

NATIONAL CHALLENGE SYSTEMS INC.

FORM 51-102F2

ANNUAL INFORMATION FORM

Certain statements made or incorporated by reference in this Annual Information Form ("AIF") are forward-looking and relate to, among other things, anticipated financial performance, business projects, strategies, regulatory developments, new services, market forces, commitments and technological developments. By its nature, such forward-looking information is subject to various risks and uncertainties, including those discussed in this AIF or in documents incorporated by reference in this AIF, which could cause the Company's actual results and experience to differ materially from the anticipated results or expectations expressed. Readers are cautioned not to place undue reliance on this forward-looking information, and the Company undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise, except in accordance with applicable securities laws.

Generally, all disclosure is made as of September 21, 2005, unless otherwise indicated.

Financial information is presented as at June 30, 2005.

Table of Contents

Item 1	Corporate Structure	1
1.01	Name and Address of Head Office	1
1.02	Incorporation	1
1.03	Subsidiaries.....	1
Item 2	General Development of the Business.....	2
2.01	Compactor History	2
2.02	Vacuum Trucks & Non-hazardous Liquid Organic Waste – Canada.....	2
2.03	Vacuum Trucks & Non-hazardous Liquid Organic Waste – USA & World	4
Item 3	Description of the Business	5
3.01	NCS' Technologies	5
3.02	Wastewater Industry	7
3.03	Organic Waste Diversion	8
3.04	Organic Waste Recycling/Disposal.....	8
3.05	Non-Hazardous Vacuum Truck Services Industry.....	9
3.06	Organic Resource Management Inc.	10
3.07	A&A Anderson Tank Service (Vancouver) Ltd.....	10
3.08	Risk Factors	10
Item 4	Dividends	11
Item 5	Related Party Transactions	12
Item 6	Description of Capital Structure	12
6.01	Preferred Shares.....	12
6.02	Common Shares	13
6.03	Reduction of Capital Stock and Deficit.....	14
Item 7	Market for Securities	14
Item 8	Directors and Officers.....	14
Item 9	Transfer Agent and Registrar	16
Item 10	Additional Information	16

ITEM 1 CORPORATE STRUCTURE

1.01 Name and Address of Head Office

National Challenge Systems Inc.

3700 Steeles Avenue West
Suite 601
Woodbridge, Ontario
L4L 8K8
Phone: (905) 264-7700
Facsimile: (905) 264-7273
Website: www.nationalchallenge.com

1.02 Incorporation

National Challenge Systems Inc. (“NCS” or the “Company”) was incorporated on January 4, 1990 under the laws of the Province of British Columbia by registration of its Memorandum and Articles pursuant to the Company Act (British Columbia). Effective September 30, 2003, the Company completed its continuance from a corporation under the Business Corporations Act of British Columbia to being a corporation under the Canada Business Corporations Act. The Company’s registered and records offices are located at 3700 Steeles Avenue West, Suite 601, Woodbridge, Ontario L4L 8K8.

The Company’s shares were listed on the Vancouver Stock Exchange on July 12, 1994 (now the Canadian Venture Exchange) and subsequently on the Toronto Stock Exchange (under the trading symbol “NLC”) on January 7, 1998 where it now trades exclusively.

1.03 Subsidiaries

The Company currently has the following wholly owned subsidiaries:

(a) Active

(i) A&A Anderson Tank Service (Vancouver) Ltd. (“A&A”)

A&A was incorporated under the laws of British Columbia as 352505 BC Ltd. on January 1, 1989 and subsequently changed its name on January 3, 1989 to A&A Anderson Tank Service (Vancouver) Ltd. A&A is a provider of non-hazardous vacuum truck and related services including the collection, transportation and disposal/recycling of non-hazardous and organic wastes. The Company acquired A&A on May 31, 2002.

(ii) Organic Resource Management Inc. (“ORMI”)

On April 30, 1984, Filtrex Sales & Services Ltd. was incorporated under the laws of Ontario. On September 30, 1992, its name was changed to Organic Resource Management Inc. ORMI is a provider of non-hazardous vacuum truck and related services including the collection, transportation and disposal/recycling of non-hazardous and organic wastes. The Company acquired ORMI on May 31, 2002. ORMI amalgamated with a former subsidiary of the Company, National Challenge Systems (Ontario) Inc., on July 1, 2002.

(b) Inactive:

(i) NCS Holdings Limited (“Holdings”)

Holdings was incorporated in Bermuda on March 4, 1999. The Company is currently inactive. Holdings owns 70% of the common shares of NCS Environmental Services Limited (“NCS ESL”), a company incorporated in Bermuda, which although currently inactive, has certain Software and Marketing Agreements for the world, excluding Canada, that will be applicable to the Company as it pursues its expansion plans in the United States.

National Challenge Systems Inc.		
A&A Anderson Tank Services (Vancouver) Ltd. 100%	Organic Resource Management Inc. 100%	NCS Holdings Limited 100%
		NCS Environmental Services Limited 70%

ITEM 2 GENERAL DEVELOPMENT OF THE BUSINESS

The primary operations of the Company since May 31, 2002 consists of operating vacuum truck fleets that provide collection, treatment and disposal services for non-hazardous liquid waste and other related services. Through its two wholly owned subsidiaries, ORMI and A&A, NCS is Canada's largest provider of vacuum truck services for the collection, treatment and disposal of organic and other non-hazardous liquid waste. NCS services more than 8,000 commercial, industrial, institutional and residential customers in Ontario, Quebec, and British Columbia. Its core focus is on the utilization of leading edge, proprietary, information, and operating technologies to provide regularly scheduled, repetitive, and dispatched services, primarily to the foodservice and food production industries.

2.01 Compactor History

Prior to March 31, 2002, the Company's primary business was the ownership, rental and distribution of waste compaction, baling and container equipment for disposing of waste ("Compactors"). Effective March 31, 2002, the Company divested 92% of its Compactor assets and incurred a substantial loss as a result. On May 31, 2002, the Company acquired ORMI and A&A and thereby entered the non-hazardous liquid waste business.

