



PHOTOCHANNEL NETWORKS INC.

3rd Quarter Report

June 30, 2002

**British Columbia Securities Commission
Quarterly and Year End Report
BC Form 51-901F**

ISSUER DETAILS

NAME OF ISSUER	FOR QUARTER ENDED	DATE OF REPORT		
		Y	M	D
PhotoChannel Networks Inc.	June 30, 2002	2002	08	29

ISSUER ADDRESS

506 – 425 Carrall Street

CITY	PROVINCE	POSTAL CODE	ISSUER FAX NO.	ISSUER TELEPHONE NO.
Vancouver	B. C.	V6B 6E3	604-893-8966	604-893-8955

CONTACT NAME	CONTACT POSITION	CONTACT TELEPHONE NO.
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CERTIFICATE

The Three schedules required to complete this Report are attached and the disclosure contained therein has been approved by the Board of Directors. A copy of this Report will be provided to any shareholder who requests it.

		Y	M	D
<i>“Peter Scarth”</i>	Peter Scarth	02	08	29
Director’s Signature	Print Full Name	Date Signed		

<i>“Cory Kent”</i>	Cory Kent	02	08	29
Director’s Signature	Print Full Name	Date Signed		

PhotoChannel Networks Inc.

Consolidated Balance Sheet

Unaudited – Prepared by Management

(expressed in Canadian dollars)

	<u>June 30, 2002</u>	<u>September 30, 2001</u>
Assets		
Current assets		
Cash and cash equivalents	\$ 723,749	\$ 5,791
Short term deposits	-	10,187
Cash held in trust	1,434	226
Accounts receivable	310,537	88,004
Prepaid expenses and deposits	16,606	26,767
	<u>1,052,326</u>	<u>130,975</u>
Capital assets	<u>677,893</u>	<u>1,357,301</u>
	<u>\$ 1,730,219</u>	<u>\$ 1,488,276</u>
Liabilities		
Current liabilities		
Trade accounts payable	\$ 1,381,152	\$ 4,483,316
Accrued liabilities	144,716	701,954
Advance on private placement	350,000	508,873
Current portion of obligation under capital leases	-	453,658
Demand loan (note 4)	262,826	467,986
	<u>2,138,694</u>	<u>6,615,787</u>
Long Term Liabilities		
Related Parties (note 4)	273,612	
Shareholders' Equity		
Capital stock	26,885,005	24,227,367
Limited partnership equity (note 2)	1,250,000	-
Special warrants	-	-
Warrants	-	1,889,000
Other contributed surplus	7,757,126	5,868,126
Deficit	(36,574,218)	(37,112,004)
	<u>(682,087)</u>	<u>(5,127,511)</u>
	<u>\$ 1,730,219</u>	<u>\$ 1,488,276</u>

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

PhotoChannel Networks Inc.

Consolidated Statements of Income (Loss) and Deficit

Unaudited – Prepared by Management

(expressed in Canadian dollars)

	Quarter Ended		Nine Months Ended	
	June 30, 2002	June 30, 2001	June 30, 2002	June 30, 2001
Revenue	\$ 48,674	\$ 9,490	\$ 133,419	\$ 61,809
Cost of sales	8,964	8,958	94,275	61,235
Gross profit	39,710	532	39,144	574
Expenses				
General and administration	604,746	609,589	1,817,429	7,436,052
Sales and marketing	177,878	106,578	297,555	1,952,184
Research and development	163,554	179,433	502,675	1,243,487
Amortization	223,079	530,706	668,092	3,217,453
	1,169,257	1,426,306	3,285,751	13,849,176
Loss from operations	1,129,547	1,425,774	3,246,607	13,848,602
Other Income				
Expense recovery (note 3)	1,292,289	-	4,039,233	-
Interest and miscellaneous income	62	9,685	599	54,432
	1,292,351	9,685	4,039,832	54,432
Gain (Loss) for the year	162,804	(1,416,089)	793,225	(13,794,170)
Translation Gain (Loss)	(143,819)	(744,472)	(255,439)	(474,548)
Deficit - beginning of period	(36,593,203)	(29,348,929)	(37,112,004)	(17,240,772)
Deficit - end of period	<u>\$ (36,574,218)</u>	<u>\$ (31,509,490)</u>	<u>\$ (36,574,218)</u>	<u>\$ (31,509,490)</u>
Gain (Loss) per share attributable to common shareholders	<u>\$ 0.00</u>	<u>\$ (0.04)</u>	<u>\$ 0.02</u>	<u>\$ (0.42)</u>
Weighted average number of common shares outstanding	<u>51,460,583</u>	<u>32,590,104</u>	<u>51,460,583</u>	<u>32,590,104</u>

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

PhotoChannel Networks Inc.

