

We are pleased to provide you with an update on the progress PhotoChannel made in its second quarter of fiscal 2005 ended March 31, 2005. PhotoChannel achieved another record quarter of revenues due to an increase in Network Revenues due to the continued growth in both network transactional revenue and network memberships fees.

Business Highlights

For Q2 – FY05 PhotoChannel reports:

- Record revenues for the quarter of \$554,742 and for the six months ended March 31, 2005 of \$995,356, up 153% over the corresponding period of 2004. This record revenue continues to be driven by increases in network transactional and membership fees, which increased by 188% and 546%, respectively, from second quarter of 2004.
- Peter Fitzgerald has assumed the role of President and CEO, in addition to his previous role of Chairman of the Board of Directors.
- Doug Rowan joined the Board of Directors of PhotoChannel at its annual general meeting.
- Wal-Mart has now deployed over 160 of its 255 locations across Canada, offering direct-to-store printing. The Company's data indicates that when in-store labs are connected directly (as opposed to the order being sent to a central fulfillment site and delivered back to the store), orders increase by as much as 400% over a six month period.
- The Company launched live sites for Eckerd Pharmacy (www.eckerd.com), Brooks Pharmacy (www.brooks-rx.com) Drugs and initiated a test for Longs Drugs (www.longs.com) with 10 locations now with direct-to-store printing.
- The Company launched a prepaid photo and printing solution now available in all 7-Eleven Canada locations.
- TELUS Mobility added a video solution for its digital camera phones.

RESULTS OF OPERATIONS

	Six month ended March 31, 2005	Six month ended March 31, 2004
Revenue	\$ 995,356	\$ 394,200
Loss from operations	(1,229,083)	(1,437,491)
Net loss	(1,220,486)	(1,359,883)
Basic and diluted net loss per share	\$ (0.01)	\$ (0.01)

Network revenue increased 153% to \$995,356 for the period ending March 31, 2005. The increase was attributable to three factors: organic growth in usage of the network from customers of the Company's photofinishing retailers; the Company's retailers commencing to print in-store; and the addition of additional customers. The two primary increases occurred in transaction commission and membership fees, which increased 188% and 546%, respectively, for the period ending March 31, 2005.

The Company's costs of operations for the period were \$2,224,439, up 21% when compared to the same period of 2004. This increase was primarily attributable to an increase in research and development, as the Company builds out its new Network platform and the cost of Network delivery as the number of transactions processed increases.

General and administration expenses for six months ended March 31, 2005 decreased by \$69,131 to \$655,764, a decrease of 10% from the comparable period last year. This decrease of was due to a decrease in legal and accounting, office and miscellaneous and interest, but was partially offset by an increase in salaries and consulting and rent.

Sales and marketing expenses for the six months ended March 31, 2005 increased by \$60,081 to \$315,521, an increase of 24% from the comparable period of 2004. This increase was due to our expansion into the US market and the related increase in staffing, printing, advertising and promotion.

Network delivery expenses for the six months ended March 31, 2005 increased by \$160,758 to \$367,892, an increase of 78% from the comparable period of 2004. This increase was primarily due to an increase in lab system installations, network usage and related bandwidth requirements and customer service.

Research and development expenses for the six months ended March 31, 2005 increased by \$192,166 to \$773,421, an increase of 33% from the comparable period of 2004. This increase was primarily due to an increase of staffing and consultants to develop the next generation, multi-media Digital Content distribution platform. Upon completion of our next generation platform, the Company believes that these current costs can be reduced by as much as 20% going forward.

Amortization expense for the six months ended March 31, 2005 increased by \$48,874 to \$111,841, an increase of 78% from the comparable period of 2004. This increase was due to acquisition of equipment during late fiscal 2004 and the first two quarters of fiscal 2005 related to an increase in infrastructure and staffing.

The Company recorded a six month net loss attributable to common shareholders of \$1,220,486 or \$0.01 per share compared to \$1,359,883 or \$0.01 per share in the same period last year. This reduction of 10% was due to a significant increase in revenues.