The Company commenced operations in January 1990 as a distributor of waste handling and compaction equipment manufactured by Marathon Equipment Company ("Marathon") of Vernon, Alabama and was appointed as a Marathon distributor on June 22, 1993. Through a series of transactions in 1998, the Company purchased solid waste compactors from Canadian Waste Services Inc ("CWS") for approximately \$12 million and entered into a 10-year subcontracting arrangement with CWS whereby the Company rented its compactor assets to CSW customers. In 2001 CWS informed the Company that it did not intend to renew its subcontracting agreements when they expired and that it intended to resume providing compactor rental services to its customers at that time. In March 2002, the Company sold to CSW the vast majority of its compactor fleet located in Western Canada, Ontario and Quebec for cash consideration of slightly in excess of \$8,000,000 resulting in a loss of \$5,156,861.

The Company retains 195 compactors located in Western Canada. The remaining compactors are all rented directly to Canada Safeway Limited ("Safeway") under a contract expiring on September 30, 2006. The Company has a contractual agreement to sell all of its remaining compactors to CWS at fair market value upon the expiration of the Safeway contract.

2.02 Vacuum Trucks & Non-hazardous Liquid Organic Waste – Canada

On May 31, 2002 the Company acquired 100% of the issued and outstanding shares of ORMI and A&A.

	ORMI	A&A	Total
Net assets acquired			
Current assets	1,073,966	845,456	1,919,422
Capital assets	377,218	699,847	1,077,065
Intangible assets	5,590,000	460,000	6,050,000
Goodwill	2,434,793	2,645,027	5,079,820
Current liabilities	(1,288,941)	(414,165)	(1,703,106)
Long-term debt	-	(449,770)	(449,770)
Future income taxes	-	(11,000)	(11,000)
	<u>8,187,036</u>	<u>3,775,395</u>	<u>11,962,431</u>
Consideration given			
Cash	1,622,000	1,559,500	3,181,500
Short-term promissory notes	200,000	290,000	490,000
Preferred shares series A	1,050,000	950,000	2,000,000
Preferred shares series B	900,000	-	900,000
Common shares	3,550,000	610,000	4,160,000
Paid to vendors	7,322,000	3,409,500	10,731,500
Acquisition costs	865,036	365,895	1,230,931
	<u>8,187,036</u>	<u>3,775,395</u>	<u>11,962,431</u>

Acquisition costs included a finder's fee of 725,000 common shares of the Company issued to Cambridge Capital Limited, a company controlled by a then director of the Company. Also included in the acquisition costs was a fee paid to Global Capital Partners Inc. ("Global") of \$625,000 and 2,475,000 warrants of the Company for the acquisition of ORMI and A&A and the sale of substantially all of the Company's compactor assets to CWS. The Global fee was proportionately allocated between the acquisitions and the sale of assets. The warrants expired unexercised on May 31, 2005.

The Company accounts for all business combinations using the purchase method, under which it allocates the excess of the purchase price of business acquisitions over the fair value of identifiable net assets acquired to intangibles and goodwill. Intangible assets relating to the Company's acquisition of A&A and ORMI were identified by management and recorded at estimated values based on a valuation performed by an independent third party valuation expert:

	<u>ORMI</u>	<u>A&A</u>	<u>TOTAL</u>
Software Licence Agreement	3,000,000	-	3,000,000
Patent Licence Agreements	1,500,000	-	1,500,000
Customer Relationships	1,090,000	460,000	1,550,000
Total Intangibles	5,590,000	460,000	6,050,000
Goodwill	2,434,793	2,645,027	5,079,820
Intangibles and Goodwill	8,024,793	3,105,027	11,129,820

The Company amortizes its intangible assets over their estimated life. The Company's Customer Relationships and the Software License (see 3.01 (a)) are amortized on a straight-line basis over 5 years and the Patent License (see 3.01 (c)) on a straight-line basis over 15 years.

The goodwill is subject to an annual impairment test. The Company must make assumptions regarding estimated future cash flows, market conditions and other factors to determine the fair value of the assets. If these estimates or related assumptions change in the future, the Company may be required to record impairment charges for these assets. In fiscal years 2005 and 2004, the Company did not record an impairment charge related to goodwill or intangibles assets. However, for the year ended June 30, 2003 impairment charges were recorded for A&A Customer Relationships and Goodwill of \$160,334 and \$1,261,971 respectively. Canadian generally accepted accounting principles only provide for downward adjustment in the event of impairment.

At June 30, 2005 intangibles are as below:

	2005			2004		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Software license agreement	\$ 3,000,000	\$ 1,850,000	\$ 1,150,000	\$ 3,000,000	\$ 1,250,000	\$ 1,750,000
Customer relationships	1,550,000	1,034,294	515,706	1,550,000	765,231	784,769
Patent license agreements	1,500,000	308,333	1,191,667	1,500,000	208,333	1,291,667
	<u>\$ 6,050,000</u>	<u>\$ 3,192,627</u>	<u>\$ 2,857,373</u>	<u>\$ 6,050,000</u>	<u>\$ 2,223,564</u>	<u>\$ 3,826,436</u>

The amortization of intangibles assets, a non-cash operating expense, was \$969,064 for each of 2005 and 2004.

2.03 Vacuum Trucks & Non-hazardous Liquid Organic Waste – USA & World

The Company is unique in the industry, having exclusive access to four proprietary technologies that provide it with low cost competitive advantages plus superior operational efficiencies and controls. These advantages plus its expert knowledge of vacuum truck services for the collection, treatment and disposal of organic and other non-hazardous liquid waste, positions NCS as a very attractive partner in organic waste and vacuum truck services projects in the United States as well as Canada. The Company is in the process of evaluating various potential business opportunities in the USA and potential ways of entering that market. In November 2003, the Company negotiated amendments to its international technology rights agreements to permanently secure its rights to:

- 1) Organic Resource Recovery System (“ORRS”¹) and Direct Land Application Process (“DLAP”²) patents for the USA and the World excluding Canada.
- 2) The Software for its own use and licensing to third parties anywhere outside of Canada.

