Have You Considered BFP Futures?

- Price situation is volatile
- Are Class I differentials legal? Where?
- Tools for price Risk Management
  - Forward Contracting (Feed & Milk)
  - Futures Market
  - Options Market
Forward Contracting

- Can be used effectively for feed purchases
  “Lock-in” feed prices

- Raw Milk Contract usually for tanker load ~ 48-50,000 lbs. delivered often directly to bottler or processor

- Assures a specific price

- Both producer and buyer can plan ahead
BFP and MILK Futures

Raw Milk

Raw Milk Contract usually for tanker load ~ 48-50,000 lbs. delivered

Delivery: to Madison, WI district of Grade A Milk at 3.5% fat up to last business day of delivery Month

Price discovery vehicle
BFP and MILK Futures

**BFP**

BFP Contract  
CME  200,000 lbs.  
CSCE  100,000 lbs.

Possible for smaller herds to use

Cash settled contract, no delivery of milk

Settled on day USDA announces BFP

Settled on:

$1000 \times (\text{contract BFP} - \text{USDA BFP})$
BFP Futures Strategy

Know your cost of production

Estimate how much your mailbox price will differ from the BFP in the future month (\(Basis = \text{mailbox price} - \text{announced BFP}\))

Attempt to find futures that will ensure your cost of production and some margin

Remember to consider your broker fees!

Remember this is a “2 account” system.

You may be required to maintain a minimum futures account balance.
BFP Futures Hedging Example

**Cash Market**
Producer expects to sell 200,000 lbs. of Grade A milk in April 1998. Expectation based on April futures is $13.25

Sell 200,000 lbs. of milk at $12.25

Lose $1.00/cwt.

**Futures Market**
Sell 2 Apr. 1998 BFP Contracts @ $11.75 (11-19-97)

Basis = $1.50

Apr. 1998 BFP Announced @ $10.75

Gain $1.00/cwt.
BFP Options

An option on a futures contract conveys the right, not the obligation, to assume a position in the underlying futures market at a specific price any time before the option expires.

A call option is the right to buy a futures contract.

A put option is the right to sell a futures contract.

With the option you spend a given amount to guarantee a minimum price but you sacrifice the settling price. Downside Protection
BFP Option Example

Cash Market
Producer expects to sell 200,000 lbs. of Grade A milk in April 1998. Expectation based on April futures is $13.25

Sell 200,000 lbs. of milk at $12.25

Lose $1.00/cwt.

Futures Market
Buy 2 Apr. 1998 BFP Put Options at a Strike Price of $11.75. Premium is $.31/cwt.

Basis = $1.50

Apr. 1998 BFP Announced @ $11.00. Exercise 2 put options.

Basis = $1.25

Gain $.75 - $.31 = $.44

Net price is $12.69 vs $12.25 without any hedging.