Caveat

The statements that are not historical facts contained in this release are forward-looking statements that involve risks and uncertainties. PhotoChannel's actual results could differ materially for those expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, technological shifts, employee retention, contract delivery, competition, general economic conditions, foreign exchange and other risks detailed in the Company's annual report and other filings.

Notice of no auditor review of interim consolidated financial statements

Under National Instrument 51-102, Part 4, subsection 4.3 (3)/(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The interim consolidated financial statements of the Company, as at and for the period ended March 31, 2005, have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

WARNING: The TSX Venture Exchange has neither approved nor disapproved the information contained in this release. The Company relies upon litigation protection for "forward-looking" statements.

MANAGEMENT DISCUSSION & ANALYSIS

Second Quarter 2005

This discussion and analysis is a review of the operating results, financial condition, and business risks of PhotoChannel Networks Inc. ("PhotoChannel" or the "Company"). This discussion should be read in conjunction with the Management's Discussion and Analysis presented in PhotoChannel's 2004 Annual Report and the consolidated financial statements and accompanying notes for the six months ended March 31, 2005 and 2004. The financial information reported herein has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and is presented in Canadian dollars, unless otherwise noted.

This discussion and analysis may contain forward-looking statements involving risks and uncertainties including, but not limited to, changes in the market and changes in the economy. Such statements reflect the Company's views at May 16, 2005 with respect to future events and are subject to certain risks, uncertainties and assumptions.

RESULTS OF OPERATIONS

	Six month ended March 31, 2005	Six month ended March 31, 2004
Revenue	\$ 995,356	\$ 394,200
Loss from operations	(1,229,083)	(1,437,491)
Net loss	(1,220,486)	(1,359,883)
Basic and diluted net loss per share	\$ (0.01)	\$ (0.01)

Network revenue increased 153% to \$995,356 for the period ending March 31, 2005. The increase was attributable to three factors: organic growth in usage of the network from customers of the Company's photofinishing retailers; the Company's retailers commencing to print in-store; and the addition of additional customers. The two primary increases occurred in transaction commission and membership fees, which increased 188% and 546%, respectively, for the period ending March 31, 2005.

The Company's costs of operations for the period were \$2,224,439, up 21% when compared to the same period of 2004. This increase was primarily attributable to an increase in research and development, as the Company builds out its new Network platform and the cost of Network delivery as the number of transactions processed increases.

General and administration expenses for six months ended March 31, 2005 decreased by \$69,131 to \$655,764, a decrease of 10% from the comparable period last year. This decrease was due to a decrease in legal and accounting, office and miscellaneous and interest, but was partially offset by an increase in salaries and consulting and rent.

Sales and marketing expenses for the six months ended March 31, 2005 increased by \$60,081 to \$315,521, an increase of 24% from the comparable period of 2004. This increase was due to our expansion into the US market and the related increase in staffing, printing, advertising and promotion.

Network delivery expenses for the six months ended March 31, 2005 increased by \$160,758 to \$367,892, an increase of 78% from the comparable period of 2004. This increase was primarily due to an increase in lab system installations, network usage and related bandwidth requirements and customer service.

Research and development expenses for the six months ended March 31, 2005 increased by \$192,166 to \$773,421, an increase of 33% from the comparable period of 2004. This increase was primarily due to an increase of staffing and consultants to develop the next generation, multi-media Digital Content distribution platform. Upon completion of our next generation platform, the Company believes that these current costs can be reduced by as much as 20% going forward.

Amortization expense for the six months ended March 31, 2005 increased by \$48,874 to \$111,841, an increase of 78% from the comparable period of 2004. This increase was due to acquisition of equipment during late fiscal 2004 and the first two quarters of fiscal 2005 related to an increase in infrastructure and staffing.

The Company recorded a six month net loss attributable to common shareholders of \$1,220,486 or \$0.01 per share compared to \$1,359,883 or \$0.01 per share in the same period last year. This reduction of 10% was due to a significant increase in revenues.

