

MANAGEMENT DISCUSSION & ANALYSIS

THIRD QUARTER 2007

This discussion and analysis is a review of the operating results, financial condition, and business risks of PhotoChannel Networks Inc. (“PhotoChannel”, the “Company”, “we” or “our”). This discussion should be read in conjunction with the Management’s Discussion and Analysis presented in our 2006 Annual Report and the consolidated financial statements and accompanying notes for the nine months ended June 30, 2007 and 2006. 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. Statements which are not historical facts reflect our views at August 31, 2007 with respect to future events and are subject to certain risks, uncertainties and assumptions. These risks and assumptions include, but are not limited to, changes in the market for our services, changes in the economy, increasing competition in our market, the risk of loss of current customers, risks related to changes in technology, employee retention, inability to deliver on contracts, failure of customers to adequately market the online photo-finishing services they provide, foreign exchange, and risks with respect to our financial capacity. These risks are set out in greater detail in our Annual Report on Form 20F filed for the year ended September 30, 2006, available on the SEC’s website at www.sec.gov/edgar.shtml and on SEDAR at www.sedar.com. Our actual results could differ materially from those expressed or implied by such forward-looking statements.

We are pleased to provide you with an update on the progress PhotoChannel made in its third quarter of fiscal 2007, represented by the period ended June 30, 2007.

Business Highlights

Third Quarter 2007 Financial Highlights

- Total revenues, (installation, membership, transaction, archive and professional fees), for the quarter were \$1,272,962, a decrease of 3% over the third quarter of 2006;
- Transactional revenues for the quarter were \$809,469, an increase of 68% over the third quarter of 2006 and comprised 64% of total revenues compared to 37% during the third quarter of 2006;
- Transactional revenues from existing customers (organic growth) increased by 72% during the third quarter of 2007 compared to the corresponding quarter of 2006;
- Gross profit margins (revenue, less network delivery expenses) were 76% of revenues, compared to 53% of revenues for the third quarter of 2006;
- Total operating expenses were \$1,732,039, a decrease of 26%, compared to \$2,355,044 for the third quarter of 2006;
- Adjusted EBITDA (net loss from operations, excluding amortization and compensation expense associated with stock option grants) was a loss of \$162,649, compared to a loss of \$840,563 in the third quarter of 2006;

- Net loss and comprehensive loss for the quarter in accordance with GAAP was \$1,639,651, which included a foreign exchange loss of \$1,369,179, compared to a loss of \$1,025,636 for the third quarter of 2006;
- Net loss per share was \$0.05, compared to a net loss per share of \$0.04 for the third quarter of 2006; and
- We ended the third quarter of 2007 with approximately \$19.6 million in cash and cash equivalents.

Nine Month 2007 Financial Highlights

- Revenues (installation, membership, transaction, archive and professional fees) for the first nine months of fiscal 2007 were \$4,112,147, an increase of 53% over the corresponding period of 2006;
- Transactional revenues for the first nine months of fiscal 2007 were \$2,571,253, an increase of 150% over the corresponding period of 2006 and comprised 63% of total revenues compared to 38% during the first nine months of 2006;
- Gross profit margins (revenue, less network delivery expenses) were 74% of revenues for the first nine months of fiscal 2007, compared to 54% of revenues for the corresponding period of 2006;
- Total operating expenses for the first nine months of fiscal 2007 were \$5,367,720, compared to \$5,154,766 for the same period of 2006;
- Adjusted EBITDA (net loss from operations, excluding amortization and compensation expense associated with stock option grants) for the first nine months of fiscal 2007 was a loss of \$405,778, compared to a loss of \$2,064,515 in the corresponding period of 2006;
- Net loss and comprehensive for the first nine months of fiscal 2007 in accordance with GAAP was \$2,394,386, which included a foreign exchange loss of \$1,371,158, compared to a loss of \$2,446,897 for the same period of 2006; and
- Net loss per share for the first nine months of fiscal 2007 was \$0.08, compared to a net loss per share of \$0.11 for 2006.

Third Quarter 2007 Metrics

- Orders processed through our network, on behalf of our retailers' customers, for the third quarter increased by 84% over the third quarter of 2006;
- Average orders processed per day during the third quarter increased by 84% over the third quarter of 2006; and
- The number of unique consumer accounts at the end of the third quarter of fiscal 2007 had increased by 181% over the end of the third quarter of 2006.

