

Risk management: Dairy-RP

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(i.e., the fine print)

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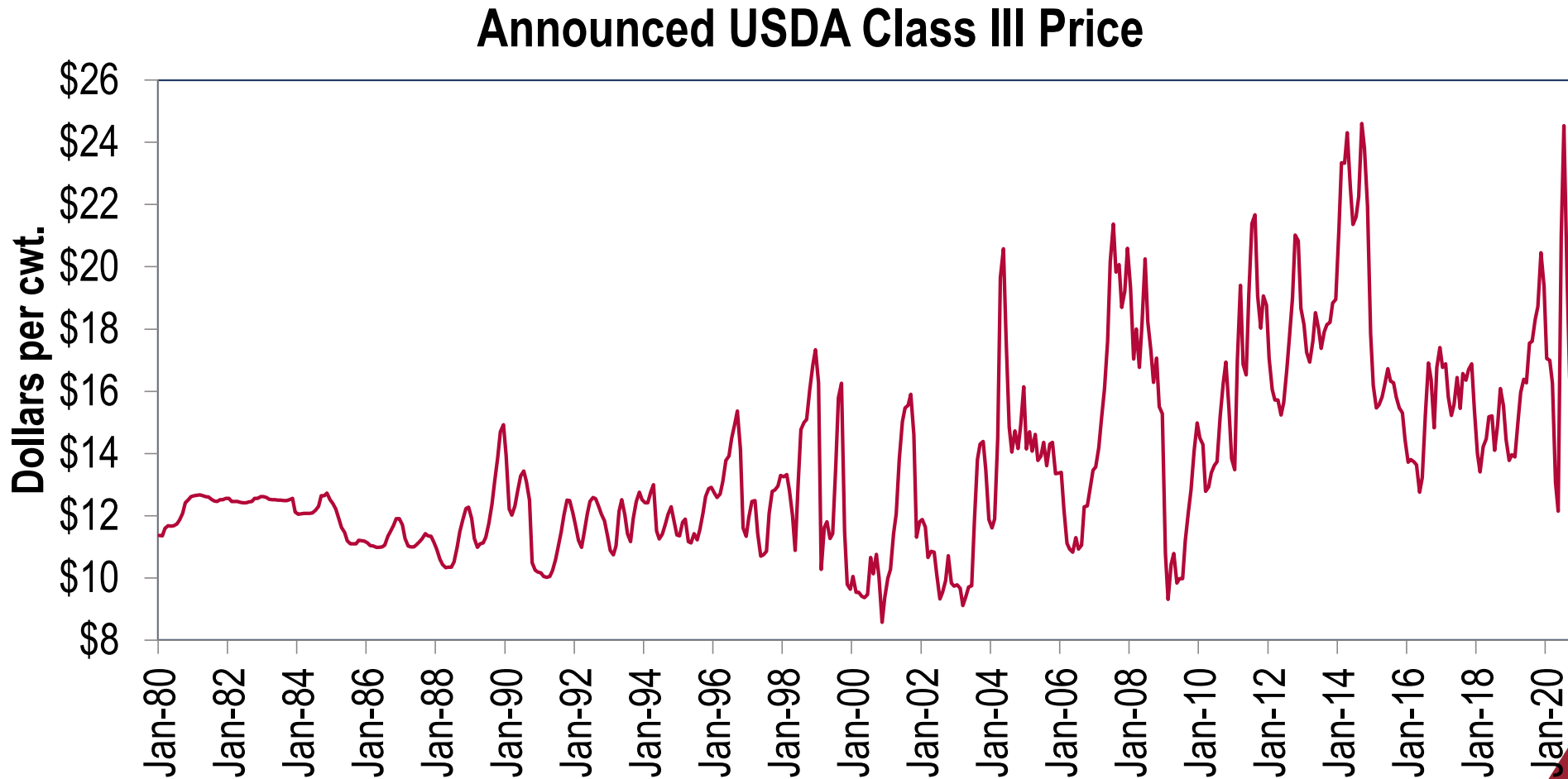
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Why risk management?

The market reality: Price fluctuations, financial risk, frustration



What can you do about volatility?

You can choose to sit it out

---or---



What can you do about volatility?

