

**PhotoChannel Networks Inc.**

**Unaudited Interim Consolidated Financial Statements  
For the three month period ended December 31, 2007**

# PhotoChannel Networks Inc.

## Consolidated Balance Sheets

Unaudited – Prepared by Management

(expressed in Canadian dollars)

	<u>December 31, 2007</u>	<u>September 30, 2007</u>
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 5,582,280	\$ 7,405,034
Accounts receivable (note 9)	4,628,577	4,045,035
Prepaid expenses and other current assets	602,141	523,356
	<u>10,812,998</u>	<u>11,973,425</u>
<b>Property and equipment</b>	3,287,351	2,760,545
<b>Deferred expenses</b>	72,966	89,804
<b>Intangible assets</b>	5,321,221	6,067,614
<b>Goodwill</b>	4,736,683	4,867,231
	<u>\$ 24,231,219</u>	<u>\$ 25,758,619</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$ 7,470,703	\$ 7,510,751
Current portion of deferred revenue	237,632	344,833
	<u>7,708,335</u>	<u>7,855,584</u>
<b>Deferred revenue</b>	167,629	171,210
<b>Asset retirement obligations</b>	118,504	120,699
	<u>7,994,468</u>	<u>8,147,493</u>
<b>Shareholders' Equity</b>		
Share capital	\$ 65,333,337	\$ 65,293,214
Warrants	4,961,826	4,961,826
Contributed surplus	10,379,880	10,215,777
	<u>80,675,043</u>	<u>80,470,817</u>
Deficit	(63,132,722)	(62,050,122)
Accumulated other comprehensive loss (note 10)	(1,305,570)	(809,569)
	<u>(64,438,292)</u>	<u>(62,859,691)</u>
	16,236,751	17,611,126
	<u>\$ 24,231,219</u>	<u>\$ 25,758,619</u>

### Approved by the Board of Directors

“Cory Kent” Director

“Peter Fitzgerald” Director

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

# PhotoChannel Networks Inc.

## Consolidated Statements of Loss and Comprehensive Loss

Unaudited – Prepared by Management

(expressed in Canadian dollars)

	Three Months Ended	
	December 31, 2007	December 31, 2006
<b>Revenue</b>	\$ 4,298,594	\$ 1,521,262
<b>Expenses</b>		
Network delivery	1,823,117	330,320
Research and development	1,494,036	594,530
General and administration	1,077,729	390,414
Sales and marketing	270,243	150,421
Amortization	789,657	109,967
	<u>5,454,782</u>	<u>1,575,652</u>
<b>Net loss before the undernoted</b>	(1,156,188)	(54,390)
Foreign exchange gain (loss)	1,461	(572)
Interest income	74,290	17,771
Accretion expense	(2,163)	-
	<u>73,588</u>	<u>17,199</u>
<b>Net loss</b>	(1,082,600)	(37,191)
<b>Other comprehensive loss:</b>		
Unrealized foreign exchange loss on translation of self sustaining foreign operations (note 10)	(496,001)	-
<b>Comprehensive loss</b>	<u>\$ (1,578,601)</u>	<u>\$ (37,191)</u>
<b>Basic and fully diluted net loss per share</b>	\$ (0.03)	\$ (0.00)
<b>Weighted average number of common shares outstanding</b>	33,321,561	24,149,268

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

# PhotoChannel Networks Inc.

Consolidated Statements of Deficit  
Unaudited – Prepared by Management  
(expressed in Canadian dollars)

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	Three Months Ended	
	December 31, 2007	December 31, 2006
Balance, beginning of period	\$ (62,050,122)	\$ (55,977,886)
Net loss for the period	(1,082,600)	(37,191)
Balance, end of the period	<u>(63,132,722)</u>	<u>\$ (56,015,077)</u>

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

# PhotoChannel Networks Inc.

## Consolidated Statements of Cash Flows

### Unaudited – Prepared by Management

(expressed in Canadian dollars)

	Three Months Ended	
	December 31, 2007	December 31, 2006
<b>Cash flows from operating activities</b>		
Net loss for the period	\$ (1,082,600)	\$ (37,191)
Items not affecting cash		
Amortization	789,657	109,967
Stock-based compensation expense	175,460	119,483
Unrealized foreign exchange loss	2,574	-
Accretion expense	2,163	-
	(112,746)	192,259
Net change in non-cash working capital items:		
Accounts receivable	(685,461)	290,548
Prepaid expenses and other current assets	(88,060)	(241,953)
Accounts payable and accrued liabilities	162,712	(27,568)
Changes in deferred expenses	16,838	16,838
Changes in deferred revenue	(100,011)	(25,876)
	(806,728)	204,248
<b>Cash flows from investing activities</b>		
Purchase of property and equipment	(786,526)	(439,911)
<b>Cash flows from financing activities</b>		
Proceeds on exercise of options and warrants	28,766	1,517,495
Effect of changes in foreign exchange rates on cash and cash equivalents	(258,266)	-
<b>Increase (decrease) in cash and cash equivalents during the period</b>	(1,822,754)	1,281,832
<b>Cash and cash equivalents - beginning of period</b>	7,405,034	2,022,015
<b>Cash and cash equivalents - end of period</b>	\$ 5,582,280	\$ 3,303,847