Highlights and Subsequent Events

During the third quarter the following significant events occurred:

- We reached an agreement in principle with FUJIFILM Canada Inc. to operate Online Photo Service for FUJIFILM retailers. As part of this agreement, we launched the new online photo service for Shoppers Drug Mart at www.shoppersdrugmart.ca on August 28, 2007. Shoppers Drug Mart is a large national chain of drug stores in Canada serving its customers through over 1,000 locations. In addition, under this agreement, we are completing the migration of Loblaw Companies Limited's online photo services to our platform. Loblaw's is Canada's largest food distributor and a leading provider of general merchandise, drugstore and financial products and services. The migration is expected to be completed and launched in the fourth quarter of calendar 2007.
- On April 25, 2007, we reached an agreement with the board of directors of Pixology plc ("Pixology") on a recommended all cash offer by us for all of the issued shares of Pixology for 40.0 pence per Pixology share (approximately \$0.90 per Pixology share), for a total purchase price of approximately \$17,650,000 before costs directly associated with the acquisition, based on exchange rates at the time of take-up. This acquisition was completed on July 2, 2007, at which time we took control of the operations of Pixology. Pixology's results of operations will be consolidated with ours in our fourth quarter of fiscal 2007 which ends September 30, 2007.
 - Pixology has developed and markets both an online solution and a kiosk solution for photofinishing retailers to allow their customers to produce prints and gifting products from their digital images. In the upcoming months, we will be converting and migrating all of Pixology's online customers onto our online platform.
 - We have already started to realize positive gains from this acquisition. As a result of this acquisition our client base has been expanded to include Tesco (online and kiosk solutions), Jessops (kiosk), Asda (Wal-Mart UK – online solution), Boots (online solution), and Costco US, Canada and Mexico (kiosk solution).
 - The majority of kiosks deployed in the world today are not connected – meaning they are standalone print only machines. Our plan is to sell a connected kiosk whereby the kiosk will still offer the full print functionality, but also offer the full online array of photo gift products for ordering. This connectivity will help convert the current kiosk model from a license based business to a transactional business.
 - The Pixology kiosk offering was different from other kiosk software makers in that they did not sell hardware for the kiosks, focusing instead on workflow and integration with all devices. The technologies employed by the two companies are very much in sync and our integration work is underway. This Fall we will roll out a new kiosk platform that not only integrates online with our websites, but is built on the same .Net platform used within our online systems. We will be releasing this new platform for one customer in October and presenting to our worldwide client base in the months to come. We plan to make it the highlight of our presentation at the Photo Marketing Association's annual tradeshow in January 2008.
 - We have developed a six month plan to fully integrate the development staff of both companies, as well as our datacenters. The talent pool in the United Kingdom office is deep and we have been able to leverage the strengths of each organization to create one team. On the datacenter side

we will consolidate the two United Kingdom facilities into one and run one facility in each of Canada and the United Kingdom.

- As part of our previously disclosed private placement of units for total proceeds of \$15,064,000 (U.S.), which closed in two tranches on March 30 and April 2, 2007, we entered into a Registration Rights Agreement with the investors. Under the Registration Rights Agreement, the Company agreed to file a preliminary prospectus in Canada and a registration statement in the United States by May 30, 2007, and a final prospectus in Canada and a registration statement in the United States by July 28, 2007 to qualify the re-sale of the shares and shares underlying the warrants sold to the investor(s). The Company filed the preliminary prospectus and registration statement on May 29, 2007, however, did not file the final prospectus and registration statement by July 28, 2007, and paid the investors an aggregate of US\$150,639.99 in liquidated damages. The final prospectus was filed and receipted on August 13, 2007 and the registration statement was filed and made effective in the United States on August 15, 2007.