Contingencies

As of May 16, 2005, there were no legal proceedings material to the Company to which the Company or its subsidiaries are a party or to which their property is subject, nor to the best of the knowledge of management, are any such legal proceedings contemplated, except as follows: on May 12, 2005 Canada Stockwatch reported that the company's former chief executive officer, Bart Copeland, has sued the company. The company has yet to receive the statement of claim from Mr. Copeland.

FINANCIAL CAPABILITY

As at March 31, 2005, the Company had a working capital deficiency of \$391,151 compared to a negative working capital position of \$47,519 as at March 31, 2004. The cash and cash equivalents on hand at the period ended were \$123,134. Excluding the deferred and unearned revenue amounts at March 31, 2005, the Company had a working capital deficiency of \$226,058. As a start-up, which continues to strive for profitability, the Company's main source of funds to meet cash shortfalls has been, and will continue to be, the sale of equity capital until it manages to reach a cashflow positive position. If requisite funding on acceptable terms cannot be attracted in a timely fashion, the Company may be forced to delay activities and, possibly, lose market opportunities to competitors. Similarly, delayed financing could force reductions in planned marketing, product deployment and development expenditures, resulting in delays in meeting its business objectives.

The contractual obligations and payments due for each of the next three years have not materially changed from the Management's Discussion and Analysis presented in the 2004 Annual Report.

TAXATION AND OTHER NON-OPERATING ITEMS

Since inception PhotoChannel has sustained significant tax losses and continues to strive to generate sufficient revenues to cover its operating

costs in an industry characterized by rapid technological change.

FUTURE ACCOUNTING CHANGES

On October 1, 2002, the Company adopted the recommendations of CICA Handbook Section 3870, Stock based Compensation and Other Stock-based Payments. The recommendations were applied prospectively to all stock-based payments to employees and non-employees granted on or after October 1, 2002. The change in accounting policy did not result in an adjustment to the Company's opening retained earnings in fiscal 2004.

Stock-based compensation to third parties is recognized and recorded in our accounts at their fair market value determined by the Black-Scholes option pricing model. For stock-based awards to employees, the Company discloses the pro forma effect on net earnings and earnings per share as if the fair value based method of accounting had been used.

CRITICAL ACCOUNTING ESTIMATES

PhotoChannel prepares its financial statements in accordance with GAAP. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are based upon historical experience and various other assumptions that are believed to be reasonable under the circumstances. These estimates are evaluated on an ongoing basis and form the basis for making judgments regarding the carrying values of assets and liabilities and the reported amount of revenues and expenses. Actual results may differ from these estimates under different assumptions. Significant estimates include, but are not limited to, the calculations used under the Black-Scholes model for the pricing of warrants and options.

Revenue recognition

Revenue is earned from the provision of the PhotoChannel Network to electronically connect photo-finishing retailers to their customers through the Internet. Revenue received in advance from installation services for the set-up of a customer website is recorded as deferred revenue and is recognized into income over the estimated term of the customer relationship period. Revenue from monthly membership fees from photo-finishing retailers for the connection to the PhotoChannel Network is recognized as the service connection is provided. Revenue from commissions earned on transactions processed by the photo-finishing retailers, utilizing the

PhotoChannel Network, is recognized at the time the digital image processing services are provided to the end customer. Revenue from archive fees from online image storage is recognized as the service is provided.

Income taxes

The company uses the liability method of accounting for income taxes. Under the liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax balances. Future tax assets and liabilities are measured using enacted tax rates expected to apply

to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment. A valuation allowance is recognized to the extent the recoverability of future income tax assets is not considered more likely than not.

BUSINESS RISKS

The business risks described in the Management's Discussion and Analysis presented in the 2004 Annual Report have not materially altered.