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

# **PhotoChannel Networks Inc.**

## **Notes to Consolidated Financial Statements**

### **Unaudited – Prepared by Management**

(expressed in Canadian dollars)

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#### **1. Nature of operations**

PhotoChannel Networks Inc. (the “Company”) offers the photofinishing retailer and its customers an online and in-store solution for producing prints and gifting products from their digital images. The Company’s online platform electronically connects the photofinishing retailer and its customers through the internet and provides digital image delivery, hosting, transaction processing and storage. The Company, through its wholly-owned subsidiary, Pixology PLC, provides the photofinishing retailer with kiosk software which allows consumers to offload digital images from their digital media and order prints and gifting products within the retailer’s locations. The kiosk software is also connected to the Company’s online platform permitting customers in-store to order gifting products from the kiosk, which are then transmitted from the kiosk to a remote fulfillment facility.

#### **2. 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, 2007. 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, 2007.

In the opinion of management, all adjustments (which include reclassifications and normal recurring adjustments) necessary to present fairly the consolidated financial position, consolidated loss and comprehensive loss, and consolidated cash flows as at December 31, 2007 and for all periods presented, have been made. All amounts herein are expressed in Canadian dollars unless otherwise noted.

##### **Basis of consolidation**

These consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada, and include the accounts of the Company and each of its wholly-owned subsidiaries, PhotoChannel Capital Inc., PhotoChannel Management Inc., Pixology PLC, Pixology Software Limited, Pixology Incorporated, Pixology Japan Limited and Flashprints Limited.

All material intercompany balances and transactions are eliminated upon consolidation.

**PhotoChannel Networks Inc.**  
**Notes to Consolidated Financial Statements**  
**Unaudited – Prepared by Management**  
(expressed in Canadian dollars)

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**Reporting currency and foreign currency translation**

These consolidated financial statements are reported in Canadian dollars. Foreign currency denominated revenues and expenses are translated using average rates of exchange during the period. Foreign currency denominated assets and liabilities are translated at the rate of exchange in effect at the balance sheet date.

The Company translates the assets and liabilities of self-sustaining foreign operations to Canadian dollars at the rate of exchange prevailing at the balance sheet dates and revenues and expenses of those operations are translated using the average rates of exchange during the period. Gains and losses resulting from these translation adjustments for the self-sustaining foreign operations are recorded in accumulated other comprehensive loss, a component of shareholders' equity, until there is a realized reduction in the net investment in the foreign operation.

**Changes in accounting policies**

(a) Capital Disclosures

Effective October 1, 2007, the Company adopted the recommendations included in the Canadian Institute of Chartered Accountants ("CICA") handbook, section 1535, Capital Disclosures. The new standard requires disclosure of qualitative and quantitative information that enables users of financial statements to evaluate the Company's objectives, policies and processes for managing capital.

(b) Financial Instruments

On October 1, 2007, the Company adopted CICA Handbook Section 3862, Financial Instruments – Disclosures and section 3863, Financial Instruments - Presentation.

Section 3862 requires disclosure about the significance of financial instruments for an entity's financial position, the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks.

Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives.

Sections 3862 and 3863 replace Section 3861, Financial Instruments – Disclosure and Presentation.

The additional disclosures, required as a result of the adoption of these standards, have been included in Note 7, Financial Instruments.

**PhotoChannel Networks Inc.**  
**Notes to Consolidated Financial Statements**  
**Unaudited – Prepared by Management**  
(expressed in Canadian dollars)

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(c) Accounting Changes

On October 1, 2007, the Company adopted the recommendations of CICA Section 1506 Accounting Changes. This Handbook section provides for expanded disclosures to be made relating to changes in accounting policies, accounting estimates and corrections of errors. Under the new standard, accounting changes should be applied retrospectively unless otherwise permitted or where impracticable to determine. As well, voluntary changes in accounting policy are made only when required by a primary source of GAAP or the change results in more relevant and reliable information. The Company has not had any such changes which impact the interim financial statements.

