

**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.	December 31, 2001	2002 03 01

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.
Robert Chisholm	C. F. O.	604-893-8955 ext. 224

CONTACT EMAIL ADDRESS	WEBSITE ADDRESS
rchisholm@photochannel.com	photochannel.com

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	2002	03	01
Director’s Signature	Print Full Name	Date Signed		

<i>“Kyle Hall”</i>	Kyle Hall	2002	03	01
Director’s Signature	Print Full Name	Date Signed		

PhotoChannel Networks Inc.

Consolidated Balance Sheet

As at December 31, 2001 and 2000

Unaudited – Prepared by Management

(expressed in Canadian dollars)

	<u>(Unaudited)</u> December 31, 2001	<u>(Unaudited)</u> September 30, 2001
Assets		
Current assets		
Cash and cash equivalents	\$ 1,031	\$ 5,791
Short term deposits	10,187	10,187
Cash Held in Trust	2,533	226
Accounts receivable	289,332	88,004
Prepaid expenses and deposits	29,014	26,767
	<u>332,097</u>	<u>130,975</u>
Capital assets	<u>1,215,642</u>	<u>1,357,301</u>
	<u>\$ 1,547,739</u>	<u>\$ 1,488,276</u>
Liabilities		
Current liabilities		
Trade accounts payable	\$ 2,178,653	\$ 4,483,316
Accrued liabilities	107,007	701,954
Advance on Private Placement	-	508,873
Current portion of obligation under capital leases	453,658	453,658
Demand loan	-	467,986
	<u>2,739,318</u>	<u>6,615,787</u>
Shareholders' Equity		
Capital stock	24,227,367	24,227,367
Special warrants	2,657,638	-
Warrants	1,889,000	1,889,000
Other Contributed Surplus	5,868,126	5,868,126
Deficit	<u>(35,833,710)</u>	<u>(37,112,004)</u>
	<u>(1,191,579)</u>	<u>(5,127,511)</u>
	<u>\$ 1,597,739</u>	<u>\$ 1,488,276</u>

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

PhotoChannel Networks Inc.

Consolidated Statements of Gain and Loss

For the three months ended December 31, 2001 and 2000

Unaudited – Prepared by Management

(expressed in Canadian dollars)

	<u>2001</u>	<u>2000</u>
Revenue	\$ 53,423	\$ 32,889
Cost of sales	81,547	23,682
Gross profit	(28,124)	9,207
Expenses		
General and administration	908,968	3,812,508
Sales and marketing	73,900	1,359,737
Research and development	164,426	547,452
Amortization	112,981	631,339
Interest expense	-	-
	<u>1,260,275</u>	<u>6,351,036</u>
Loss from operations	1,288,399	6,341,829
Other Income		
Expense recovery	2,746,944	-
Interest and miscellaneous income	493	61,402
	<u>2,747,437</u>	<u>61,402</u>
Gain (Loss) for the year	1,459,039	(6,280,427)
Translation Gain (Loss)	(180,744)	113,991
Deficit - beginning of year	<u>(37,112,004)</u>	<u>(17,565,664)</u>
Deficit - end of year	<u>\$ 35,981,710</u>	<u>\$ 23,732,100</u>
Gain (loss) per share attributable to common shareholders	<u>\$ 0.03</u>	<u>\$ (0.40)</u>
Weighted average number of common shares outstanding	<u>41,776,587</u>	<u>15,748,263</u>

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

PhotoChannel Networks Inc.

Consolidated Statements of Cash Flows

For the three months ended December 31, 2001 and 2000

Unaudited – Prepared by Management

(expressed in Canadian dollars)

