



EDITORIAL COMMENT

KNOW THE MILK-PRICE BASIS FOR YOUR FARM

MANY of you will be familiar with what's called basis in grain marketing . . . the difference between the cash price at a major market and what a grower actually might get paid at his local elevator. Recently, the Central Illinois price for corn was \$5.50-1/2 per bushel. Local bids were around \$5.40. So, the basis would have been 10 cents, less the cost of trucking.

In dairy, basis is the difference between your mailbox price and the Class III price for the same month. You need to know your basis so you can anticipate what your milk income is going to be in the months ahead. If you know how much above the Class III price you can expect to get paid, then you can track Class III futures and calculate expected milk income. (Getting a handle on basis is trickier in high-fluid areas since the Class I price is an advanced price.)

Knowing your basis also is extremely important if you forward contract. By knowing the costs you need to cover and your basis, you have a more sound idea of when to forward contract or not.

Since 2001, the average basis at the Hoard's Dairyman Farm has been \$3.59 per hundred-weight. Remember, we have Guernseys with an average protein test of 3.4 percent and fat test of 4.6. Besides components, quality payments and other premiums add to a farm's basis. Producer price differential also is a factor . . . ours has averaged 25 cents per hundred since 2001.

Our highest annual average basis was \$4.19 in 2005, when the Class III average was \$15.39 and average PPD was 27 cents. Our lowest average basis was \$2.50 in 2002, when the Class III price averaged \$10.42 and PPD averaged 55 cents.

Basis is seasonal. For us, the basis was highest in the fourth quarter over the past seven years, \$4.05, and lowest in the third, \$2.95, and we take that into account when planning budgets.

Tracking basis also may give you some idea of how competitive your milk price is. We changed to cheese-yield pricing in the fall of 2004. Our basis went up, but so did the Class III price. Therefore, we looked at basis as a percent of average Class III price. Our basis averaged 25 percent above the Class III during the three years before the switch and 28 percent after the move. We thought this indicated we had made a step in the right direction, especially since premiums in Wisconsin were supposed to be going down.

Keeping track of basis involves crunching a lot of numbers. Setting up a spreadsheet simplifies the process. Clear patterns and directions are difficult to parse out. However, knowing your basis is an important part of understanding milk checks and is well worth the time and effort.