**3. Recently issued accounting standards**

**CICA Handbook Section 3031, Inventories**

In March 2007, the CICA issued Handbook Section 3031, Inventories, which has replaced Section 3030 with the same title. This revision aligns Canadian GAAP with International Financial Reporting Standards. It establishes four basic principles: Inventory should be measured at the lower of cost and net realizable value; the cost of inventory includes costs directly attributable to its acquisition as well as an appropriate portion of fixed and variable production overheads; if the units in inventory are interchangeable, their cost should be determined using either a first-in first-out or weighted average cost formula; and write-downs of inventory to its net realizable value should be reversed if the value subsequently recovers. This section applies to interim and annual financial statements for years beginning on or after January 1, 2008 and will be adopted by the Company during the fiscal year beginning October 1, 2008. The Company expects there to be no impact on the consolidated financial statements as a result of implementing the requirements of this standard.

**CICA Handbook Section 3064, Goodwill and Intangible Assets**

In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets which will replace Handbook Section 3062, Goodwill and Other Intangible Assets and Section 3450, Research and Development Costs. This revision aligns Canadian GAAP with International Financial Reporting Standards and establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. This section applies to fiscal years beginning October 1, 2008 and will be adopted by the Company on that date. Management is currently in the process of determining the impact of this standard on the Company's consolidated financial statements.

**International Financial Reporting Standards**

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies will be required to converge with International Financial Reporting Standards ("IFRS") for fiscal years beginning on or after January 1, 2011 with comparatives presented on the same basis. The impact of the transition to IFRS on the Company's consolidated financial statements has not yet been determined.

# PhotoChannel Networks Inc.

## Notes to Consolidated Financial Statements

### Unaudited – Prepared by Management

(expressed in Canadian dollars)

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#### **Emerging Issues Committee Abstract 169, Determining whether a contract is routinely denominated in a single currency**

In January 2008, the CICA Emerging Issues Committee issued EIC 169, Determining whether a contract is routinely denominated in a single currency. This abstract provides guidance on how to interpret one particular requirement of CICA Handbook Section 3855, Financial Instruments – Recognition and Measurement relating to the accounting for contracts entered into which are denominated in a foreign currency. This abstract is applicable for interim and annual periods ending on or after March 2008 and must be applied retrospectively. The Company will adopt this abstract in the second quarter of fiscal 2008, commencing January 1, 2008. Management is currently in the process of determining the impact of this abstract on the Company's consolidated financial statements

#### **4. Seasonality of operations**

Demand for photofinishing products is highly seasonal, with a significant proportion of recurring revenues being generated during the Company's first fiscal (fourth calendar) quarter. The Company's limited operating history, coupled with its rapid growth may have overshadowed seasonal or cyclical factors which might have influenced business to date. Due to the seasonal nature of our business, the results of operations for any interim period are not necessarily indicative of the results of operations to be expected for the fiscal year.

#### **5. Acquisition of Pixology PLC**

On July 2, 2007, the Company acquired all of the outstanding shares of Pixology PLC ("Pixology"), a company incorporated in England and Wales and a provider of software and online solutions for the digital photography industry. The Company paid cash of \$18,657,729, including transaction costs of \$1,170,442.

The acquisition of Pixology gives the Company global reach and an international presence in the delivery of solutions for online printing. In addition, it expands the Company's product offerings into the important kiosk software market providing access to well established market-proven technology that could otherwise take up to two years to develop at an estimated cost of \$2,000,000.

The preliminary purchase price allocation summarizing the estimated fair value of the assets acquired and liabilities assumed at the date of the acquisition is as follows:

Cash and cash equivalents	\$	8,146,421
Other current assets		4,055,407
Property and equipment		462,104
Intangible assets – acquired software		3,923,616
Intangible assets – customer relationships		3,018,549
Goodwill		5,135,490
Current liabilities		(5,959,518)
Asset retirement obligations		(124,340)
Net identifiable assets and liabilities acquired for cash	\$	18,657,729

# PhotoChannel Networks Inc.

## Notes to Consolidated Financial Statements

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(expressed in Canadian dollars)

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The factors that contributed to the recognition of goodwill included securing access to development synergies, cost saving opportunities, access to additional markets around the world and the acquisition of a talented workforce.

This preliminary purchase price allocation is based on initial calculations by management of the fair value of assets and liabilities as of July 2, 2007. The final purchase price allocation is dependent on the finalization of valuations of certain intangible assets acquired, including customer relationships. Management expects to complete these valuations during the second quarter of fiscal 2008.

Any final adjustment may change the purchase price allocation, which could materially affect the residual value attributed to goodwill. None of the goodwill arising on the acquisition of Pixology is deductible for tax purposes.