(a) Patent Rights

The Company owns 70% of NCS ESL, its corporate vehicle for expansion outside of Canada. In March 2000, NCS ESL entered into an arm’s-length (see Item 5) intangible asset purchase and sale agreement (“APSA”) whereby it purchased the United States patents covering the ORRS and DLAP technologies from Organic Resource Technologies International Inc. (“OII”), a company partially owned by two of the Directors of NCS. In consideration for these assets, OII received 30% of the common shares of NCS ESL.

Under the terms of the agreement, NCS was to deliver certain minimum requirements to NCS ESL prior to December 31, 2003. Failure to meet these minimum requirements would have resulted in NCS forfeiting its 70% equity position in NCS ESL to OII and, thereby, its ability to pursue its business strategy outside of Canada. On November 11, 2003, the parties amended the APSA to remove all deadlines and conditions, thus securing NCS’ 70% equity stake in NCS ESL. This amendment was provided by OII at no cost to the Company.

(b) The Software

On February 14, 2002, NCS ESL signed an arm’s-length software licence agreement with Path Information Systems Inc. (“Path”), a company controlled by one of the Directors (see Item 5), whereby it obtained a perpetual nonexclusive license for the use of the Software worldwide excluding Canada (“Worldwide License”). For more information on the Software (see 3.01(a) below). The Worldwide License was granted to NCS ESL at a one-time cost of \$100 and restricts NCS ESL to use the software in the non-hazardous liquid waste industry (“Industry”).

On February 14, 2002, NCS ESL signed a software maintenance agreement with Path (“US Maintenance Agreement”) whereby Path provides ongoing maintenance, support, upgrades and customization of the Software.

¹ Storage and Disposal of Organic Waste, United States Patent #5,568,996

² Process for Disposal of Decomposable Organic Waste, United States Patent #5,645,623

The US Maintenance Agreement requires the Company to pay an annual fee of US\$5,000 to Path. Software maintenance, support and customization are provided by Path at market rates at the Company's direction. Path has not provided any maintenance, support, upgrades and customization of the Software to NCS ESL to date and accordingly has waived the annual fee to date.

In November 2003, Path and NCS ESL entered into a worldwide excluding Canada marketing agreement ("Marketing Agreement") for the Software which: (1) gives NCS ESL the right to market Software licenses to third parties for use in the non-hazardous waste industry (the "Industry") anywhere in the world excluding Canada and (2) makes the Software exclusive to NCS ESL for the Industry. Licenses marketed by NCS ESL under the Marketing Agreement are at no charge from Path and do not restrict NCS ESL in any way with respect to the fees it can charge to third party licensees. The Marketing Agreement gives NCS ESL flexibility to exploit the Software to its benefit. This Marketing Agreement was provided by Path at no cost to NCS. No value has been assigned to the Software from Path outside of Canada.

ITEM 3 DESCRIPTION OF THE BUSINESS

3.01 NCS' Technologies

National Challenge is Canada's largest provider of vacuum truck services for the collection, treatment and disposal of organic and other non-hazardous liquid waste. NCS has a total of 91 employees and services in excess of 8,000 commercial, industrial, institutional and residential customers in Ontario, Quebec, and British Columbia. The Company is unique in the industry having exclusive access to four proprietary technologies that provide it with a low cost, competitive advantage plus superior operational efficiencies and controls. These technologies are:

(a) Sophisticated Enterprise Management and Route Optimization System ("Software")

The Software was designed and created specifically for the Company to manage all aspects of providing organic and other non-hazardous liquid waste and related services. It consists of four modules:

- Comprehensive customer relationship management
- Map-based routing, scheduling and dispatch
- Global positioning of vehicles and map-based tracking
- Wireless hand-held work order and data collection

The wireless handheld module, the most recent addition to the Software, has been successfully tested and in use at the Company's Ottawa operation and is planned for full roll out in the Fall of 2005.

All modules are fully integrated and allow remote access via the Company's secure, virtual private network, over the internet. The efficiency and planning capabilities of the Software allows NCS to accurately plan, optimize and measure personnel productivity performance in real-time. The Company has an exclusive License for the use the Software in the organic and other non-hazardous liquid waste related services industry ("Industry") anywhere in the World.

The proprietary Software is owned by Path Information Systems Inc., formerly 1329206 Ontario Inc., a company controlled by one of the Directors.

On May 31, 2002, the Company signed an arms-length (see Item 5) software licence agreement with Path wherein it obtained an exclusive Canadian License for the use the Software in the Industry anywhere in Canada ("Canadian License") for a one-time cost of \$100. The Canadian License was exclusive to NCS for a period of three years, after which Path would have had the right to market the Software in geographical areas of Canada that were then not being serviced by the Company. On November 11, 2003, the Company and Path amended the Canadian License to make it perpetually exclusive to the Company for the Industry. This amendment was provided at no cost to NCS.

On May 31, 2002, the Company signed a software maintenance agreement with Path (“Maintenance Agreement”) whereby Path provides ongoing maintenance, support, upgrades and customization of the Software. The Maintenance Agreement requires the Company to pay an annual fee of \$3,000 to Path. Software maintenance, support and customization are provided by Path at market rates at the Company’s direction and sole discretion. Path has provided all maintenance, support, upgrades and customization of the Software to date at cost and has waived the annual fee to date.

As at May 31, 2002, the Company’s Canadian License was valued at \$3 million by an independent valuator as part of intangibles assets valuation performed related to the acquisition of ORMI and A&A. (see 2.02 above)

(b) Patented Organic Resource Recovery System (“ORRS”)

The ORRS is a unique, patent protected approach to on-site management of organic waste, consisting of a mill, a holding tank and vacuum truck collection. Produce and other food related wastes are ground into slurry by a mill, reducing waste volume by an average of 5:1. The waste slurry is discharged into the holding tank where it is stored until collected by vacuum operated transport.

Organic waste recycling and diversion from landfill continues to be a major issue for most municipalities. ORRS was developed to be a competitive alternative to containerized on-site storage and collection of food waste. ORRS provides a number of benefits over container-based alternatives including reduced transportation, reduced physical space requirements, reduced odour generation and vermin attraction, reduced waste handling and improved waste quality suitable for many recycling options.