---or---

You can choose to do something about it



Price fluctuation impacts your goals

- Be more profitable
- Send kids to college
- Expand farm's net worth
- Solidify retirement
- Transition
- Expand



Price swings put obstacles in the way of these goals

Price instability hinders profitability

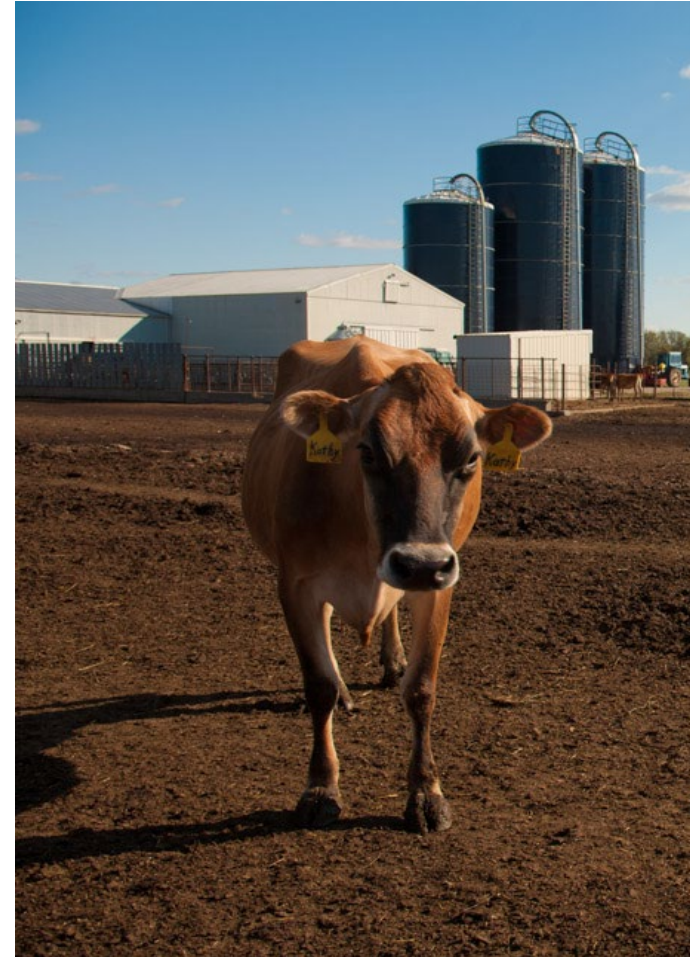
Risk management can help you:

Smooth out unpredictable price swings

Ensure future profitability

Protect and grow your net worth

Achieve your goals



Risk management works

- **Markets were stronger at the end of last year and into the beginning of this year**
 - Many took advantage of those opportunities, *despite the market optimism*
- **A year ago, Dairy-RP offered April-June 2020 Class III floors at \$16.17 and Class IV floors at \$16.70 for \$0.13**
 - \$0.75 and \$5.04/cwt above where Q2 prices settled
 - Protection opportunities improved from these levels later in 2019
- **\$3.00+ DMC payments for April/May**

Know your options



Dairy Revenue Protection (Dairy-RP)



Dairy Margin Coverage (DMC)



Traditional risk management (other cooperative or broker programs)



Livestock Gross Margin (LGM-Dairy)



When it comes to risk management, which of the following do you most agree with?

- **I would absolutely lose my head if I left money on the table**
- **I am looking to protect a consistent profit level on my dairy year-in and year-out**
- **I think it's fun to not know what's going to be in my check each month**
- **I am just looking for a way to limit my downside risk when things are catastrophically bad**



When it comes to risk management, which of the following do you most agree with?

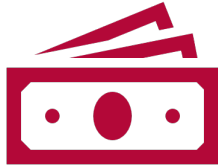
| If this is you: | You should look at: |
|--|--------------------------------|
| I would absolutely lose my head if I left money on the table | Dairy-RP or DMC |
| I am looking to protect a consistent profit level on my dairy year-in and year-out | Futures or forward contracting |
| I think it's fun to not know what's going to be in my check each month | An insane asylum |
| I am just looking for a way to limit my downside risk when things are catastrophically bad | DMC or Dairy-RP |





Dairy Revenue Protection (Dairy-RP)