#### 6. Asset retirement obligation

The following table summarizes the changes in the balance of asset retirement obligation during the period ended December 31, 2007:

Balance, September 30, 2007	\$	120,699
Accretion expense included in general and administration expenses		2,163
Impact of foreign currency translation		(4,358)
Balance, December 31, 2007	\$	118,504

The asset retirement obligation relates to the Company's requirement to restore leased premises to their original condition at the end of the lease term. As at December 31, 2007, the estimated total undiscounted cash flows required to settle the obligation are approximately \$116,000. The obligation is expected to be settled at the end of the lease term in 2008. The credit-adjusted risk-free interest rate used to discount the estimated cash flows was 7.5%.

#### 7. Financial instruments

The Company is exposed to a number of risks related to changes in foreign currency exchange rates, interest rates, collection of accounts receivable, settlement of liabilities and management of cash and cash equivalents.

The Company has established policies and procedures to manage these risks, with the objective of minimising any adverse effects that changes in these variables could have on the consolidated financial statements.

# **PhotoChannel Networks Inc.**

## **Notes to Consolidated Financial Statements**

### **Unaudited – Prepared by Management**

(expressed in Canadian dollars)

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#### **Classification of financial instruments**

The Company has made the following classifications for its financial instruments:

- Cash and cash equivalents are classified as "Assets held for trading" and are measured at fair value at the end of each period with any resulting gains or losses recognized in operations;
- Accounts receivable are classified as "Loans and receivables" and are recorded at amortized cost, which upon their initial measurement is equal to their fair value. Subsequent measurement of trade receivables is at amortized cost, which usually corresponds to the amount initially recorded less any allowance for doubtful accounts; and
- Accounts payable and accrued liabilities are classified as "Other financial liabilities" and are measured at amortized cost.

Included in accounts receivable on the face of the balance sheet are amounts of \$25,948 (September 30, 2007 - \$45,443), representing sales tax receivable.

#### **Credit risk**

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents and accounts receivable. The Company maintains cash and cash equivalents with various high credit quality financial institutions located in Canada and the United Kingdom. The Company's cash equivalents consist primarily of deposit investments with commercial banks in the United Kingdom. Of the amounts held with financial institutions on deposit, \$891,193 is covered by either the Financial Services Compensation Scheme in the United Kingdom or the Canada Deposit Insurance Corporation, leaving \$4,691,087 at risk should the financial institutions with which the deposits are held cease trading. The Company considers the likelihood of this happening to be remote.

The Company's accounts receivable are all from large, well-known retailers located in Canada, the United States and the United Kingdom. Credit risk from accounts receivable encompasses the default risk of retail customers. Prior to accepting new customers, the Company assesses the risk of default associated with a particular company.

Management does not believe that there is significant credit risk arising from any of the Company's customers; however, should one of the Company's main customers be unable to settle amounts due, the impact on the Company could be significant. The maximum exposure to loss arising from accounts receivable is equal to their total carrying amounts. As at December 31, 2007, four customers each account for 10% or more of total accounts receivable (September 30, 2007 – four customers).

**PhotoChannel Networks Inc.**  
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**Financial assets past due**

At December 31, 2007, the Company does not consider any of its financial assets to be impaired.

The following table provides information regarding the ageing of financial assets that are past due but which are not impaired.

**At December 31, 2007**

	Financial assets that are past due but not impaired				Carrying value on the balance sheet \$
	Neither past due nor impaired	31 – 60 days	61 – 90 days	91 days +	
Accounts receivable	41%	14%	13%	32%	4,521,263

The definition of items that are past due is determined by reference to terms agreed with individual customers. Of the 91 days+ balance at December 31, 2007, 3% has been subsequently collected and 26% relates to two companies for which the Company is withholding payments of corresponding amounts. None of the amounts outstanding have been challenged by the respective customer(s) and the Company continues to conduct business with them on an ongoing basis. Accordingly, management has no reason to believe that this balance is not fully collectable in the future.

The Company reviews financial assets past due on an ongoing basis with the objective of identifying potential matters which could delay the collection of funds at an early stage. Once items are identified as being past due, contact is made with the respective company to determine the reason for the delay in payment and to establish an agreement to rectify the breach of contractual terms.

**Interest rate risk**

The only financial instruments that expose the Company to interest rate risk are its cash and cash equivalents. The Company's objectives of managing its cash and cash equivalents are to ensure sufficient funds are maintained on hand at all times to meet day to day requirements and to place any amounts which are considered in excess of day to day requirements on short-term deposit with the Company's banks so that they earn interest. When placing amounts of cash and cash equivalents on short-term deposit, the Company only uses high quality commercial banks and ensures that access to the amounts placed can be obtained on short-notice.

# **PhotoChannel Networks Inc.**

## **Notes to Consolidated Financial Statements**

### **Unaudited – Prepared by Management**

(expressed in Canadian dollars)

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#### **Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach is to ensure that it has sufficient liquidity to meet its liabilities when due.