RESULTS OF OPERATIONS

	Nine months ended June 30, 2007	Nine month ended June 30, 2006
Revenue	\$ 4,112,147	\$ 2,684,380
Loss from operations	(1,255,573)	(2,470,386)
Net loss	(2,394,386)	(2,446,897)
Basic and diluted net loss per share	\$ (0.08)	\$ (0.11)

We have four main sources of revenue derived from the provision of the PhotoChannel Network (the "Network") to electronically connect photo-finishing retailers to their customers through the Internet: installation revenue (including licensing fees), membership fees, transaction fees and archive fees. For further information on our revenue recognition policies, see Critical Accounting Estimates, Revenue Recognition, below in this report.

Network revenue increased 53% to \$4,112,147 for the nine month period ending June 30, 2007 compared to the same period last year. The increase was attributable to three factors: organic growth in usage of the Network from customers of our photo-finishing retailers; our retailers commencing to print in-store; and additional customers using the Network. We believe that organic growth will continue to grow as the Internet is increasingly adopted by consumers as a means to print images. Based upon our past experience, we have traditionally seen an ongoing increase in the use of our service as in-store printing is adopted. Also, the first nine months of this year included revenue generated from services provided to CVS Pharmacy, which came online in February, 2006, but did not begin offer the one-hour print in-store model until July, 2006. In the future, we expect to add additional customers, including Shoppers Drug Mart (launched August 28, 2007) and Loblaw in Canada.

Increases were seen in transaction, professional and membership fees, which increased 150%, 28% and 27%, respectively, for the nine month period ending June 30, 2007.

Transaction revenue for the nine month period ended June 30, 2007 was up 150% from the comparable period of fiscal 2006 from \$1,026,610 to \$2,571,253. During this third quarter, transactional revenue comprised 64% of total revenue, up from 37% of total revenue during the third quarter of fiscal 2006.

The photofinishing business is a cyclical business and we are now experiencing the seasonality in our online photo offering. Going forward we expect to realize the same or similar trends as we have witnessed in fiscal 2007 with existing retailers, with our first quarter being our strongest quarter. Although our third quarter transactional revenue increase by 68%, as compared to the same quarter of fiscal 2006, we continue to expect our annual transactional revenue to increase in excess of 100% over fiscal 2006 given this seasonality. We believe that the increase in transactional revenue continues to signal the growing adoption of the use of the online Network.

Professional fees were up 28% or \$54,940 from the corresponding nine month period of fiscal 2006, as we provided more email marketing assistance to its retailer base. We have seen that email marketing by our retail partners leads to increases in the number of orders placed by their customers and a related increase in transactional fees to us. We expect to continue assisting our customers in the future as requested, in order to drive additional orders through our Network.

Membership fees also increased 27% or \$141,417 over the same period of fiscal 2006, but decreased by 15% from our second quarter of fiscal 2007. This sequential decrease was the result of one of our customers outsourcing support of their in-store lab servers to a third party. We expect to see membership fees remain constant or to increase as stores of new and existing customers are connected to the Network.

Revenue related to installations decreased during the nine months by 32%, from \$842,816 to \$574,871, which is offset by a reduction in our cost of installations for the nine month period, compared to the same period last year totalling \$237,776. Installation revenues have primarily consisted of lab system installations in our retail partner locations to enable one-hour printing, but also include a nominal monthly charge for licensing fees. Many of our new retail partners are electing to install or have already installed their own lab systems. We expect this trend will continue, leading to reduction of our revenues related directly to installations. However, while we expect revenues from installations of lab systems to continue to decrease, with our acquisition of Pixology, which derives significant revenue through licensing fees, we expect revenue from installation fees will increase overall when we consolidate earnings during our fourth quarter of fiscal 2007.

The costs of operations for the nine month period ended June 30, 2007 were \$5,367,720, up 4% or \$212,954 when compared to the same period of fiscal 2006. This increase was primarily attributable to an increase in research and development as we continue to enhance and expand our product offering to new and existing retailers.

Research and development expenses for the nine months ended June 30, 2007 increased by \$290,153 to \$2,024,256, an increase of 17% from the comparable period of 2006. This increase was primarily due to an increase in staffing and consultants used to develop and enhance our product offering and a stock-based compensation expense resulting from the distribution of stock options, as an incentive, to the development team. We believe that our networked online platform enables us to offer one of the most comprehensive solutions in the marketplace today for one hour in-store printing and gifting. Our research and development expenses help ensure that we maintain this market advantage.