	<u>2001</u>	<u>2000</u>
Cash flows from operating activities		
Gain (Loss) for the period	\$1,459,039	\$(6,280,427)
Items not affecting cash		
Amortization	112,981	631,339
	<u>1,572,020</u>	<u>(5,649,088)</u>
Net change in non-cash working capital items	(3,612,059)	708,006
	<u>(2,040,039)</u>	<u>(4,941,082)</u>
Cash flows from investing activities		
Disposal (Purchase) of capital assets	28,678	(432,717)
Short term deposits	-	548,146
	<u>28,678</u>	<u>115,429</u>
Cash flows from financing activities		
Cash in trust	(2,307)	-
Repayment on capital lease	-	(52,408)
Issuance of common shares, net of expenses	-	910,821
Convertible debenture	(467,986)	-
Issuance of Special Warrants - net of expenses	2,657,638	-
Translation adjustment	(180,744)	(216,289)
	<u>2,006,601</u>	<u>642,124</u>
Increase (decrease) in cash and cash equivalents	(4,760)	(4,183,529)
Cash and cash equivalents - beginning of year	<u>5,791</u>	<u>5,229,057</u>
Cash and cash equivalents - end of period	<u>\$ 1,031</u>	<u>\$ 1,045,528</u>

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

PhotoChannel Networks Inc.

Notes to Consolidated Financial Statements

December 31, 2001, and 2000

Unaudited – Prepared by Management

(expressed in Canadian dollars)

Note 1:

While the information presented in the accompanying interim three 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 financial statements. These financial statements follow the same accounting policies and methods as the Company's September 30, 2001 annual financial statements.

Note 2:

Expense recovery is the result of PhotoChannel, Inc. filing under Chapter 7 of the United States Bankruptcy Code with the United States Bankruptcy Court, District of Connecticut on November 1, 2001.

Note 3:

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.

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rchisholm@photochannel.com	photochannel.com

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

<u>“Peter Scarth”</u>	Peter Scarth	March 1, 2002
Director’s Signature	Print Full Name	Date Signed

<u>“Kyle Hall”</u>	Kyle Hall	March 1, 2002
Director’s Signature	Print Full Name	Date Signed

SCHEDULE "B"

PhotoChannel Networks Inc.

Year-To-Date Ended December 31, 2001 and 2000

1. Analysis of expenses and deferred costs

	December 31, 2001	December 31, 2000
General and administration		
Accounting and legal	116,393	328,338
Investor relations	11,208	161,175
Office and miscellaneous	185,142	1,038,968
Salaries and consulting	574,527	2,109,504
Rent	21,698	174,523
	<u>908,968</u>	<u>3,812,508</u>
Sales and marketing		
Miscellaneous	14,898	27,494
Printing, advertising and promotion	-	1,238,330
Salaries and consulting	59,002	93,913
	<u>73,900</u>	<u>1,359,737</u>
Research and development		
Website planning	-	105,355
Salaries and consulting	164,034	428,340
Miscellaneous	392	13,757
	<u>164,426</u>	<u>547,452</u>

2. Related Party Transactions

There were no related party transactions to date in the year.

3. Summary of securities issued and options granted during the period.

(a) Summary of securities issued during the period

Date of Issue	Type of Security	Type of Issue	Number	Price	Total Proceeds	Type of Consideration	Type of Commission Paid
Oct 17, 2001	Special Warrants	Private Placement	26,576,381	\$0.10	\$2,657,638	Cash & Debt Settlement	NIL

(b) Summary of options granted during the period.

Date	Number	Name of Insider Optionee	Description of other Optionee	Exercise Price	Expiry Date
	NIL				

4. Summary of Securities as at the end of the reporting period

(a) Authorized Share Capital as at December 31, 2001

Class	Authorized
Common Shares	500,000,000
Preferred Shares	10,000,000

(b) Number and Value of Shares Issued and Outstanding as at December 31, 2001

Class	Issued	Value
Common Shares	41,776,587	\$2,506,595

(c) Options, Warrants and Convertible Securities Outstanding as at December 31, 2001