The Company does not have any borrowing or debt facilities and settles its financial obligations out of cash and cash equivalents. The ability to do this relies on the Company collecting its accounts receivables in a timely manner and by maintaining sufficient cash on hand.

The Company manages liquidity risk through ongoing review of accounts receivable balances and the following up of amounts past due and the management of its cash and cash equivalents and their allocation between cash on hand and short-term deposit.

At December 31, 2007, the Company's accounts payable and accrued liabilities were \$7,470,703 all of which fall due for payment within twelve months of the balance sheet date.

#### **Currency risk**

The Company generates revenues and incurs expenses and expenditures primarily in Canada, the United States and the United Kingdom and is exposed to risk from changes in foreign currency rates. In addition, the Company holds financial assets and liabilities in foreign currencies that expose the Company to foreign exchange risks. The Company does not utilise any financial instruments or cash management policies to mitigate the risks arising from changes in foreign currency rates.

At December 31, 2007, through its wholly owned, self-sustaining subsidiary, the Company had cash and cash equivalents of \$5,362,377, accounts receivable of \$2,930,461 and accounts payable of \$5,825,107 which were denominated in UK £. Gains and losses arising upon translation of these amounts into Canadian dollars for inclusion in the consolidated financial statements are recorded within other comprehensive income, a component of shareholders' equity.

#### **Market risk**

Market risk is the risk to the Company of adverse financial impact due to changes in the fair value of future cash flows of financial instruments as a result of fluctuations in interest rates and foreign currency exchange rates. Market risk arises as a result of the Company generating revenues and incurring expenses in foreign currencies, holding cash and cash equivalents which earn interest and having operations based in the United Kingdom in the form of its wholly owned subsidiary, Pixology.

The Company has completed a sensitivity analysis to estimate the impact on net loss and other comprehensive loss for the period which a 5% change in foreign exchange rates or 0.5% change in interest rates during the period ended December 31, 2007 would have had.

# PhotoChannel Networks Inc.

## Notes to Consolidated Financial Statements

### Unaudited – Prepared by Management

(expressed in Canadian dollars)

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This sensitivity analysis includes the following assumptions:

- Changes in individual foreign exchange rates do not cause foreign exchange rates in other countries to alter
- Changes in market interest rates only affects interest received on cash and cash equivalents held on deposit
- Changes in market interest rates do not cause a change in foreign exchange rates

The results of the sensitivity analysis can be seen in the following table:

	Impact on net loss	Impact on other comprehensive loss
	\$	\$
Change of +/- 5% in US\$ foreign exchange rate	+/- 25,000	-
Change of +/- 5% in UK£ foreign exchange rate	+/- 20,000	+/- 697,000
Change of +/- 0.5% in interest rates	+/- 5,200	-

The principal reason a change in UK£ exchange rates would impact other comprehensive loss so significantly is as a result of the Company's significant net investment in its wholly owned, United Kingdom based self-sustaining subsidiary.

#### *Limitations of sensitivity analysis*

The above table demonstrates the effect of either a change in foreign exchange rates or interest rates in isolation. In reality, there is a correlation between the two factors.

Additionally, the financial position of the Company may vary at the time that a change in either of these factors occurs, causing the impact on the Company's results to differ from that shown above.

## **8. Capital risk management**

The Company considers its share capital, warrants and contributed surplus as capital, which at December 31, 2007 totalled \$80,675,043.

The Company manages its capital structure in order to ensure sufficient resources are available to meet day to day operating requirements; to allow it to enhance existing product offerings as well as develop new ones and to have the financial ability to expand the size of its operations by taking on new customers. In managing its capital structure, the Company takes into consideration various factors, including the seasonality of the market in which it operates, the growth of its business and related infrastructure and the upfront cost of taking on new clients.

The Company's Board of Directors takes full responsibility for managing the Company's capital and does so through quarterly board meetings, review of financial information, and regular communication with Officers and senior management.

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Methods used by the Company to manage its capital include the issuance of new share capital and warrants which has historically been done through private placements primarily with institutional investors. Debt financing is not used by the Company at this time.

The Company is not subject to any externally imposed capital requirements.

