

## Dairy Future Options Market: Basic Terminology

**Basis:** The difference in the price you receive at the farm versus the announced Class III (BFP) price. Normally in Colorado, this is a positive number but in July, August and September of 1999 the Class III price was higher than the Federal Order blend price. Therefore the basis was negative.

	<b>June</b>	<b>July</b>	<b>August</b>	<b>September</b>
Class III Price	\$11.42	\$13.59	\$15.79	\$16.26
Blend Price	\$13.09	\$13.38	\$13.68	\$15.83
Basis	+\$ 1.67	(\$ 0.21)	(\$ 2.11)	(\$ 0.43)

**Blend Price:** Class III + producer price differential (PPD)

**PPD:** Producer Price Differential results from the sum of the value of Class I, II (which is more than Class III) and IV (which may or may not be more than Class III), plus any additional value derived out of the market above class values.

**Cash Market:** The value of your milk in the marketplace without using the futures market or forward contracts.

**Class III Price** = skim price X 0.965  
 +  
 3.5 lbs of butterfat X butterfat value

**Skim Price** = 3.01 lbs protein X protein value  
 +  
 5.9 lbs other solids X other solids value

**Forward Contract:** A cash market transaction in which two parties agree to the sale and purchase of a commodity at some future time under such conditions as the two agree.

**Futures Market Contract:** A transferable agreement to make or take delivery of a standardized amount of a commodity, such as milk. The milk (Class III) contracts are cash settled so physical delivery does not take place. The price for the commodity is established in the trading pit. You can contract a Class III price 12 months out. On May 4, 2000, you could contract the March 2001 Class III at \$10.71/cwt.

**Put Option:** A contract which gives the holder the right, but not the obligation to sell the underlying futures contract at a specific price within a specific period of time. It gives you the ability to put a price floor on your milk. Simply put it is a form of insurance, for this insurance you will pay a fee or premium.

**Hedge/Hedging:** The purchase or sale of futures and/or option contracts in an effort to establish a profitable price for your commodity, in this case milk. In reality, one who hedges is a price risk manager who is unwilling to allow the "cash market" to determine the price he will receive.

**Mailbox Price:** Net price received for milk on the farm. Typically would include quality and volume premiums but all marketing costs such as hauling, marketing fees, etc. would be deducted.

**Margin:** An amount of money deposited by both the buyers and sellers of contracts to ensure the performance of the terms of the contract, in reality it is a security deposit.

**Margin Call:** A call from a brokerage firm requiring a customer to deposit funds into his/her margin account to bring it up to the required minimum level. If you sold a 200,000 lb. September contract for \$12.45 and the price went up to \$13.45, you would need to deposit \$2,000.00 into your margin account. If you are making your future contracts through Dairy Farmers of America (DFA), we will be making the margin call payments for you and your account is settled with DFA through your milk check.

**Price Risk Manager:** The use of the futures/option markets to secure a profit margin for their dairy operation.

**Speculator:** Could be defined as a dairy operation that does not use the futures/options market to determine their price but is willing to accept the monthly cash market price. A dairy speculator could also be defined as a dairy producer who uses the future/option markets in an effort to "beat the market" or profit from market fluctuations.