



NEWS ALERT

February 17, 2005

This is the second of a series of four News Alerts.

In October of 2004, T.O. Geoff Baker of Ohio brokered a meeting with IDQ Executive Vice President of Supply Chain Services, John Gainor and CFO, Jim Simpson. The meeting was held in Minneapolis to accommodate IDQ. Mr. Cooper of the DQQA/DQOC had advised Mr. Baker that Mr. Gainor had the 11 points and that the meeting should only be held if Mr. Gainor was prepared to provide a plan for a Unified Supply Chain that addressed the 11 points. Mr. Baker, after talking with IDQ, told Mr. Cooper that all parties understood the meeting protocol.

Prior to this meeting, certain franchisees told Mr. Cooper that IDQ had never actually been interested in a Unified Purchasing program with the DQQA/DQOC. IDQ's plan was to create USCI and then put the DQQA/DQOC out of business within two years.

Notwithstanding the above information, the meeting with Mr. Gainor went ahead on October 21st. John Gainor and Jim Simpson represented IDQ. Representing the DQQA/DQOC were Rick Brandes, Kevin Allen, Mike Leeper, Gary Ignasiak and Harris Cooper. The meeting lasted 1 1/2 to 2 hours. Mr. Gainor did not have any proposal to make. Instead, he reminded the DQQA/DQOC negotiating committee and Board of Directors of the issue of "trust".

Mr. Gainor asked if he could share the 11 points with his USCI council, and he was told he could. He said that he would be back to us.

On December 22, 2004, the DQQA/DQOC received Mr. Gainor's proposal. We advised Mr. Gainor that the directors would take up the proposal at the January 3, 2005 board meeting.

The following is the full proposal that the DQQA/DQOC directors received, and addressed at the January 3, 2005 meeting:

December 22, 2004

Harris Cooper
Executive Director
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International Dairy Queen, Inc.
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Dear Harris and DQOC Board Members:

In response to our meeting in late October 2004, I have worked with members of our Supply Chain Council to develop a plan for the unified, combined distribution of products in the *Dairy Queen*® system. As you requested, I am forwarding our response to you for distribution to the DQOC board members. Our goal has been simple—to combine the purchasing of all product in the *Dairy Queen*® system to obtain for all *Dairy Queen*® operators the very best in price, service, and quality. I realize that we have taken different paths over the years to achieve these objectives. It is my professional recommendation that now is an opportune time for us to work together to optimize the *Dairy Queen*® supply system and allow our franchisees to achieve greater savings.

Two years ago, Chuck Mooty asked me to evaluate the current state of the *Dairy Queen*® supply system. As a result of my evaluation, I made a series of recommendations to Chuck designed to improve the competitiveness of all *Dairy Queen*® franchisees. As you are aware, last year IDQ began implementing a strategy that will change dramatically IDQ's involvement in the distribution of product over the coming years. In the past year IDQ committed to and implemented the following:

1. A defined schedule of margin reductions on covered products (does not include products such as mix and meat that have a voluntary 1% service fee program or manufactured novelties and cakes).
2. A stand-alone entity for supply chain activities with the creation of Unified Supply Chain, Inc. (USCI).
3. The involvement of franchisees in the supply chain effort through the creation of a Supply Chain Advisory Council (SCAC).
4. A commitment to an annual financial review of the USCI with the SCAC's participation to ensure IDQ's compliance with its commitments to reduce purchasing and distribution margins over time.

Implementation of these and other recommendations are just the start of our development of a complete supply chain strategy to support the *Dairy Queen*® system for many years to come. Critical, however, to maximum success is the involvement of all *Dairy Queen*® franchisees. The time has come for the *Dairy Queen*® system to unite behind a unified, combined supply chain and involve all franchisees in creating the best possible purchasing and distribution system.

Over the past weeks I have asked our Supply Chain Council to set aside "emotion" and deal strictly with the "facts." Our rich DQ heritage comes unfortunately with a lot of hurt, anger and distrust. We must set these feelings aside so that we can move forward together. I recognize that the transition of multiple organizations into a unified body can be a difficult and sensitive venture. I also recognize the need for all parties to be represented during the transition in order to ensure that all views are heard and the interests of all *Dairy Queen*® franchisees are served. Harris, I feel it is imperative that we view *Dairy Queen*® franchisees as a whole and not label them as IDQ supporters or DQOC supporters. That will be my approach as we form a combined entity.