**9. Accounts receivable**

	<b>As at December 31, 2007</b>	<b>As at September 30, 2007</b>
Trade accounts receivable	\$ 4,521,263	\$ 3,927,420
Goods and services tax recoverable	25,948	45,443
Other	81,366	72,172
<b>Total</b>	<b>\$ 4,628,577</b>	<b>\$ 4,045,035</b>

**10. Share capital, stock options and loans receivable**

**a) Consolidated statement of shareholders' equity**

	<b>Capital stock</b>		<b>Other capital accounts</b>				<b>Total shareholders' equity</b>
	<b>Number of Common Shares</b>	<b>Amount</b>	<b>Contributed surplus</b>	<b>Warrants</b>	<b>Deficit</b>	<b>Accumulated other comprehensive loss</b>	
<b>Balance - September 30, 2007</b>	33,315,536	\$ 65,293,214	\$ 10,215,777	\$ 4,961,826	\$ (62,050,122)	\$ (809,569)	\$ 17,611,126
Issuance of shares on exercise of options	19,702	40,123	(11,357)	-	-	-	28,766
Stock-based compensation recorded in net loss	-	-	175,460	-	-	-	175,460
Loss for the period	-	-	-	-	(1,082,600)	-	(1,082,600)
Other comprehensive loss	-	-	-	-	-	(496,001)	(496,001)
<b>Balance December 31, 2007</b>	<b>33,335,238</b>	<b>\$ 65,333,337</b>	<b>\$ 10,379,880</b>	<b>\$ 4,961,826</b>	<b>\$ (63,132,722)</b>	<b>\$ (1,305,570)</b>	<b>\$ 16,236,751</b>

**b) Options**

The Company has a stock option plan (the "Plan") which is described in note 11(e) to the most recent audited consolidated financial statements for the year ended September 30, 2007. The Plan grants to directors, employees and consultants of the Company the option to purchase common shares of the Company. The Plan allows for a maximum of 10% of the Company's issued and outstanding common shares be reserved for issuance, less any previously granted and outstanding options. As at December 31, 2007, the Company has reserved 1,579,563 common shares. 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 options' maximum term is five years as determined by the rules of the TSX Venture Exchange. Options vest over eighteen (18) months. During the three months ended December 31, 2007, no options (Three months ended December 31, 2006 – 745,000) were granted to employees.

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**11. Segment information**

The Company has a single reportable segment based on the manner in which the Company has organized its operations and provision of financial information to senior management.

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

Description	Three Months Ended December 31, 2007	Three Months Ended December 31, 2006
Canada	\$ 1,155,131	\$ 1,129,220
United States	555,165	383,178
United Kingdom	2,588,298	-
Other	-	8,864
Total	\$ 4,298,594	\$ 1,521,262

Revenue is attributable to the geographic location of the Company's customer. As at December 31, 2007 and September 30, 2007, the Company's assets by geographical location are as follows:

	Canada	United Kingdom	Total
<b>December 31, 2007</b>			
Property and equipment	\$ 2,913,640	\$ 373,711	\$ 3,287,351
Goodwill and intangible assets	\$ -	\$ 10,057,904	\$ 10,057,904
<b>September 30, 2007</b>			
Property and equipment	\$ 2,354,737	\$ 405,808	\$ 2,760,545
Goodwill and intangible assets	\$ -	\$ 10,934,845	\$ 10,934,845

Major customers representing 10% or more of the Company's sales for the period are as follows:

	Three Months Ended December 31, 2007	Three Months Ended December 31, 2006
Customer A	\$ 1,443,642	\$ 788,658
Customer B	\$ 979,073	\$ -
Customer C	\$ 453,650	\$ 330,606
Customer D	\$ 188,745	\$ 230,017

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**12. Related Party Transactions**

During the period ended December 31, 2007, the Company advanced loans to officers of the Company in the amount of \$68,000 with interest payable at a rate of 7% per annum. Included in accounts receivable at December 31, 2007 is \$68,761, comprising the principal amount and accrued interest. These loans fall due for repayment within one year from the date of issue. At September 30, 2007, an amount of \$48,615 was due from an officer of the Company. This amount was repaid in full on October 25, 2007.

During the period ended December 31, 2007, the Company incurred legal fees of \$22,558 (period ended December 31, 2006 - \$29,082) for services provided by a law firm of which a director of the Company is a partner. Accounts payable and accrued liabilities at December 31, 2007 included \$9,044 (September 30, 2007 \$47,334) related to these services.

During the period ended December 31, 2007, the Company incurred expenses in relation to setting up e-mail marketing campaigns on behalf of a number of our retail customers of \$23,860 (Period ending December 31, 2006 - \$nil) with a company of which a director of the Company is Chairman and Chief Executive Office. Accounts payable and accrued liabilities at December 31, 2007 included \$13,000 (September 30, 2007 - \$nil) related to these services. The amounts charged were recorded at their exchange amount, which is the amount of consideration established and agreed to by the related parties and having normal trade terms.

**13. Revenue**

Description	Three Months	Three Months
	Ended	Ended
	December 31, 2007	December 31, 2006
Transaction fees	\$ 3,018,482	\$ 1,044,195
Installation fees	973,063	143,063
Membership fees	170,322	232,479
Professional fees	136,727	86,518
Archive fees	-	15,007
Total	<u>\$ 4,298,594</u>	<u>\$ 1,521,262</u>

**14. Commitments**

At December 31, 2007, the Company was committed to purchasing items of equipment with a cost of \$3,004,824 (2006 - \$Nil).