The Company has an agreement with ORTI, a company partially owned by two Directors of the Company (see Item 5). The agreement gives NCS exclusive rights to sell ORRS in Canada until May 1, 2008. A royalty of \$200/machine is payable to ORTI for each system sold. ORTI has waived all royalties to date.

(c) Patented Direct Land Application Process (“DLAP”)

The DLAP is a patent protected solution for recycling high-fat content organic waste that uses the natural digestion ability of microbes found in soil to convert organic waste into stable soil organic matter. NCS has an exclusive license to DLAP in Canada until the patent expires in 2017.

DLAP is performed on agricultural farms in conjunction with normal agricultural practices. It is a cost-effective method of recycling organic waste. In addition, access to DLAP eliminates a non-hazardous liquid waste vacuum truck operators’ reliance on third parties for waste recycling/disposal.

On February 20, 2002, the Company signed an arms-length exclusive licensing agreement (the “License”) with ORTI, a company partially owned by two Directors of the Company (see Item 5), for DLAP in Canada and obtained a 15-year, fixed price option to purchase all of the outstanding shares of ORTI (the “Option”). The Option was granted at no cost to the Company. The License is for a 15-year period and is exclusive to the Company for use of the DLAP throughout Canada. The license requires the payment of \$25,000 per year plus royalties on waste processed using DLAP outside of the Province of Ontario. ORMI has perpetual rights to the DLAP in the Province of Ontario at no cost or royalty; the Company has inherited these rights through its purchase of ORMI. To date no royalties have been paid, and ORTI has waived the requirement to pay the annual license fee.

(d) Liquid Waste Decant Capabilities (“Decant”)

The Decant process removes excess water and discharges it to the municipal sewage system. ORMI has many years of experience developing and operating grease interceptor waste Decant facilities. Grease interceptor waste contains various concentrations of fats, oils and greases (“FOG”), food solids and significant amounts of water. Removing the water prior to disposal reduces the amount of waste for disposal and therefore the cost of disposal.

Strategically located Decant facilities act as hubs for grease interceptor service operations. They add further economic efficiency by allowing for consolidation of bulk loads for transportation to final disposal/recycling. The Company intends to locate Decant facilities wherever it establishes major grease interceptor operations.

3.02 Wastewater Industry

NCS' core focus is on regularly scheduled, repetitive, non-hazardous liquid waste removal and disposal services, primarily to the foodservice and food production industries. These services are essential to the operational maintenance of its customers, and vital to the maintenance, efficiency and longevity of wastewater collection and treatment infrastructures. As a result, NCS' core services are relatively resilient to economic downturns and stand to benefit significantly from the continued proliferation of regulations stemming from increasing environmental pressures as well as the protection of aging and/or undersized wastewater treatment infrastructures.

Wastewater treatment facilities are generally owned by local municipalities and are designed to process and treat wastewaters prior to discharge into the environment. Wastewater treatment operators are under environmental pressures to continuously improve the quality of treated wastewater being discharged into the environment. Sewer systems convey wastewaters from the generators to the wastewater treatment facility. Treatment facilities are designed to specific waste receiving criteria. The cost of operating the treatment process is directly related to the quality or "strength" of wastewater to be processed. High-strength wastewater contains high levels of impurities, such as FOG, and is more difficult and, therefore, more expensive to process than regular, lower-strength waste. High-strength wastewaters, that contain excessive quantities of FOG, cause blockages and sewer overflows that are costly and can be detrimental to public health. Longevity of sewer pipes can also be adversely affected by wastewater quality. For example, FOG, which is comprised of fatty acids, has a low PH, and, therefore, its acidity causes accelerated corrosion and deterioration of concrete sewer pipes. In addition, overloaded wastewater treatment facilities and/or systems limit the municipality's capacity to expand its economic base.

Municipalities throughout Canada and the United States are actively pursuing solutions that reduce the negative affects associated with the discharge of excessive amounts of high-strength wastewaters. The Company believes that as regulatory authorities address these issues they will begin mandating some of services that the Company provides. Mandated servicing would greatly expand the Company's markets.

The Company provides a number of services that focus on the non-hazardous wastewater market:

(a) Grease Interceptor Servicing

Grease interception devices are mandatory in all commercial and industrial facilities wherever FOG could be discharged into the sewer system, including restaurants, cafeterias, grocery stores, institutional kitchens and food processors. Most municipalities have strict sewer discharge limit bylaws that govern the amount of FOG and solids that can be discharged. Interceptors are designed to prevent excessive amounts of FOG and solids from entering the sewer system. Interceptors must be periodically emptied in order to meet sewer discharge bylaws, prevent serious drain problems and protect the sewer and wastewater treatment systems. The Company's trained service crews use vacuum trucks to pump out grease interceptors and transport the waste for processing and final recycling/disposal.

(b) Industrial Food Processing Wastewater Residuals

Industrial food and beverage processors must meet sewer-use bylaws that govern the quality of the wastewater they discharge to the sewer system. To achieve this, they employ a myriad of technologies to remove excess FOG and organic solids from their wastewater. The removed residuals must ultimately be disposed. The Company provides collection and transportation services of these residuals for processing and final recycling/disposal.

(c) Sewer, Drain, Tank & Site Cleaning

The Company provides vacuum truck services relating to sewer, drain, tank and site cleaning for industrial, commercial, institutional and municipal facilities.

(d) Other Vacuum Truck Related Services

The Company provides other services related to non-hazardous vacuum truck services including: septic and holding tank pumping; catch basin cleaning; sump and lift-station cleaning and interceptor replacements.

(e) Compliance Management Services

In addition to the above services, the Company intends to provide compliance management services to regulators. The major factor that prevents regulators from implementing mandatory service requirements is the high cost of compliance management. NCS' proprietary Software contains the foundation for a comprehensive electronic compliance management system that would utilize: (a) radio frequency identification, (b) mobile hand-held computing for service data collection, (c) automatic wireless database updating, and (d) a visual map-based user interface accessible via the internet. The Company intends to develop and market its compliance management software to municipalities.