When we last met on October 21, 2004, you requested that we address the issues identified in your October 8, 2003, letter to Chuck Mooty. Although the points identified in your letter are important, I believe that they represent only some of the topics that need to be addressed to accomplish our objective of unification. Additionally, at our October meeting we agreed that we would use our current supply chain structure (i.e., SCAC and USCI management along with the enhancements made to our supply chain resources within USCI) as the basis for our response.

Structure:

The current SCAC consists of twelve members—one member from each of the nine regions; one at-large member; one appointed representative of the FAC; and a member appointed by IDQ Canada and the CDQ CO-OP per the UFA (Unified Purchasing Agreement). The appointed positions are currently split between two- and three-year terms, with the first group coming up for election in March 2006. As you know, these initial members (with the exception of the at-large member) were recommended by each FAC representative for his or her region. Additionally, I appointed the at-large member based on a recommendation from Crest Oelke with the goal of ensuring that we had a mixture of diverse ideas on our Council. We do have several DQOA members on our council today.

Initial membership in the SCAC has been restricted to franchisees that purchased 70% or more of their product through IDQ given that the DQOC and the USCI still compete within certain purchasing and distribution activities. Our intent is to open up the Council to all franchisees that are actively involved in the management of their stores once a combined supply chain is established to represent all franchisees.

In order to transition to a single supply chain, we propose that the DQOC have four seats on the SCAC. These positions would be filled by the executive officers of the DQOC (president; vice president; treasurer; secretary). Once open elections are held starting in April 2007, the DQOA would have one additional seat to fill with a franchisee that is active in his or her stores on a daily basis, similar to the seat currently appointed by the FAC.

To clarify the Council structure at the point of agreement, the SCAC would consist of nine members representing regions; one FAC-appointed member; an at-large member; a representative from Canada (Unified Purchasing Agreement) and four DQOC representatives. This interim structure would represent all parties and serve until the first open elections are held, which would be moved back to April 2007. At that time all nine regional positions and the one at-large position would be elected, with five positions carrying two-year terms and five positions carrying three-year terms. The four DQOC seats would then expire in April 2007, as an open election process will have filled all member positions with *Dairy Queen*® franchisees who are active in their stores on a daily basis. The representative appointed by the DQOA, as well as the

representatives appointed by the FAC and Canada, will continue to serve in addition to the elected positions, for a total membership of thirteen on the SCAC. Obviously, we will need to further define the election process, but our intent is to develop a process whereby members are elected by their peers since all franchisees will be purchasing from a combined entity. Additionally, we would extend to the Texas *Dairy Queen*® operators the right to elect one council member if they were willing to commit to and participate in a combined distribution entity.

Harris, as we discussed in October, the USCI management team will be responsible for day-to-day supply chain operations, including forecasting, promotion planning, RFP development and execution, management of distribution and logistics and all other efforts associated with the execution of the work involved in implementing a successful supply chain for the *Dairy Queen*® system. USCI will retain the right to hire and set performance standards for its employees, but input of the SCAC will be factored into decisions surrounding employees and appropriate consideration will be given to concerns expressed by Council members. I am committed to a unified supply chain effort, as I shared with you previously, and have spent the past year recruiting and hiring the best talent available to accomplish this for *Dairy Queen*® franchisees. I urge you or your board members to discuss directly with any of our current SCAC members our approach and their involvement in all aspects of the supply chain.

Committees:

USCI currently has its Council members participate in the details of all aspects of its business. All members participate in conference calls, attend quarterly meetings in person and attend an annual Supply Chain Summit where all vendors and distributors are invited to participate. Currently, our committee structure is used for day-to-day information sharing with each USCI department leader soliciting input and receiving direction on key initiatives from the franchisee representatives of each committee. Our committee structure is comprised of the following: Distribution, Purchasing, Dairy and Logistics, Systems and Promotion Planning, Communications and Financial Review. The appointed DQOC representatives would select one of their members to serve on each of the committees to work with their fellow franchisees in making recommendations and decisions.

To facilitate a timely and orderly transition, we propose that a Transition Committee be formed for the first twelve months. This committee will meet at least monthly and will be responsible for approval and execution of strategy, ensuring that relationships with vendors and distributors are maintained and making sure transition plans are implemented. We propose that this committee consist of the Executive Vice President Supply Chain USCI, the Chairman and Vice Chairman of the Supply Chain Council, the Executive Director of the DQOA and the President and Vice President of the DQOC. In addition, per your earlier request, the DQOA Executive Director or a DQOA member of his or her choosing will serve on the financial review committee.