Dairy-RP is



Milk price floors

Downside protection
Full access to upside



Gov't subsidized

Offered through USDA crop
insurance program

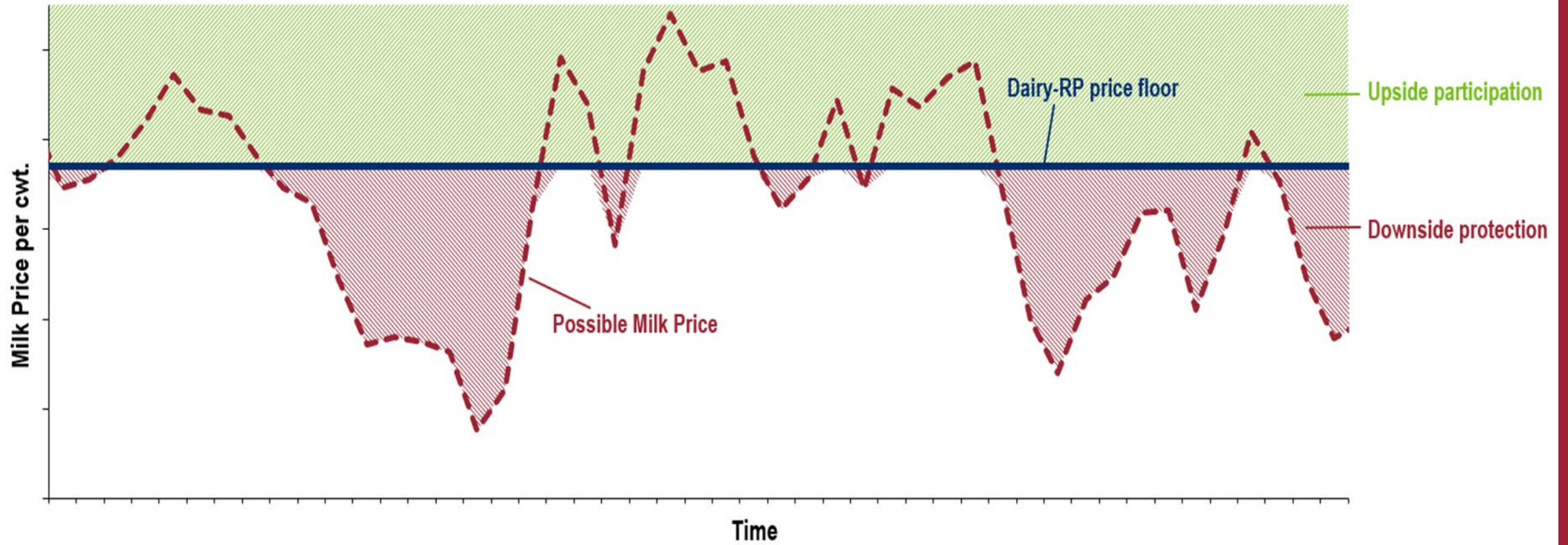


Customizable and easy to use

Can use with DMC and
DFA's forward contracting
programs



Price floors





Dairy-RP Process

Coverage levels

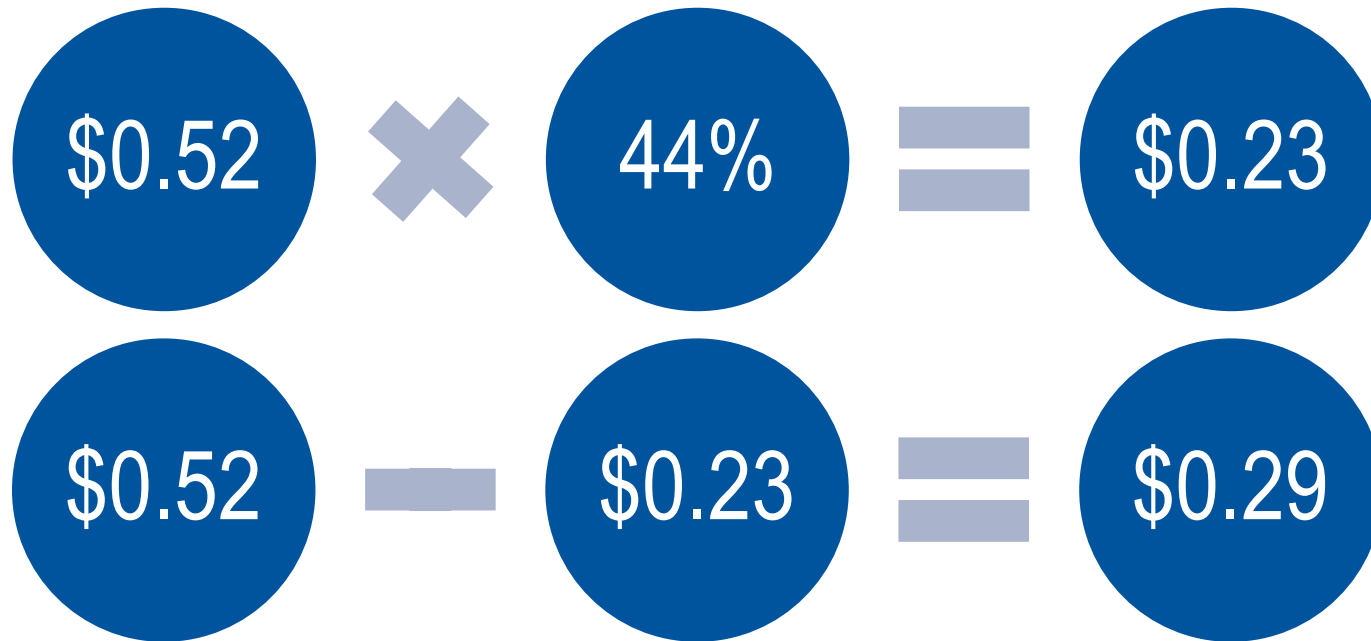
- For coverage level, RMA looks at the average of each day's CME Group futures prices for that quarter and then multiplies by the coverage level to provide a level of protection