3.03 Organic Waste Diversion

In addition to its core business in the wastewater services industry, the Company also believes it is uniquely positioned to participate in the collection, transportation and recycling/disposal of solid organic waste.

The collection, transportation and disposal of organic waste is a large, growing and under-serviced market. Sixty-seven percent³ of North America's annually discarded waste is comprised of organic materials. At industrial, commercial and institutional ("IC&I") waste generators, such as supermarkets, institutions, food processors and restaurants, organic materials can represent 55% to 90%⁴ of the total discarded waste stream. However, as of March 2001, only 2.6% of the 22 million tons of food scraps generated were being recovered⁵ largely because collection is typically highly inefficient. Inefficient handling results in smelly waste that attracts vermin and flies. Furthermore, organic waste is heavy and bulky resulting in the consumption of excess floor space and smaller, frequent collections due to the necessity of having many small tote bins on site to hold this waste.

The US government is targeting to divert 35%⁶ of all waste from landfill. This is estimated to result in an increase in food waste recycling from the 2.6%⁷ to 14%, or 5.4 times the recycled mass. ORMI and A&A, with (a) ORRS; (b) its Software; (c) DLAP; and (d) Decant capabilities bring substantial and proprietary efficiencies to this market.

3.04 Organic Waste Recycling/Disposal

The Company continues to face difficulties re-permitting and expanding its DLAP facilities. Despite this, the Company still believes that DLAP is currently the cheapest and best alternative for disposal of organic waste in jurisdictions that have substantive agricultural activities such as Ontario and is therefore continuing its efforts to develop new sites and re-permit its existing ones. Managing DLAP has been and continues to be challenging, primarily because of concerns related to managing unprocessed waste, such as odour.

The Company's strategy is to control a significant portion of its recycling/disposal options, either through equity participation or by obtaining preferential supply agreements in the markets it services. In addition to its DLAP, the Company has always used many third-party processing/recycling alternatives for the disposal of the waste it collects. Beginning with technology reviews in the mid 1980s that identified DLAP as the lowest-cost technology, Company management has kept diligently educated on all organic waste recycling, diversion and disposal technologies in both North America and Europe.

Technologies for processing organic waste generally fall into two categories; aerobic, which includes composting, and anaerobic, which includes digestion for methane production (known as "bio-gas"). The methane produced in anaerobic digestion can be used to create electricity and/or heat. Although there are examples of both technologies operating in Ontario, there is still an "extreme shortage" of organic waste disposal capacity.⁸ In addition, there is

³ US Environmental Protection Agency, 1998 Waste Generation Report

⁴ Cynthia Greene, US Environmental Protection Agency, unpublished report, March 14, 2001

⁵ Cynthia Greene, US Environmental Protection Agency, unpublished report, March 14, 2001

⁶ US Environmental Protection Agency, 1998 Waste Generation Report

⁷ US Environmental Protection Agency, 1998 Waste Generation Report

⁸ January 2005, Private Sector IC&I Waste Management System In Ontario report prepared for the Ontario Waste Management Association

a significant shortage of solid waste disposal options such as landfills. This is resulting in many municipalities implementing or planning to implement organic waste diversion programs, which in turn will create an even greater demand for recycling/disposal alternatives. The Company believes this is consistent throughout North America. Governments are taking steps to promote the development of additional organic recycling capacity such as the recent announcement in Ontario that it would soon begin allowing small generators of energy (such as bio-gas plants) to sell the electricity they produce into the power grid.

Anaerobic digestion of organic waste for bio-gas production is a widely proven technology that has been in constant commercial use in Europe for many years. Bio-gas digesters are situated on farms or centrally in urban centers where they typically process manure or sewage sludge in combination with off-farm organic waste. Bio-gas digesters provide a beneficial service to the agricultural community by alleviating many of the negative environmental impacts of the land application of unprocessed manure. Bio-gas digesters require a clean, continuous and consistent supply of the liquid organic waste they process. Organic waste that contains a high percentage of FOG material, such as that collected by NCS, produces substantially higher methane yields than other organic wastes such as food waste and manure.

The growth of new organic waste recycling facilities in Ontario would supply the Company with access to additional, competitively priced disposal capacity giving the Company an opportunity to substantially increase its business. In addition the Company has the potential of supplying logistics management and transportation services to bio-gas digester operations moving both the manure feedstock from, and digested waste to, farms. Also the Company's ORRS technology is ideally suited to supply organic waste to bio-gas digesters. The ORRS liquefies solid organics which facilitates the most efficient transportation of waste to the digester facility. Liquefied organic waste is also much easier to process at the digester than solid organic waste.

The same progressive systems that have enabled the Company to provide consistent excellent service and grow into the largest collector and disposer of high-fat-content, liquid organic waste in Ontario, would also provide significant operational benefits to new organic waste recycling facilities, particularly bio-gas digesters. As a result, NCS is routinely contacted by potential developers of organic waste recycling facilities wishing to secure the Company's substantial organic waste stream and gain access to its operating systems. The Company believes that its combination of logistics expertise, extensive farm and residuals management experience (DLAP), combined with its overall knowledge of organic recycling technologies, positions it well to evaluate and participate in bio-gas digester opportunities as they arise throughout North America.

3.05 Non-Hazardous Vacuum Truck Services Industry

The organic and other non-hazardous liquid vacuum truck services industry is highly fragmented. It is estimated that approximately 52,000 companies operate in this industry in North America.⁹ Management estimates that few of these companies have annual revenues in excess of \$1.5 million. Most are family owned, logistically unsophisticated, and inefficiently operated and managed. However, they tend to operate well-maintained and well-equipped vacuum trucks and associated equipment. As well, they have limited exit strategy options as there are no national vacuum truck operators and therefore, limited markets to sell their businesses. The Company believes that its expertise, management software systems and technologies position it well to build a major national vacuum truck services provider in both Canada and the United States.

The Company plans to launch a consolidation effort that includes acquiring, licensing technology and/or providing operational management services to vacuum truck operators in both Canada and the United States.