Franchisee Association:

It is important for the *Dairy Queen*® system to have active franchisee representation and participation. IDQ supports the formation and inclusion of all franchisees in such an organization, with *Dairy Queen*® franchisees electing leaders and directing the efforts of a strong franchisee association. USCI will, through a combined distribution entity in which all *Dairy Queen*® franchisees participate, fund through incremental margin dollars generated from additional volume, mutually agreed upon membership dues to a franchisee association for all *Dairy Queen*® franchisees that fully participate with the combined supply chain initiative. Obviously, the details of the association, the dues structure and term will need to be addressed once an agreement to pursue a combined distribution structure moves forward.

Transition of Vendors—Approval of Lyons-Magnus, Other DQOC Vendors, Crown Select Cone Company:

Lyons Magnus and all other DQOC vendors will remain approved vendors in the *Dairy Queen*® system as long as they meet reasonable standards and specifications required of all *Dairy Queen*® vendors, until such time the SCAC and Purchasing Committee conduct a product RFP that creates savings for the combined system and select a single supplier, if appropriate for the *Dairy Queen*® system. All current DQOC vendors will be invited to participate in the RFP. Current USCI vendors will be treated in the same manner with the sole intent of ensuring that all vendors are treated in a fair and equitable manner and that decisions benefit all *Dairy Queen*® franchisees.

The SCAC will approve the RFP process designed by USCI and will participate in the process and review USCI's recommendation and selection of the vendor(s) that meets the service, quality, and price requirements of the *Dairy Queen*® system. We anticipate that all vendor and product categories will be reviewed through an RFP

process within the first two years and appropriate vendor transitions completed during this same time period. Crown Select Cone Company will remain an approved vendor in the *Dairy Queen*® system as long as it meets reasonable standards and specifications required of all *Dairy Queen*® vendors for at least a two-year period of time, after which time the SCAC and Purchasing Committee can decide to conduct a Request for Proposal. If the DQOA wants to divest of its ownership position in Crown Select Cone Company, USCI will use its best efforts to assist DQOA in finding a purchaser.

RFP Process:

The USCI has developed new vendor/distributor agreements that will be reviewed by the SCAC. The USCI has also developed a revised RFP process that will be reviewed and approved by the SCAC. If additional changes are required as a result of a combined distribution entity, such changes will be discussed and agreed upon during the period leading up to the implementation of a combined entity. The appropriate committee members (i.e., Purchasing, Distribution, and others) will participate with USCI staff in the selection and recommendation to the Council of the qualified vendor/distributor based on the elements of service, quality and price. All Council members will have the right to challenge a selection where the low cost party is not recommended by the USCI and the appropriate committee. If a decision is challenged by the majority of the Council based on price, the term of the contractual arrangement will be limited to one year. Product costs requested through the RFP process shall be submitted net of any allowances and discounts. Terms of each RFP will be for at least one year and not greater than two years. The term of each RFP will be recommended by USCI to the appropriate committee and will be subject to approval by the majority of the Council members. Exceptions to term requirements can be made with prior approval by the Council for products requiring significant investments in capital related to tooling, dies and molds and other unique business requirements.

Distribution:

USCI will present a recommended distribution network within the first six months after a combined distribution entity is in place. All currently approved DQOC distributors will remain as approved distributors, as long as they meet reasonable standards and specifications required of all *Dairy Queen*® distributors, until such time as the Supply Chain Council and Distribution Committee completes and implements a Request for Proposal for the territory serviced by such distributor. At this point, we anticipate that total system integration for distribution may take up to three years to complete. The USCI has developed a distribution RFP, which will be reviewed and approved by the Council. If additional changes are required as a result of unification efforts, such changes will be discussed and agreed upon during the period leading up to the implementation of a combined distribution entity. The appropriate Distribution committee members will participate with USCI staff, along with the local Distribution Advisory Committees (DAC's) in the review, selection and recommendation of the qualified distributors based on the elements of service, quality and price.

We feel it is critical to agree on the structure and working process as noted above and then begin to work together to finalize the details on other outstanding items dealing with contracting parties, term (recommended ten years), cancellation and mediation. Additionally the financial requirements will need to be revisited, as well as agreement on definitions related to cost, defined margins and the scope of a combined distribution entity.

Harris, we are at a crossroads in the *Dairy Queen*® system where continued improvements in supply chain efforts can facilitate increased profitability for our operators. We understand that a combined distribution entity will take work, and we are prepared and excited to pursue a solution that benefits all *Dairy Queen*® franchisees. We will await your review of our proposal on structure and working process with the DQOC board and look forward to meeting in person to discuss next steps.

Sincerely,

John Gainor
Executive Vice President Supply Chain, USCI

See next News Alert for the Directors' correspondence and response to Mr. Gainor.