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**15. Reconciliation to accounting principles generally accepted in the United States of America**

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”), which differ in certain material respects from those principles and practices that the Company would have followed had its financial statements been prepared in accordance with accounting principles and practices generally accepted in the United States (“US GAAP”).

The reconciliation of the loss for the year based on Canadian GAAP to US GAAP is as follows:

- (a) The reconciliation between Canadian GAAP and US GAAP of the net loss for the period is as follows:

	<b>Three Months Ended December 31, 2007</b>	<b>Three Months Ended December 31, 2006</b>
Net loss for the period under Canadian GAAP	\$ (1,082,600)	\$ (37,191)
Change in fair value of embedded foreign currency derivatives relating to warrants	(84,249)	-
Net loss for the period under U.S. GAAP	<u>(1,166,849)</u>	<u>(37,191)</u>
Other comprehensive loss:		
Unrealized foreign exchange loss on translation of self-sustaining foreign operations	(496,001)	-
Comprehensive loss under U.S. GAAP	<u>\$ (1,662,850)</u>	<u>\$ (37,191)</u>
Basic and fully diluted loss per share under U.S. GAAP	<u>\$ (0.05)</u>	<u>\$ (0.00)</u>

At December 31, 2007, 4,857,147 warrants (2006 – 1,260,987) and 1,579,563 options (2006 – 2,034,660) were outstanding and could potentially dilute basic earnings per share, but were excluded from the calculation of diluted shares as their effects would anti-dilutive.

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(b) The reconciliation of the balance sheet between Canadian GAAP and U.S. GAAP is as follows:

	December 31, 2007		September 30, 2007	
	Canadian GAAP	U.S. GAAP	Canadian GAAP	U.S. GAAP
<b>ASSETS</b>				
Current assets	\$ 10,812,998	\$ 10,812,998	\$ 11,973,425	\$ 11,973,425
Intangible assets	5,321,221	5,321,221	6,067,614	6,067,614
Goodwill	4,736,683	11,247,746	4,867,231	11,378,294
Other long-term assets	3,360,317	3,360,317	2,850,349	2,850,349
Total assets	<u>\$ 24,231,219</u>	<u>\$ 30,742,282</u>	<u>\$ 25,758,619</u>	<u>\$ 32,269,682</u>
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>				
Current liabilities	\$ 7,708,335	\$ 7,708,335	\$ 7,855,584	\$ 7,855,584
Warrants liability	-	4,777,986	-	4,693,737
Long-term liabilities	286,133	286,133	291,909	291,909
<b>SHAREHOLDER'S EQUITY</b>				
Share capital	65,333,337	65,225,177	65,293,214	65,185,054
Warrants	4,961,826	-	4,961,826	-
Contributed surplus	10,379,880	12,737,881	10,215,777	12,573,778
Deficit	(63,132,722)	(58,687,660)	(62,050,122)	(57,520,811)
Accumulated other comprehensive loss	(1,305,570)	(1,305,570)	(809,569)	(809,569)
	<u>\$ 24,231,219</u>	<u>\$ 30,742,282</u>	<u>\$ 25,758,619</u>	<u>\$ 32,269,682</u>

(c) Stock-based compensation

Effective October 1, 2004, the Company adopted FAS No. 123, Accounting for Stock-Based Compensation, as subsequently revised by FAS No. 123(R) ("FAS 123(R)"), Share-Based Payment, effective October 1, 2006. The adoption of FAS 123(R), effective October 1, 2006 under the modified prospective method, had no material impact on the Company's financial position or results of operations. Under US GAAP, the Company recognizes the grant-date fair value of stock-based compensation awards granted to employees and directors over the requisite service period for all awards granted, modified, repurchased or cancelled after October 1, 2004 and the unvested portions of outstanding awards as at October 1, 2004. The Company also adopted CICA Handbook Section 3870, Stock-Based Compensation and Other Stock-Based Payments effective October 1, 2004 for awards granted on or after October 1, 2002.

As a result of these new accounting standards in Canada and the United States, there are no material GAAP differences related to the Company's stock-based compensation awards during the period ended December 31, 2007 and 2006.

At December 31, 2007, the total compensation cost related to non-vested awards not yet recognized was \$292,381, which will be recognized over the remaining vesting period of 5 months.

