac{1}{2}$ the simple average of the daily settlement prices on the CBOT July corn futures contract and $\frac{1}{2}$ the simple average of the May contract.

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What is a cause of a loss?

- Loss of Gross Margin from Projected Gross Margin

Milk ↓ Inputs ↑ = Indemnity
Milk ↑ Inputs ↓ = No Indemnity
Milk ↓ Inputs ↓ = Possible Indemnity
Milk ↑ Inputs ↑ = Depends

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What is not covered under LGM Dairy?

- LGM Dairy Insures a margin.
- It does not cover production related losses
 - Loss of Production
 - Inefficient Production
 - Livestock Death
 - Disease

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How much milk can you sign up?

- There is a maximum of 24 million # of milk /crop year. The most you could do in 1 month is 24 million # of milk. There really is not a minimum.
- The program does not favor volume
 - It is not bias towards large or small producers

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Crop Year? Milk?

- The crop year for the LGM Dairy Insurance is from July 1st, to June 30th.
 - This applies to sign up periods only.
 - A contract can originate in one crop year, and settle in another.
 - Example: March 2009 signup- purchase insurance for 50,000# of milk for June, July, August and September. The contract originates in the 2009 crop year and settles in the 2010 crop year.

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How do I Know how much corn or soybean meal to sign up?

- Convert all feedstuffs to units of energy, and units of protein.
- Or, use the Net Energy of Lactation (Nel) and % Crude Protein of the ration.
 - This allow the entire ration to be protected based on corn and soybean meal equivalents.

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How do I Know How Much Corn and Soybean Meal to Sign up?

- You decide how much to sign up.
- You must sign up between .00364 -0.02912 Tons of corn per cwt of milk, (7.28-58.24 #/cwt).
- You must sign up between 0.000805 – 0.00642 tons of Soybean meal per cwt of milk (1.61-12.84 #/cwt).

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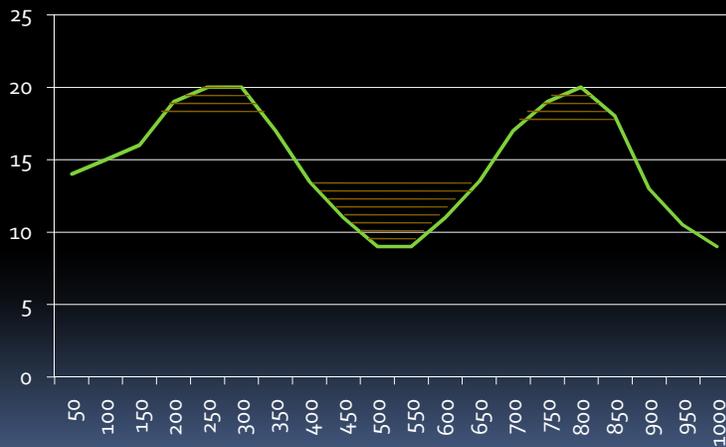
What does this mean for me?

- By setting a floor on milk prices and a ceiling on feed prices; Over time LGM Dairy insurance will provide more consistent income.
- You may leave your premium on the table when prices are high, But you will collect an indemnity when prices fall.

This provides a more even cash flow

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Milk Price Movement With LGM Dairy Insurance



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Some may say Insurance companies just take your money, they don't like to pay out!

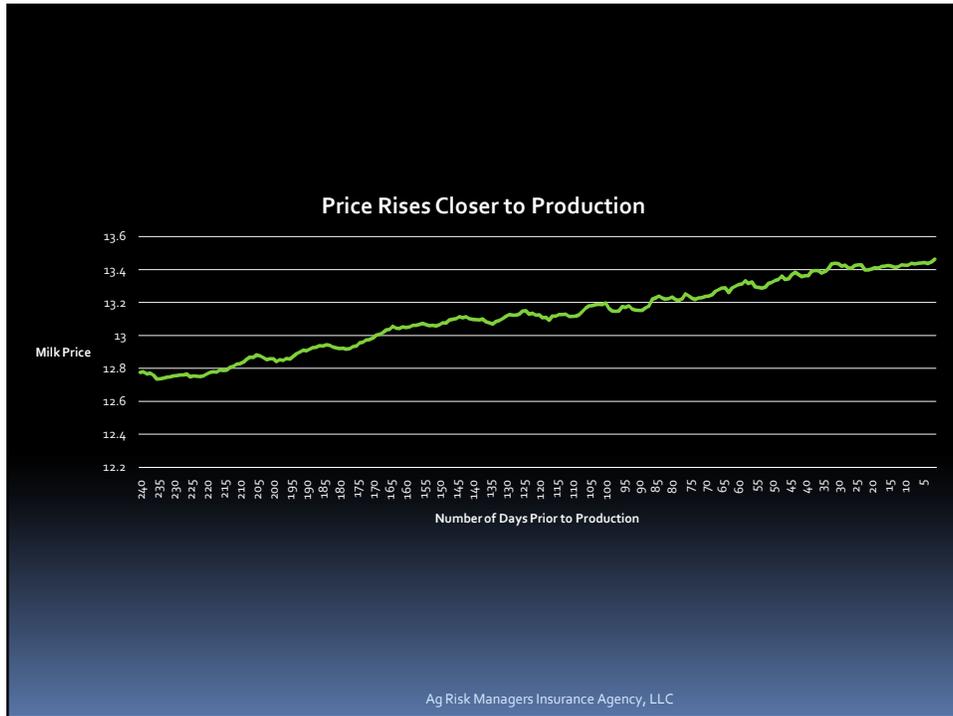
- LGM Dairy Insurance is designed to pay out what you pay in over time, minus a 3% commission fee. The government pay's the insurance agencies to administer the program.
- LGM Dairy is not designed to scam you out of all your \$!!