Consolidated Statements of Cash Flows

Unaudited – Prepared by Management

(expressed in Canadian dollars)

	Quarter Ended		Nine Months Ended	
	June 30, 2002	June 30, 2001	June 30, 2002	June 30, 2001
Cash flows from operating activities				
Gain (Loss) for the period	\$ 162,804	\$ (1,416,089)	\$ 793,225	\$ (13,794,170)
Items not affecting cash				
Amortization	223,079	530,706	668,092	3,217,453
	385,883	(885,383)	1,461,317	(10,576,717)
Net change in non-cash working capital items	(795,952)	342,705	(3,871,774)	4,182,029
	(410,069)	(542,678)	(2,410,457)	(6,394,688)
Cash flows from investing activities				
Disposal (Purchase) of capital assets	(22,161)	792,676	11,316	(608,239)
Short term deposits	-	(30)	10,187	744,243
	(22,161)	792,646	21,503	136,004
Cash flows from financing activities				
Cash in trust	-	(21,954)	(1,208)	(21,954)
Long term liabilities	273,612	-	273,612	-
Repayment on capital lease	(453,658)	(20,461)	(453,658)	(66,008)
Advance on private placement	(32,882)	-	(158,873)	-
Demand loan	262,826	297,012	(205,160)	455,411
Issuance of common shares - net of expenses	-	-	2,657,638	1,010,377
Issuance of Warrants - net of expenses	-	-	-	-
Limited partnership units	1,249,900	-	1,250,000	-
Translation adjustment	(143,819)	(499,697)	(255,439)	(340,792)
	1,155,979	(245,100)	3,106,912	1,037,034
Increase (decrease) in cash and cash equivalents	723,749	4,868	717,958	(5,221,650)
Cash and cash equivalents - beginning of period	-	2,539	5,791	5,229,057
Cash and cash equivalents - end of period	\$ 723,749	\$ 7,407	\$ 723,749	\$ 7,407

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

PhotoChannel Networks Inc.

Notes to Consolidated Financial Statements

June 30, 2002

Unaudited – Prepared by Management

(expressed in Canadian dollars)

Note 1:

While the information presented in the accompanying interim nine month financial statements is unaudited, it includes all adjustments which are, in the opinion of management, necessary to present fairly the financial position, results of operations and cash flows for the interim period presented. It is suggested that these interim financial statements be read in conjunction with the Company's September 30, 2001 annual audited statements. These financial statements follow the same accounting policies and methods as the Company's September 30, 2001 annual financial statements.

Note 2:

On February 14, 2002, PhotoChannel Networks Limited Partnership (the "PhotoChannel LP") was formed under a Limited Partnership Agreement to carry on the sales, marketing and deployment of the PhotoChannel Network in specified market segments. On June 4, 2002, the PhotoChannel LP closed on a private placement of 1,250 Limited Partnership units (the "LP Units"), at a price of \$1,000 per unit. PhotoChannel has granted to PhotoChannel LP a software license to commercially exploit the PhotoChannel Network in Canada. PhotoChannel will receive payments for services provided to the PhotoChannel LP from a software license agreement and management and operating services agreements (representing software rights, management, personnel and facilities and equipment that PhotoChannel has agreed to provide to PhotoChannel LP), which will enable PhotoChannel to continue its development, deployment and exploitation of its leading edge digital imaging network software in other market segments.

It was a condition of the PhotoChannel LP that each limited partner enter into an agreement with PhotoChannel, pursuant to which PhotoChannel has the right to acquire the LP Units from the limited partner, at any time on or before June 30, 2004, in exchange for 10,000 units of PhotoChannel, each unit comprised of one common share and one common share purchase warrant. Each warrant will entitle the holder to purchase a further common share of PhotoChannel, at a price of \$0.10 per share, at any time on or before the earlier of two years from the date of issue of the PhotoChannel units and June 30, 2004.

Note 3:

The Company reported an expense recovery of \$4,039,233 for the nine months ended June 30, 2002. This amount was the result of two separate occurrences. First, on November 1, 2001, PhotoChannel, Inc., the Company's US operating subsidiary, filed under Chapter 7 of the United States Bankruptcy Code with the United States Bankruptcy Court, District of Connecticut. PhotoChannel, Inc.'s principal operations related to the provision of online photo-print services directly to consumers. The provision of this service did not prove viable, and PhotoChannel, Inc. was unable to continue as an operating entity. Of the total expense recovery for the period ended June 30, 2002, \$2,746,944 resulted from the bankruptcy of PhotoChannel, Inc. and the remaining

\$1,292,289 was the result of debt settlements with various creditors in PhotoChannel Networks Inc. for cents on the dollar.

Note 4:

As at June 30, 2002, a director had made cash loans to the Company totaling \$162,826. In addition, a significant shareholder had made a loan to the Company in the amount of \$100,000. Over the last 14 months, the Company has, also, accrued a total of \$273,612 for wages and consulting fees by employees and consultants of the Company, which to date have been unpaid. As at June 30, 2002, the Company has signed a promissory with each of these employees and/or consultants, converting this amount to a long-term loan, which will be due at the early of September 30, 2003 or such earlier date as the Company has sufficient working capital. These notes are non-interest bearing.

Note 5:

Gain (Loss) per share has been calculated based on a basic earnings per share basis, as calculation on a fully dilutive basis would have been anti-dilutive.