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(d) Warrant Liability

Under US GAAP, the Securities Exchange Commission (“SEC”) determined that it is not possible to treat as equity, warrants whose exercise price currency denomination is different from the functional currency of the entity. The SEC generally views such instruments as derivative liabilities. Therefore, the Company applied FAS No. 133, “Accounting for Derivative Instruments and Hedging Activities”, and allocated the fair value of warrants issued whose exercise price currency denomination is different than the Company’s functional currency as a liability, to be carried at fair value, with changes in fair value to be recorded in operations. The change in fair value of these warrants for the period ended December 31, 2007 was \$84,249 and was charged to operations.

(e) Cash flow statements

The Canadian accounting standard for the preparation of cash flow statements is consistent with the guidance provided by International Accounting Standard (IAS) 7, and accordingly, the cash flow statements presented herein have not been reconciled to US GAAP under the accommodation provided by the SEC.

(f) Redemption of Limited Partnership units

During the year ended September 30, 2004, the Company redeemed limited partnership units and recorded the cost as a charge to deficit for Canadian GAAP purposes. Under US GAAP, the Company applied SFAS No. 141, “Business Combinations”, and allocated the cost of issuing the common shares and share purchase warrants to goodwill, after first considering any allocation to tangible and intangible assets acquired. This resulted in an increase of \$6,511,063 in goodwill and shareholders’ equity. The Company applies SFAS No. 142, “Goodwill and Other Intangible Assets”, in determining if there is any impairment in value. As at December 31, 2007, no impairment in value has been recorded to date.

(g) Accounts receivable

No allowance for doubtful accounts has been included against accounts receivable in the first quarter of fiscal 2008 or 2007.

(h) Income taxes

The Company follows the liability method with respect to accounting for income taxes. Deferred tax assets and liabilities are determined based on temporary differences between the carrying amounts and the tax basis of assets and liabilities. Deferred income tax assets and liabilities are measured using enacted tax rates that will be in effect when these differences are expected to reverse. Deferred income tax assets are reduced by a valuation allowance, if based on the weight of available evidence; it is more likely than not that some portion or all of the deferred tax assets will not be realized.

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In July 2006, the Financial Accounting Standards Board (the “FASB”) issued Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes, or “FIN 48”, which clarifies the accounting for uncertainty in income taxes recognized in a company’s financial statements in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the de-recognition, classification, interest and penalties, accounting in interim periods, and disclosure requirements for uncertain tax positions. The Company adopted the provisions of FIN 48 beginning October 1, 2007.

We file income tax returns in the U.S., Canada and the United Kingdom. We are subject to income tax examination by tax authorities in all jurisdictions from our inception to date. Our policy is to recognize interest expense and penalties related to income tax matters as tax expense. At December 31, 2007, we do not have any significant accruals for interest related to unrecognized tax benefits or tax penalties. Based on the Company’s evaluation, there are no significant uncertain tax positions requiring recognition in accordance with FIN 48.

(i) Commitments:

During the period ended December 31, 2007, the Company incurred operating lease expenses of \$210,873 (Period ended December 31, 2006 - \$42,055).

(j) Recent U.S. announcements

*FASB 157 – Fair Value Measurement*

FAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. These definitions would be applied effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently assessing the impact of this statement.

*FASB 159 – The Fair Value for Financial Assets and Financial Liabilities*

In February 2007, the FASB issued FAS No. 159, The Fair Value for Financial Assets and Financial Liabilities (“FAS No. 159”). FAS No. 159 permits entities to choose to measure financial assets and liabilities, with certain exceptions, at fair value at specified election dates. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. FAS No. 159 is effective for the Company in fiscal years beginning October 1, 2008. The Company is currently evaluating the impact of FAS No. 159 on its consolidated financial position and results of operations.

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*FASB 141(R) – Business Combinations*

In December 2007, the FASB issued FAS No. 141(R), Business Combinations ("FAS 141(R)"). FAS 141(R) establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. FAS 141(R) also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. FAS 141(R) is effective for the Company in fiscal years beginning October 1, 2009. This standard will only be applicable to acquisitions after October 1, 2009. While the Company has not yet evaluated this statement for the future impact of FAS 141(R), the Company does not expect FAS 141(R) to have any impact on its consolidated financial position and results of operations related to its current businesses.

*FAS 160 – Non-controlling Interests in Consolidated Financial Statements*

In December 2007, the FASB issued FAS No. 160, Non-controlling Interests in Consolidated Financial Statements. FAS 160 requires ownership interests in subsidiaries held by other parties to be classified as equity in the consolidated financial statements and changes in ownership interests in a subsidiary to be accounted for as equity transactions. Deconsolidation of a subsidiary is to be accounted for at fair value. FAS 160 is applicable for fiscal years beginning on or after December 15, 2008 on a prospective basis, except for the presentation and disclosure requirements which are to be applied to all periods presented. While the Company has not evaluated this new standard, the Company does not currently have any partially owned subsidiaries and does not expect, based on its current structure, the adoption to have any significant impact.