A diagram illustrating the calculation of a coverage level. It consists of three red circles connected by a multiplication sign and an equals sign. The first circle contains the value "\$16.55", the second circle contains "95%", and the third circle contains "\$15.72".

$$\$16.55 \times 95\% = \$15.72$$

Premium

- Using the example value of a 95% coverage level, you would be eligible for a government subsidy of 44%



Endorsement

| Factor | In our example |
|---------------------------------|----------------|
| Minimum price per cwt protected | \$15.72 |
| Milk production protected | 600,000 pounds |
| Total revenue guarantee | \$94,335 |
| | |
| Premium per cwt | \$0.29 |
| Total premium due | \$1,743 |
| | |
| MPC Yield | 5,285 |

What does a 95% coverage level in Dairy-RP indicate?

- How much of the milk price I am protecting
- How much of my milk I am protecting

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Quarterly settlement

- **Two pieces:**

- USDA announced prices
 - Class III and Class IV
 - Butterfat, protein, other solids
- Production per cow in your area compared to the estimate at the time you booked

$$\text{Announced price} \times \text{Volume enrolled} \times \text{Yield adjustment factor} \\ = \text{Final revenue}$$

Yield adjustment

- **MPC at time of booking: 5,285**
 - Estimate for how much milk per cow would be produced in Q2 2021 in your region (NC, VA, TN, KY)
 - Compares with where your actual region's MPC ended up
- **LOWER milk per cow = lower final revenue = stronger indemnity**
 - $5,200 \text{ act} / 5,285 \text{ est} = 0.984$
- **HIGHER milk per cow = higher final revenue = lower indemnity**
 - $5,350 \text{ act} / 5,285 \text{ est} = 1.012$

Final revenue

- Lower MPC:

$$\$15.00 \times 6,000 \text{ cwts} \times 0.984 = \$88,560$$

- Higher MPC:

$$\$15.00 \times 6,000 \text{ cwts} \times 1.012 = \$91,080$$

Payments

- Paid out to producer minus the 39-cent premium following the final month of the coverage



Impact on milk checks

There is NO impact on milk checks

- **Everything that happens within Dairy-RP happens OUTSIDE of milk checks as a separate calculation**

| Dairy-RP | | Milk Check | |
|------------|---------------------|---|----------------|
| Booked | \$15.72 | Settled | \$15.00 |
| Settled | \$15.00 | Basis | \$1.00 |
| Adjustment | \$0.72 | Final Check | \$16.00 |
| | Received separately | | |
| | | Final milk price received in essence | \$16.72 |

What class of milk is your check based on?

- **Class I**
- **Class III**
- **Class IV**
- **Some combination of Class III and Class IV**

What class of milk is your check based on?

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- Class III
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Personalization

Customize your protection by:

- **Protecting a weighted average of Class III and Class IV prices**
 - Or adjusting the protein and butterfat levels to match your dairy's production
- **Why? Protect more of your milk basis, and thus more of your milk check**

How often can you purchase separate Dairy-RP insurance endorsements?

- Annually
- Quarterly
- Monthly
- Daily

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- Annually
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Personalization

Customize your protection by:

- **Layer in endorsements, adding as many Dairy-RP coverages as you'd like in each quarter, up to 100% of your production**
- **Why? Take advantage of market movements and potentially mitigate higher premium costs**



We are crop insurance agents

If you haven't established a Dairy-RP relationship,
please let us know and we can help

Forward contracts vs. Dairy-RP

Additional comparisons

| | Forward contracts | Dairy-RP |
|---------------------------------|--|---|
| Amount of milk protected | Primarily done in 200,000 pound increments per month; amounts based on historical production | No size constraints; can protect up to 100% of what you expect to produce |
| Upside opportunity | Limited; may be available for a sizeable fee | Unlimited, and for a reduced cost |
| Downside protection | Typically the best price available on any given time | Protects floors that are 5% lower than futures |
| Cash flow management | Settles monthly in milk checks (when using coops) | Settles on an average of three months, in the month following that coverage |



Poll: What is stopping you from utilizing a risk management strategy?

What do you need to know?

Before you use a risk management strategy:

- **Understand how your milk is priced**
 - Relate your price back to Class III and IV
- **Understand how your strategy relates to your milk check**
- **Understand what factors into your basis**
- **Explore what opportunities are available in different programs**
- **Choose to be consistent and deliberate, focusing on the numbers within your plan rather than the emotions in the market**




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**Following this presentation,
will you agree to explore a risk
management strategy with a
trusted partner?**

- Yes
- No
- Maybe