QUARTERLY FINANCIAL INFORMATION

The following table provides selected quarterly information for PhotoChannel's eight most recent quarters. This information is unaudited, but reflects all adjustments of a normal, recurring nature which are, in the opinion of management, necessary to present a fair statement of PhotoChannel's results of operations for the periods presented. Quarter-to-quarter comparisons of PhotoChannel's financial results are not necessarily meaningful and should not be relied upon as an indicator of future performance.

	Jun. 30, 2003	Sept. 30, 2003	Dec. 31, 2003	Mar. 31, 2004
Revenue	\$ 110,063	\$ (28,793) <small>note 1</small>	\$ 173,644	\$ 394,200
Loss from operations	(590,907)	(841,492)	(696,283)	(1,437,491)
Net loss	(590,907)	(596,492)	(696,283)	(1,359,883)
Basic and diluted net loss per share	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)

	Jun. 30, 2004	Sept. 30, 2004	Dec. 31, 2004	Mar. 31, 2005
Revenue	\$ 208,766	\$ 149,235	\$ 440,614	\$ 995,356
Loss from operations	(575,563)	(1,261,202)	(476,778)	(1,229,083)
Net loss	(575,563)	(1,261,202)	(476,778)	(1,220,486)
Basic and diluted net loss per share	\$ -	\$ (0.01)	\$ -	\$ (0.01)

Note 1 – In fiscal 2003, due to recent accounting pronouncements around revenue recognition, the Company commenced deferring revenue related to the set-up of a customer website and recognizing it into income over the estimated term of the customer relationship period. The Company made the adjustment for the deferral for fiscal 2003 in its fourth quarter and this resulted in a reduction of fourth quarters' revenue when viewed on a quarter by quarter basis. As the amount related to the individual quarters was not deemed material, the Company has not restated its quarterly results.

OUTSTANDING SHARE INFORMATION AS AT May 16, 2005

Authorized

Common shares	Unlimited
Preferred shares	Unlimited

Issued and outstanding

Common shares	178,577,341
---------------	-------------

Options Outstanding 15,724,667

Warrants Outstanding 9,746,000

ADDITIONAL INFORMATION

Additional information related to the Company can be found on SEDAR at www.sedar.com.

PhotoChannel Networks Inc.

Consolidated Balance Sheet

Unaudited – Prepared by Management

(expressed in Canadian dollars)

NOTICE THAT FINANCIAL STATEMENTS HAVE NOT BEEN REVIEWED BY AN AUDITOR

PhotoChannel Networks Inc.

Interim Financial Statements for the period ended March 31, 2005

The Issuer's auditors have not reviewed or been involved in the preparation of these financial statements.

PhotoChannel Networks Inc.

Consolidated Balance Sheet

Unaudited – Prepared by Management

(expressed in Canadian dollars)

	<u>March 31, 2005</u>	<u>September 30, 2004</u>
Assets		
Current assets		
Cash and cash equivalents	\$ 123,134	\$ 955,965
Accounts receivable	375,678	321,149
Inventory	59,365	4,113
Prepaid expenses	15,277	14,126
	<u>573,454</u>	<u>1,295,353</u>
Capital assets	<u>627,793</u>	<u>650,339</u>
	<u>\$ 1,201,247</u>	<u>\$ 1,945,692</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 799,512	\$ 575,844
Deferred revenue	165,093	175,769
	<u>\$ 964,605</u>	<u>\$ 751,613</u>
Shareholders' Deficiency		
Capital stock	\$ 42,035,624	\$ 41,702,604
Contributed surplus	7,165,029	7,060,029
Loans receivable	-	(17,600)
Warrants	1,996,082	2,188,653
Deficit	(50,960,093)	(49,739,607)
	<u>236,642</u>	<u>1,194,079</u>
	<u>\$ 1,201,247</u>	<u>\$ 1,945,692</u>

Approved by the Board of Directors

"Peter Fitzgerald" Director

"Cory Kent" Director

The accompanying notes are an integral part of these financial statements.

PhotoChannel Networks Inc.