The Company has been working since June 2002 on development of proprietary infrastructure and management systems that it believes are required to successfully manage vacuum truck services companies throughout North America from its centralized dispatch and customer service center located in Woodbridge, Ontario. During the year the Company substantially completed this development effort and has now begun implementation of the final elements of its systems to its service fleet. As a result, the Company is now able to begin working on its consolidation strategy.

⁹ Tom Rulseh, Cole Publishing Inc., Three Lakes WI

3.06 Organic Resource Management Inc.

ORMI, NCS' Ontario based operating subsidiary, has been servicing the entire Ontario market and parts of Quebec for over 20 years.

ORMI's provides primarily repeat, scheduled liquid organic waste removal services to the restaurant, foodservices and food retail industries.

As part of the regulatory changes, the Ministry of Environment required that ORMI commence a complete re-permitting of all of its DLAP facilities. This is an extensive undertaking that the Company has been working on for over two years. A number of the Company's smaller disposal sites have been closed during this re-application process; however, the Company's main DLAP facility remained open until late November 2004 when the MOE required ORMI to stop hauling into this main disposal facility until the final requirements of the re-permitting were completed. In the interim, the majority of the waste is being trucked to alternative third-party disposal sites located outside of the Province. This has resulted in a dramatic increase in the Company's transportation expense. In addition, the actual cost of disposal is significantly more expensive than using ORMI's own facilities.

ORMI has over 5,000 customer locations. In December 2004 the Company began increasing rates to the Ontario customers in order to offset the erosion to the gross margin that had occurred from the increase in disposal costs. By March 31st over 95% of all Ontario based customers had received rate increases with the balance in place by June 30th.

ORMI's annual revenue for the year end June 30, 2005 was \$8,898,000 up 6% from the previous year's \$8,414,000.

3.07 A&A Anderson Tank Service (Vancouver) Ltd.

A&A, NCS' British Columbia based operating subsidiary, has been providing vacuum truck services in Vancouver and the Lower Mainland for over 30 years.

A&A's vacuum truck services vary from ORMI's in that a much smaller portion of its business is repeat scheduled service and with the larger portion being more responsive in nature. Over the last several years, A&A implemented a number of software enhancements designed specifically to manage the business requirements associated with a more responsive business model.

At present the only disposal option available in the Lower Mainland for non-hazardous liquid wastes, including FOG and food processing residuals, is delivery to municipal sewage treatment operated by the Greater Vancouver Regional District (the "GVRD"). There are no Decant facilities in the Lower Mainland. The GVRD has continued increasing prices at its liquid waste receiving facilities. The Company believes there is a significant opportunity to establish a Decant facility in the GVRD and is actively pursuing a site.

A&A has over 3,000 customer locations. Annual revenue for the year end June 30, 2005 was \$4,992,000 up 6% from the previous year's \$4,689,000 reflecting an increase in non-repetitive project work for the year.

3.08 Risk Factors

(a) Technology and Competition

The Company's success depends on remaining competitive in the development of systems, technologies and services in its area of expertise. Environmental technology is an evolving field in which new developments are expected to continue at a rapid pace. Competition in the non-hazardous liquid waste services industry is intense and expected to increase, both from within the industry and from those diversifying into the field. Some of NCS' competitors and potential competitors may have greater development, financial or personnel resources.

NCS is subject to the risks generally associated with new systems development and deployment, including lack of acceptance, delays in development and failure of systems to function properly. The market growth potential is subject to certain risks, including costs to develop and deploy such systems, the cost and feasibility of development, introduction of competing technologies and regulatory forces.

The Company believes there are two major constraints to the advancement of the ORRS program. First the capital cost of installed ORRS equipment as compared to containerized collection alternatives, and second the lack of readily available, low-cost organic recycling alternatives in Canada and the United States.

Over the past few years ORMI has been impacted by a number of government regulatory changes that directly affect the way liquid organic waste is handled and processed in Ontario. As a result of these changes, most of the third party disposal facilities in Ontario that receive and process liquid organic waste have significantly reduced their capacity or have closed down altogether. This has had a major impact on the Industry's cost of recycling/disposal.

The Company has been successful in renewing the permits for one of its smaller Ontario DLAP sites. The Company does not control the timeline for completion of the final requirements on the main facility, and continues to work towards obtaining permits to re-open the facility. Failure to obtain permitting would result in the continued need for alternative, more expensive disposal. The Company cannot be assured of the availability of such alternative options for all of its collected waste.

The Company is actively working on a number of new disposal sites that, if successfully permitted, would result in more than doubling the Company's prior Ontario capacity. This additional capacity would allow ORMI to pursue a number of contracts that it is unable to acquire today because of a lack of competitively priced disposal options. In most cases, the waste generated by these potential customers is being transported outside the Province at much higher costs. ORMI seeks to establish an in-province solution on a long-term contractual basis with these large generators. There are currently no new alternative organic recycling options being made available in Ontario.

(b) Risk Associated with Acquisition

As part of its growth plan, NCS is seeking acquisitions that are a good fit for the strategic direction of the Company. The Company does not have control over the market conditions prevailing or likely to prevail in the future, which may impact the ability to finance and execute this strategy. These variables include market valuations of potential targets and stock price volatility of NCS. There can be no assurances that the Company will be able to identify suitable acquisition candidates available for sale at reasonable valuations, consummate any acquisition or successfully integrate any acquired business into its operations. However, the Company continues to believe that with its technologies, systems and experienced management team, it is uniquely positioned to capitalize on a substantial opportunity.

(c) Compactors

Prior to March 31, 2002, the Company's primary business was the ownership, rental and distribution of waste compactor equipment for disposing of waste. In March 2002, the Company sold to Canadian Waste Services Inc ("CSW") the vast majority of its compactor fleet located in Western Canada, Ontario and Quebec.

As part of the sale agreement the Company retained 195 compactors located in Western Canada. These remaining compactors are all rented directly to Canada Safeway Limited ("Safeway") under a contract, expiring on September 30, 2006. The Company has a contractual agreement to sell all of its remaining compactors to CWS at fair market value upon the expiration of the Safeway contract.