Network delivery expenses for the nine months ended June 30, 2007 decreased by \$154,731 to \$1,078,671, a decrease of 13% from the comparable period of 2006. This decrease was primarily due to a decrease of \$237,776 or 35%, related to the installation of new lab systems required for direct to in-store printing and CD burning equipment. This decrease is directly related to the decrease in installation fees for the third quarter. As well, telecommunication costs decreased by \$9,323 or 5%, with a further related expense recovery of \$16,669 from prior periods, as we negotiated a better rate for bandwidth with our telecommunication provider. This decrease was partially off-set by an increase of \$44,663 or 17%, due to an increase in customer support costs related to expanded time zone coverage.

General and administration expenses for nine months ended June 30, 2007 increased by \$159,398 to \$1,384,193, an increase of 13% from the comparable period of 2006. This increase was primarily due to an increased expense for stock-based compensation, but also from smaller increases in accounting and legal, salary, office and miscellaneous, public company fees and rent.

Sales and marketing expenses for the nine months ended June 30, 2007 decreased by \$179,974 to \$519,438, a decrease of 26% from the comparable period of 2006. This decrease was primarily due to reduction in printing, advertising and promotion and consulting fees, while being partially offset by a charge for stock-based compensation, and increases in travel and miscellaneous expenses.

Amortization expense for the nine months ended June 30, 2007 increased by \$98,108 to \$361,162, an increase of 37% from the comparable period of 2006. This increase was due to the purchase of additional equipment and software to handle the growing transactional volume, along with new PC's related to existing and additional staffing.

We recorded a nine month net loss attributable to common shareholders of \$2,394,386 or \$0.08 per share compared to \$2,446,897 or \$0.11 per share in the same period last year. This decrease of 2% was primarily due to increases in revenues as the volume of transactions conducted through the Network continues to increase, but was significantly off-set by foreign exchange loss, as the Canadian dollar appreciated strongly against the US dollar and during our third quarter we had a large amount of cash held in US dollars as a result of our most recent private placement. Although we did not expect such a large variance between the Canadian and US currencies (approximately 8.7%) during the quarter, these US funds we used by us to acquire Pixology in British Pounds and the US dollar only lost 5.7% to the British Pound Sterling from March 31, 2007 to the time of acquiring stock from Pixology's shareholders.

Contingencies

As of August 31, 2007, there were no legal proceedings material to us to which we or our 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.

FINANCIAL CAPABILITY

As at June 30, 2007, we had working capital of \$19,557,130 compared to working capital of \$953,567 as at June 30, 2006. The cash and cash equivalents on hand, including cash held in trust, at the end of the period were \$19,638,372. On July 2, 2007 we announced that we had received acceptances from the holders of over 94% of the outstanding Pixology shares, and has determined to complete the acquisition of Pixology under the proposed terms originally announced on April 25, 2007. Upon the purchase of all the issued and to be issued common shares of Pixology, we expect to spend approximately \$17,650,000 before costs directly associated with the acquisition based on exchange rates at the time of take-up. At the time of acquisition Pixology had approximately \$8,100,000 cash that we acquired upon purchase, which will be added to working capital. We have a limited operating history and the successful implementation of our business strategy depends on numerous factors including economic, competitive and other conditions and uncertainties, the ability to hire and retain qualified personnel, the ability to obtain financing for continued development and commercialization of its products. Adverse economic or competitive conditions or the failure to hire and retain qualified personnel or obtain financing when required could affect our operations in the future. We do not have any immediate cash requirements for our ongoing operations.

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 2006 Annual Report.

TAXATION AND OTHER NON-OPERATING ITEMS

Since inception we have 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.

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.

Revenue recognition

Revenue is earned from the provision of the PhotoChannel Network which enables photo-finishing retailers to electronically connect 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. Revenue for professional fees from development and marketing are recognized as the service is provided.

Income taxes

We use 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 2006 Annual Report have not materially altered.

MANAGEMENT'S STATEMENT OF RESPONSIBILITY

The consolidated financial statements contained in this report have been prepared by management in accordance with generally accepted accounting principles and have been approved by the Board of Directors. The integrity and objectivity of the consolidated financial statements are the responsibility of management. In addition, management is responsible for all other information in this report and for ensuring that this information is consistent, where appropriate, with the information contained in the consolidated financial statements.