Consolidated Balance Sheet

Unaudited – Prepared by Management

(expressed in Canadian dollars)

	Three Months Ended		Six Months Ended	
	March 31, 2005	March 31, 2004	March 31, 2005	March 31, 2004
Revenue	\$ 554,742	\$ 220,556	\$ 995,356	\$ 394,200
Expenses				
General and administration	304,511	400,742	655,764	724,895
Sales and marketing	202,861	84,239	315,521	255,440
Network delivery	246,349	135,026	367,892	207,134
Research and development	492,902	286,565	773,421	581,255
Amortization	59,332	33,491	111,841	62,967
	<u>1,305,955</u>	<u>940,063</u>	<u>2,224,439</u>	<u>1,831,691</u>
Net loss from operations	(751,213)	(719,507)	(1,229,083)	(1,437,491)
Other Income (loss)				
Translation gain (loss)	(473)	7,068	(2,889)	26,121
Interest and miscellaneous income	1,259	80	4,767	2,728
Expense recovery	-	48,759	-	48,759
Gain on disposal of property, plant, and equipment	6,719	-	6,719	-
	<u>7,505</u>	<u>55,907</u>	<u>8,597</u>	<u>77,608</u>
Net (loss) gain for the period	(743,708)	(663,600)	(1,220,486)	(1,359,883)
Deficit - beginning of period	<u>(50,216,385)</u>	<u>(40,872,342)</u>	<u>(49,739,607)</u>	<u>(40,176,059)</u>
Deficit - end of period	<u>\$ (50,960,093)</u>	<u>\$ (41,535,942)</u>	<u>\$ (50,960,093)</u>	<u>\$ (41,535,942)</u>
(Loss) Gain per share attributable to common shareholders	<u>\$ (0.00)</u>	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>
Weighted average number of common shares outstanding	<u>149,207,517</u>	<u>130,258,732</u>	<u>149,207,517</u>	<u>130,258,732</u>

The accompanying notes are an integral part of these financial statements.

PhotoChannel Networks Inc.

Consolidated Balance Sheet

Unaudited – Prepared by Management

(expressed in Canadian dollars)

	Three Months Ended		Six Months Ended	
	March 31, 2005	March 31, 2004	March 31, 2005	March 31, 2004
Cash flows from operating activities				
Net (loss) gain for the period	\$ (743,708)	\$ (663,600)	\$ (1,220,486)	\$ (1,359,883)
Items not affecting cash			111,841	
Amortization	59,332	33,491		62,967
Loss on sale of property, plant and equipment	(6,719)	-	(6,719)	-
	(691,095)	(630,109)	(1,115,364)	(1,296,916)
Net change in non-cash working capital items	33,460	(436,802)	102,059	(896,312)
	(657,635)	(1,066,911)	(1,013,305)	(2,193,228)
Cash flows from investing activities				
(Purchase) Disposal of property, plant and equipment	(44,505)	(84,878)	(82,576)	(227,874)
	(44,505)	(84,878)	(82,576)	(227,874)
Cash flows from financing activities				
Cash in trust	-	-	-	345,000
Loan Receivable	17,600	32,210	17,600	73,889
Issuance of common shares on exercise of warrants and options	19,500	38,608	245,450	1,015,105
	213,100	70,818	263,050	1,433,994
Increase (decrease) in cash and cash equivalents	(489,040)	(1,080,971)	(832,831)	(987,108)
Cash and cash equivalents - beginning of period	612,174	1,198,273	955,965	1,104,410
Cash and cash equivalents - end of period	\$ 123,134	\$ 117,302	\$ 123,134	\$ 117,302

The accompanying notes are an integral part of these financial statements.

PhotoChannel Networks Inc.

Consolidated Balance Sheet

Unaudited – Prepared by Management

(expressed in Canadian dollars)

1. Summary of significant accounting policies

General

These unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) in Canada, using the same accounting policies as outlined in Note 2 to the most recent audited consolidated financial statements for the year ended September 30, 2004. These unaudited interim consolidated financial statements do not include all disclosures required for annual financial statements and should be read in conjunction with the audited consolidated financial statements for the year ended September 30, 2004. Certain comparative figures in the Consolidated Financial Statements have been reclassified to conform to the current period presentation.