The annual rental revenue from the Safeway compactors was \$518,000 for 2005 (\$469,000 for 2004). During 2005 the Company took a write-down of \$322,000 reflecting a quoted value for the fleet of compactors.

(d) Dependence on Key Personnel

NCS' success will depend to a significant extent upon its management group. The loss of the services of key executive personnel could have a material adverse effect on NCS.

ITEM 4 DIVIDENDS

The Class A preferred shares provide for the payment of the 12% dividend at the Company's discretion to be either (i) in cash or (ii) in additional Class A preferred shares. The Class A preferred shares paid no dividends in

2004 or 2005. The cumulative dividends in arrears on the Class A preferred shares as at June 30, 2005 is \$492,490 (\$209,192 at June 30, 2004). No dividends may be paid on any other class of shares until these shares have been redeemed.

The Company has never paid cash dividends on its common share and does not anticipate paying any cash dividends in the foreseeable future. Subject to the terms of the revolving credit facility with Textron Financial Canada Ltd., there are no other restrictions, which prevent the Company from paying dividends.

ITEM 5 RELATED PARTY TRANSACTIONS

During the year, the Company incurred charges from directors or companies and/or individuals related to them. These amounts have been recorded at their exchange amount, being the amount agreed to by all parties, for amounts approximately as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Consulting fees	\$ -	\$ 83,000	\$41,000
Software development cost	223,000	204,000	225,000
Interest expense	9,000	13,000	24,000
Dividends on preferred shares	283,298	189,192	240,000
Rent expense	-	48,000	48,000

(a) Consulting agreement

Pursuant to a Consulting Agreement with a company related to a director, the Company was committed to an annual consulting fee of \$90,000 to May 31, 2007. The consulting agreement was terminated in May 2004.

(b) Software

The software development costs are for work performed by Path. The terms of the Company's Software licences (see 3.01(a) and 2.03(b)) with Path were established in February 2000, prior to the Director being appointed to the NCS Board. Subsequent amendments to the licences were negotiated with an independent committee of the Board.

(c) Interest on Long-term debt

On October 20, 2003, four notes payable to related parties were replaced with a single note payable for \$251,188 (\$188,391 at June 30, 2005). The new note is repayable in 36 equal monthly installments of \$6,977, the last of which is due September 1, 2007. Long-term debt also includes a loan payable to a company owned by certain directors for \$87,977 (2004 - \$82,660).

(d) Patent license agreement

Pursuant to patent license agreements with companies related to directors of the Company as described in Item 3(c), the Company has use of patent products at a minimum annual patent license fee of \$25,000. The charges for 2005 and 2004 were waived by the licensor.

ITEM 6 DESCRIPTION OF CAPITAL STRUCTURE

6.01 Preferred Shares

Below is a summary of the issued preferred shares:

	<u>2005</u>		<u>2004</u>	
	<u>Issued</u>	<u>Amount</u>	<u>Issued</u>	<u>Amount</u>
Class A	2,048,000	\$ 2,048,000	2,048,000	\$ 2,048,000
Class B	900,000	900,000	900,000	900,000
	<u>2,948,000</u>	<u>2,948,000</u>	<u>2,948,000</u>	<u>2,948,000</u>
Class A accrued dividends	-	492,490	-	209,192
	<u>2,948,000</u>	<u>\$ 3,440,490</u>	<u>2,948,000</u>	<u>\$ 3,157,192</u>

(a) Authorized

An unlimited number of Class A and Class B preferred shares.

An unlimited number of preferred shares issuable in series

(b) Class A preferred shares:

Non-voting, non-participating, entitled to a 12% cumulative dividend per annum to be paid quarterly, redeemable at any time and convertible on or after June 1, 2007 into common shares at the option of either the Company or the preferred shareholder. The conversion into common shares is to be calculated by dividing the redemption value of the preferred shares at \$1.00 per share by an amount per common share, which would be equal to the lesser of:

- (i) \$0.40; or
- (ii) the average weighted market price over the 15-day period immediately prior to the date upon which conversion notice is given.

The provision for a 12% dividend on the new Class A preferred shares is cumulative and can be paid in cash or in additional Class A preferred shares at the Company's discretion. The cumulative dividends in arrears on the Class A preferred shares as at June 30, 2005 is \$492,490 (2004 - \$209,192). No dividends may be paid on any other class of shares until these shares have been redeemed.

(c) Class B preferred shares:

Non-voting, non-participating, with no entitlement to dividends, redeemable at any time and convertible on or after June 1, 2007 into common shares at the option of either the Company or the preferred shareholder. The conversion into common shares is to be calculated by dividing the redemption value of the preferred shares at \$1.00 per share by an amount per common share, which would be equal to the lesser of:

- (i) \$0.40; or
- (ii) the average weighted market price over the 15-day period immediately prior to the date upon which conversion notice is given.

6.02 Common Shares

Authorized 100,000,000; issued as follows:

	<u>Number of Shares</u>		<u>Book Value</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Opening balance	34,147,323	34,134,198	\$ 11,003,150	\$ 23,999,848
Private Placement	5,040,000	-	613,000	-
Employee Share Compensation	310,000	-	46,500	-
Directors' compensation	145,000	13,125	18,523	3,302
Reduction of capital	-	-	-	(13,000,000)
Closing balance	<u>39,642,323</u>	<u>34,147,323</u>	<u>\$ 11,681,173</u>	<u>\$ 11,003,150</u>

During 2004 the Company received net proceeds of \$613,000 related to a private placement of 5,040,000 shares. In conjunction with the private placement, the investors received 2,520,000 warrants at \$0.20 expiring on July 11, 2005. The common shares and warrants that were related to the above private placement were issued from treasury during 2005. The warrants expired on July 11, 2005 without exercise.

6.03 Reduction of Capital Stock and Deficit

As approved by the shareholders at the Company's annual general meeting on November 17, 2003, the Company reduced capital stock and deficit in the unconsolidated financial statements of the parent company by \$13,000,000 in 2004. The reduction in capital stock and deficit absorbs prior years' losses, which related primarily to its former activities in the compactor sector.