Management maintains a system of internal accounting controls to provide reasonable assurance that the Company's assets are safeguarded and accounted for, and to facilitate the preparation of relevant, reliable, and timely financial information. Where necessary, management uses its best judgment to make estimates required to ensure fair and consistent presentation of this information.

Our management, including the Chief Executive Officer and Chief Financial Officer, believe that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within us have been prevented or detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override of the control. The design of any systems of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

There has been no change in our internal control over financial reporting during the Company's third quarter of fiscal 2007, ended June 30, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. At the end of our second quarter of fiscal 2007, by way of our market capitalization, we were deemed an accelerated filer under Sarbanes Oxley. We are in the process of reviewing internal controls and implementing measures to comply Sarbanes Oxley.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control, and exercises this responsibility principally through the Audit Committee. The Audit Committee includes four directors, three of whom are not involved in our daily operations. The functions of the Audit Committee are to review the quarterly and annual consolidated financial statements; review the adequacy of the system of internal controls; review any relevant accounting, financial and security regulatory matters; and recommend the appointment of external auditors.

QUARTERLY FINANCIAL INFORMATION

The following table provides selected quarterly information for our 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 our results of operations for the periods presented. Quarter-to-quarter comparisons of our financial results are not necessarily meaningful and should not be relied upon as an indicator of future performance.

	Sep. 30, 2005	Dec. 31, 2005	Mar. 31, 2006	Jun. 30, 2006
Revenue	\$ 556,372	\$ 542,714	\$ 831,146	\$ 1,310,520
Net loss from operations	1,046,061	613,004	812,858	1,044,524
Net loss for the period	1,030,701	615,366	805,895	1,025,636
Basic and diluted net loss per share	\$ 0.01	\$ -	\$ -	\$ -

	Sep. 30, 2006	Dec. 31, 2006	Mar. 31, 2007	Jun. 30, 2007
Revenue	\$ 1,390,771	\$ 1,521,262	\$ 1,317,923	\$ 1,272,962
Net loss from operations	168,774	54,390	742,106	459,077
Net loss for the period	185,404	37,191	717,544	1,639,651
Basic and diluted net loss per share	\$ 0.01	\$ -	\$ 0.03	\$ 0.06

QUARTERLY REVENUE BREAKDOWN

	Sep. 30, 2005	Dec. 31, 2005	Mar. 31, 2006	Jun. 30, 2006
Revenue	\$	\$	\$	\$
Installation fees	153,236	79,017	291,160	472,639
Membership fees	142,276	158,655	170,358	196,607
Transaction commission fees	181,797	233,733	309,940	482,938
Archive fees	31,011	30,056	30,123	30,119
Professional fees	48,052	41,253	29,564	128,218
Total Revenues	556,372	542,714	831,145	1,310,521

	Sep. 30, 2006	Dec. 31, 2006	Mar. 31, 2007	Jun. 30, 2007
Revenue	\$	\$	\$	\$
Installation fees	397,114	143,063	280,056	151,752
Membership fees	225,788	232,479	235,163	199,395
Transaction commission fees	660,593	1,044,195	717,589	809,469
Archive fees	21,263	15,007	15,000	15,004
Professional fees	86,013	86,518	70,115	97,342
Total Revenues	1,390,771	1,521,262	1,317,923	1,272,962

OUTSTANDING SHARE INFORMATION AS AT AUGUST 31, 2007

Authorized

Common shares	Unlimited
Preferred shares	Unlimited

Issued and outstanding

Common shares	33,307,081
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Options Outstanding 1,623,279

Warrants Outstanding 4,857,147

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 from 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 inability to deliver on contracts, failure of customers to continue marketing the online solution, competition, general economic conditions, foreign exchange and other risks detailed in the Company's annual report and other filings. Additional information related to the Company can be found on the SEC's website at www.sec.gov/edgar.shtml and SEDAR at www.sedar.com.

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 and auditor.

The interim consolidated financial statements of the Company, as at and for the period ended June 30, 2007, have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has 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.

ADDITIONAL INFORMATION

Additional information related to the Company can be found on the SEC's website at www.sec.gov/edgar.shtml and SEDAR at www.sedar.com.