In the opinion of management, all adjustments (which include reclassifications and normal recurring adjustments) necessary to present fairly the consolidated financial position, consolidated earnings, and consolidated cash flows as at March 31, 2005 and for all periods presented, have been made. The earnings for the six months ended March 31, 2005 are not necessarily indicative of the earnings for the full year ending September 30, 2005. All amounts herein are expressed in Canadian dollars unless otherwise noted.

The consolidated financial statements also included the accounts of PhotoChannel Networks Limited Partnership (the PhotoChannel LP) for all periods that the PhotoChannel LP was in existence up until the redemption of the Limited Partnership units in April 2004, as per Note 7 to the most recent audited consolidated financial statements for the year ended September 30, 2004.

All material intercompany balances and transactions are eliminated upon consolidation.

Research and development

Research costs are expensed in the period incurred. Where, in the opinion of management, the deferral criteria established under GAAP are satisfied in all material respects, development costs are capitalized and amortized over the estimated life of the related products. Otherwise, development costs are charged as an expense in the period incurred. To date, no development costs have been deferred.

Property, plant and equipment

Property, plant and equipment are recorded at cost less accumulated amortization. Amortization of property, plant and equipment is charged over the estimated useful lives of the assets at the following annual rates:

Computer equipment	30% straight-line
Software	33% - 100% straight-line
Furniture and office equipment	20% straight-line
Leasehold improvements	life of the lease

The Company assesses the carrying value of long-lived assets for recoverability whenever events or changes in circumstances indicate that the carrying value may not be recoverable from future undiscounted cash flows. An impairment loss equal to the difference in the asset carrying value and its fair value is recognized in the period in which the determination is made.

Revenue recognition

Revenue is recognized when all of the following criteria have been met: persuasive evidence of an arrangement exists; the services have been provided; the price is fixed or determinable; customer acceptance has been received or implied; and the collection of sales proceeds is reasonably assured. Many of the company's sales arrangements consist of multiple elements, which may include installation services, monthly membership fees, transactions processed, or archive fees. Under Emerging Issues Committee 142, "Revenue Arrangements with

PhotoChannel Networks Inc.

Consolidated Balance Sheet

Unaudited – Prepared by Management

(expressed in Canadian dollars)

Multiple Deliverables”, the fee from a multiple element sales arrangement is allocated to each of the individual elements based on each element’s relative fair value. The portion of the fee that is allocated to an element is recognized as revenue when all of the criteria for revenue recognition have been met for that element.

Revenue is earned from the provision of the PhotoChannel Network to electronically connect photo-finishing retailers to their customers through the Internet. Revenue received in advance from installation services for the set-up of a customer website is recorded as deferred revenue and is recognized into income over the estimated term of the customer relationship period. Revenue from monthly membership fees from photo-finishing retailers for the connection to the PhotoChannel Network is recognized as the service connection is provided. Revenue from commissions earned on transactions processed by the photo-finishing retailers, utilizing the PhotoChannel Network, is recognized at the time the digital image processing services are provided to the end customer. Revenue from archive fees from online image storage is recognized as the service is provided.

Stock-based compensation plan

Effective October 1, 2002, the company adopted Canadian Institute of Chartered Accountants (CICA) Handbook Section 3870, “Stock-Based Compensation and Other Stock-Based Payments”. The recommendations were applied prospectively to all stock-based compensation to employees and non-employees awarded on or after October 1, 2002.

No compensation expense is recorded for the company’s employee stock-based compensation. Consideration paid on the exercise of stock options is recorded as capital stock.

Stock-based compensation to third parties is recognized and recorded in the accounts of the company at its fair market value determined by the Black-Scholes option pricing model.

Financial instruments

Financial instruments are classified in accordance with the substance of the contractual arrangement. Financial liabilities, which are defined as any contractual obligation to deliver cash or another financial asset to another party, are classified as liabilities. Where a financial instrument contains both a debt and equity component, the instruments are presented at their component fair values at the time they were originally issued.