ITEM 7 MARKET FOR SECURITIES

The Company's shares were initially listed on the Vancouver Stock Exchange and on January 7, 1998 became listed on The Toronto Stock Exchange where they now trade exclusively. The trading symbol for the Company's common shares is "NLC". The monthly volumes and price ranges for the year ended June 30, 2005 are listed below:

<u>Month</u>	<u>Volume</u>	<u>High</u>	<u>Low</u>
Jul-04	328,300	0.15	0.11
Aug-04	736,169	0.20	0.12
Sep-04	284,675	0.20	0.15
Oct-04	185,000	0.17	0.12
Nov-04	353,042	0.12	0.09
Dec-04	436,235	0.12	0.08
Jan-05	260,774	0.11	0.08
Feb-05	197,800	0.09	0.08
Mar-05	319,474	0.09	0.07
Apr-05	485,980	0.10	0.07
May-05	635,370	0.10	0.06
Jun-05	176,850	0.09	0.06
Total	<u>4,399,669</u>	<u>0.20</u>	<u>0.06</u>

ITEM 8 DIRECTORS AND OFFICERS

The following table sets forth the name, municipality of residence, principal occupation within the five preceding years and other stated information with respect to each current Director and Officer of the Company as at the date of this Annual Information Form. The term of office of each of the present Directors expires immediately prior to the election of Directors at the Company's Annual General Meeting scheduled for October 24, 2005. The last Annual General Meeting was held on November 18, 2004.

Name and Municipality Of Residence	Principal Occupation	Office with Corporation	Director Since/ Expire	Issued Common Share	
				No.	%
Dr. Robert A. Bandeen, Toronto, ON	President and Director of Cluny Corporation; former President of Crownex Inc.; former Chairman, President and Chief Executive Officer of Crown Life Insurance Company and President and Chief Executive Officer of Canadian National Railways	Chairman and Director	06/04/98 10/24/05	248,625	0.6
Charles Buehler (a) Tottenham, ON	Founder of Organic Resource Management Inc.	C.E.O and Director	04/28/00 10/24/05	9,213,453	23.2
Douglas M. Carruthers (a) Waterloo, ON	President and Chief Executive Officer of the Company from April 28, 2000 to present; President of Organic Resource Technologies Inc.; Consultant to solid waste industry since 1980	President and Director	04/28/00 10/24/05	265,200	0.7
Donald R. Carse, Jr. London, England	May 1, 2000 to March 25, 2002, Chief Financial Officer of National Challenge Systems Inc.; January 1999 to May 2000, Vice-President, Corporate Development of the Company; worked for 25 years with investment, commercial and development banks in the U.S. and overseas	Director	04/25/02 10/24/05	313,562	0.8
Frank Facto Toronto, ON	Over 20 years experience in the Human Resources and Procurement professions; currently, Senior Human Resources Consultant for The City of Toronto. Former President and director of the Toronto Municipal Credit Union	Director	05/31/02 10/24/05	278,625	0.7
Martin Fallick, Toronto, ON	Director: Canadian Sales Agency Limited (since Feb. 1986), Monterey Transportation Limited (since Aug. 1986), Allied International Marketing, Inc. (since Dec. 1997); former President, Fairway Canadian Express, Vice President Sales, Direct Transport (1983-1986), Canadian General Sales Manager, Canadian Pacific Express; over 45 years of experience in all modes of transportation and storage throughout North America, Asia and Europe	Director	04//25/02 10/24/05	462,525	1.2
Matthew Gaasenbeek, Toronto, ON	Chairman of Northern Crown Capital (Since Nov. 1983); past Chairman, Ontario Development Corporation; former President of Camreco Inc. and former Senior Vice President and Director of Midland Doherty Limited	Director	10/21/04 10/24/05	None	0.0
Ian Kelland Mississauga ON	From 1996 to 2003, Mr. Kelland was the Director of Retail Operations at CN Intermodal where he was responsible for an \$80 million annual expense budget and the consolidation of 9 regional dispatch centers into one central office that included a staff of 85, dispatching and managing a fleet of over 400 trucks. Prior to CN, he was Vice President Operations for Frederick Transport; and, Vice President Finance of Federal Industries Truckload Operations	VP Operations & CFO	N/A	311,000	0.8

- (a) In addition to the shares owned by each of Charles Buehler and Douglas Carruthers, 45,000 shares are registered in Organic Resource Technologies Inc. (owned each as to 1/3) and 514,958 shares are registered in Organic Resource Technologies International Inc. (owned each as to 1/3)

The Board currently has an Audit Committee and a Compensation Committee both composed of entirely independent Directors. The current members of the Audit Committee are: Matthew Gaasenbeek (Chairman), Donald R. Carse, Jr., and Frank Facto. The current members of the Compensation Committee are: Martin Fallick (Chairman), Frank Facto and Robert A. Bandeen.

Charles H. Buehler, who beneficially owns, directly or indirectly, or exercises control or direction over 9,213,453 common shares, representing approximately 23% of the issued and outstanding common shares of the Company, is the only person or corporation who beneficially owns, directly or indirectly, or exercises control or direction over common shares carrying more than 10% of the voting rights attached to all outstanding common shares of the Company.

ITEM 9 TRANSFER AGENT AND REGISTRAR

Pacific Corporate Trust Company
625 Howe Street, 10th Floor,
Vancouver, British Columbia V6C 3B8

ITEM 10 ADDITIONAL INFORMATION

Additional information, including Directors' and officers' remuneration and indebtedness and the principal holders of National Challenge's securities, options to purchase securities and interests of insiders in material transactions, as applicable, are contained in the management information circular of National Challenge dated September 19, 2005 which was prepared and mailed to shareholders prior to the annual general meeting of shareholders scheduled for October 24, 2005. Additional financial information is provided in National Challenge's comparative Financial Statements and MD&A for the year ended June 30, 2005.

The comparative financial statements and additional information may be obtained through the Company's website at www.nationalchallenge.com, or on SEDAR at www.sedar.com or upon request in writing to the Chief Financial Officer, National Challenge Systems Inc., 3700 Steeles Avenue West, Suite 601, Woodbridge, Ontario, L4L 8K8.