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What has history told us about Milk Prices?

- The best milk price you will get is when the milk leaves on the bulk truck.
- Milk prices tend to rise as they approach the settle month.
- The further out a person contracts, the more \$ you potentially leave on the table.

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What has history told us about corn & Soy prices?

- Corn prices tend to erode over time.
- Soybean Meal tends to rise over time.
- LGM Dairy can help this work to your advantage!

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Tools for Risk Management

- Forward contract with the creamery
- Sell Futures on the CME
- Buy Options on the CME
- Purchase LGM Dairy Insurance
- Do Nothing! Just take what you get as your milk leaves on the milk truck.

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How does LGM Dairy compare to other Risk Management tools?

- LGM Dairy Insurance has advantages and disadvantages over other Risk Management tools.

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LGM Dairy vs. Forward Contracting with the creamery

- Advantages:
 - Maintain up side price potential
 - Flexible production requirement
 - Limits up side potential of feed
 - Should yield higher gains

- Disadvantages
 - More expensive
 - Limited sign up period

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LGM Dairy Vs. Selling Futures on CME

- Advantages
 - No Margin Calls!
 - Flexible production guidelines
 - Smaller producers can participate
 - Maintain upside potential

- Disadvantages
 - Limited sign up period
 - May not offer enough for large farms
 - More up front cost

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LGM Dairy Vs. Buying Options on CME

- Advantages
 - Usually less expensive
 - Smaller producers can participate

- Disadvantages
 - Limited sign up period

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Strategies for LGM Dairy

- Identify Risk
- Determine amount of milk to protect
- Determine the amount of corn and soybean meal to protect
- Develop a marketing plan
- Focus on Margins

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Strategies for LGM Dairy

- The key to any marketing plan is consistency.
 - Only executing a marketing plan for a few months may or may not work to your benefit. A marketing plan is a long term commitment, that should be amended periodically.
- The purpose of a written marketing plan is take the emotion out of making decisions.
 - Emotion leads to second guessing, and second guessing leads to missed opportunity
 - Stick to your guns!!

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Strategies for LGM Dairy

- Focus on income over feed cost.
 - Just looking at milk prices can be deceiving
 - Example, 2007 compared to 2008
 - High prices may not be more profitable
 - Margin depicts a more accurate picture of profitability

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How far out should I Contract?

- Our studies tell us that the most opportune time to sign up is between 4-8 months out.
 - Any closer than that, the damage has already been done. The prices may move a little, but the loss may not out weigh the cost.
 - Any farther than that, the cost may out weigh the benefit.

(See selling milk futures and Buying Puts Charts)

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How do I know if I should implement LGM Dairy Insurance as Risk management Program?

- Has your farm expanded?
- Are you a beginning farmer?
- Are you leveraged?
- Are your pockets deep enough to absorbed a significant loss for 1 year...or more?

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LGM Dairy does not relieve an operation from its obligation to capitalize on favorable markets when they present themselves. LGM Dairy Insurance is only one Risk Management Tool. Each of the mentioned tools can add value to an operation. Don't miss out on opportunities when they present themselves.

- If you participate in LGM Dairy Insurance, you can still implement other Risk Management Programs

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Overview

LGM Dairy Insurance is a program which allows large and small producers to limit their exposure to volatile price movements for milk and corn/soybean meal. Over time it will level off milk prices, and contribute to more consistent income.

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