Net loss per share

Basic net earnings (loss) per share are computed using the weighted average number of common shares outstanding during the year. The treasury stock method is used for the calculation of diluted net earnings (loss) per share. Under the treasury stock method, the weighted average number of common shares outstanding for the calculation of diluted net earnings (loss) per share assumes that the proceeds to be received on the exercise of dilutive stock options and warrants are applied to repurchase common shares at the average market price for the period. Stock options and warrants are dilutive when the average market price of the common shares during the period exceeds the exercise price of the options and warrants.

Income taxes

The company uses the liability method of accounting for income taxes. Under the liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax balances. Future tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment. A valuation allowance is recognized to the extent the recoverability of future income tax assets is not considered more likely than not.

PhotoChannel Networks Inc.

Consolidated Balance Sheet

Unaudited – Prepared by Management

(expressed in Canadian dollars)

2. Accounts receivable

	<u>As at March 31, 2005</u>		<u>As at September 30, 2004</u>
Trade accounts receivable	\$ 375,678	\$	279,009
GST receivable	-		42,140
Total	<u>\$ 375,678</u>	<u>\$</u>	<u>321,149</u>

3. Capital stock, stock options and loans receivable

a) Capital stock

Issued	<u>As at March 31, 2005</u>		<u>As at September 30, 2004</u>
Common shares	178,577,341		176,347,341
Amount	\$ 42,035,624	\$	41,702,604

b) Options

The Company has a stock option plan that grants to directors and certain employees of the Company the option to purchase up to 18,000,000 common shares of the Company. The exercise price of each option is determined by the market price of the Company's stock on the date of the grant and an option's maximum term is five years. Options generally vest over 18 months to four years. During the six months ended March 31, 2005, 1,000,000 options (2003 – 3,275,000) were granted to employees.

4. Business segment information

The Company only reportable segment is the provision of digital image delivery, hosting, storage and financial reporting for photofinishing retailers.

The Company's sales by geographical area are as follows:

Revenue	<u>Canada</u>		<u>US</u>		<u>Other</u>	
For the six months ended March 31, 2005	\$	728,908	\$	263,338	\$	3,110
For the six months ended March 31, 2004	\$	264,311	\$	125,545	\$	4,344

Revenue is attributable to the geographic location of the Company's customer. As at March 31, 2005 and 2004, all of the Company's property, plant and equipment were located in Canada.

PhotoChannel Networks Inc.

Consolidated Balance Sheet

Unaudited – Prepared by Management

(expressed in Canadian dollars)

5. Revenue

Description	Six Months	Twelve Months
	March 31, 2005	September 30, 2004
Installation fees	\$ 277,192	\$ 187,940
Membership fees	244,668	96,519
Transaction fees	391,778	361,350
Archive fees	45,867	57,091
Other	35,851	60,240
Total	<u>\$ 995,356</u>	<u>\$ 763,140</u>

6. Expense details

	March 31, 2005
General and administration	
Accounting and legal	\$ 16,893
Investor relations	37,500
Office and miscellaneous	107,531
Public company fees	33,637
Salaries	245,830
Consulting	169,783
Interest	586
Rent	44,004
	<u>\$ 655,764</u>
Sales and marketing	
Salaries	\$ 51,066
Consulting	205,052
Printing, advertising and promotion	31,316
Travel and Miscellaneous	28,087
	<u>\$ 315,521</u>
Network Delivery	
Telecommunication costs	\$ 105,477
Customer Service	100,129
Lab system installation	129,692
Other	32,594
	<u>\$ 367,892</u>
Research and development	
Salaries	\$ 447,764
Consulting	278,550
Miscellaneous	47,107
	<u>\$ 773,421</u>

PhotoChannel Networks Inc.

Consolidated Balance Sheet

Unaudited – Prepared by Management

(expressed in Canadian dollars)