Security	Number	Exercise Price	Value	Expiry Date
Share Purchase Warrants	1,000,000	\$1.75 US	\$1,750,000	May 11, 2005
Stock Options	10,000	\$1.47	Nil	Apr 16, 2002
Stock Options	175,000	\$1.13	Nil	Feb. 19, 2003
Stock Options	87,000	\$0.50	Nil	Oct. 8, 2003
Stock Options	108,333	\$0.50	Nil	Feb. 3, 2004
Stock Options	125,000	\$0.72	Nil	Apr. 20, 2004
Stock Options	475,000	\$1.00	Nil	Mar. 16, 2005
Stock Options	150,000	\$1.91	Nil	May 31, 2005
Stock Options	355,736	\$1.00 US	Nil	June 28, 2005
Stock Options	50,000	\$1.00 US	Nil	June 29, 2005
Stock Options	299,320	\$1.00 US	Nil	July 25, 2005
Stock Options	199,320	\$1.00 US	Nil	Aug. 10, 2005
Stock Options	100,000	\$1.00 US	Nil	Sept. 18, 2005
Stock Options	100,000	\$1.57	Nil	Oct. 2, 2005
Stock Options	915,480	\$1.47	Nil	Oct. 3, 2005
Stock Options	25,000	\$1.00 US	Nil	Oct. 16, 2005
Stock Options	100,000	\$1.00 US	Nil	Oct. 27, 2005
Stock Options	65,000	\$1.00 US	Nil	Nov. 17, 2005
Stock Options	100,000	\$1.00 US	Nil	Nov. 27, 2005
Stock Options	575,000	\$1.47	Nil	Dec. 2, 2005
Stock Options	100,000	\$1.00 US	Nil	Dec. 4, 2005
Stock Options	5,400,000	\$0.15	Nil	July 26, 2006
Special Warrants ⁽¹⁾	26,576,381	Nil	\$2,657,638	Feb. 17, 2002

⁽¹⁾ Each Special Warrant is exercisable to acquire, for no additional consideration, one common share and one common share purchase warrant. Each warrant will entitle the holder to acquire a further common share at a price of \$0.10 per share at any time on or before October 17, 2002. Each Special Warrant was deemed exercised on February 17, 2002, and the underlying common shares and warrants issued.

(d) Shares in Escrow as at December 31, 2001

NIL

5. List of directors and officers as at December 31, 2001

Directors

Peter Scarth
Peter Fitzgerald
Cory Kent
Kyle Hall
TJ Kerbs

Officers

Peter Scarth, Chief Executive Officer
Kyle Hall, President and Chief Operating Officer
Timothy J Kerbs, Executive Vice President
Robert Chisholm, Chief Financial Officer
Mo Asgari, V.P. Technology
Pat Spice, Secretary

SCHEDULE “C”

MANAGEMENT DISCUSSION AND ANALYSIS

Description of Business

PhotoChannel Networks Inc. (“PhotoChannel” or the “Company”) is an e-commerce and Internet infrastructure company providing the photo-finishing retailer with an electronic “turnkey” networked solution for its customers, through the “PhotoChannel Network”. The PhotoChannel Network electronically connects the photo-finishing retailer and its customers through the Internet and additionally provides hosting and storage and backend reporting. This turnkey network solution enables the photo-finishing retailer to meet the needs of its customers for both film and digital photography.

The company has focused its operational efforts on deploying the PhotoChannel Network within photo-finishing retail partner locations. The on-line photo-finishing operation located at www.photochannel.com, while still being functionally active, has ceased to be the major focus of the Company’s business.

The Company is headquartered in Vancouver, British Columbia, Canada and trades on the Canadian Venture Exchange in Canada (symbol – PNI). The accompanying financial statements for the first quarter ended December 31, 2001 are expressed in Canadian dollars.

Operations and Financial Condition

Revenue for the first quarter ended December 31, 2001 was \$53,423 versus \$32,889 the same quarter last year. Revenue for the period ended December 31, 2001 consisted of revenue generated from the PhotoChannel Network connecting photo-finishing retailers to their customers. Revenue for the comparable period of 2000 consisted from revenue generated from the online photo print service, which is no longer the Company’s direction. Revenue increased 62% for the three months ended December 31, 2001 due to the change in business focus and new PhotoChannel Network customers.

Management’s strategy for the Company as an e-commerce and Internet infrastructure company is to generate substantially all future revenue from monthly fees charged to members of The PhotoChannel Network, transaction fees for photographs printed through the Network and fees for the storage of photographs by the photo-finishing retailers’ customers.

The Company reported a gross profit loss for the period of \$28,124 versus a gross profit of \$9,207 for the comparable period of 2000. This loss was the result of the large upfront costs associated with connecting new customers to the PhotoChannel Network. These one-time costs are associated with SDSL line hook-ups and the cost of physically connecting the PhotoChannel Network to the photo-finishing retailers’ LAN.

The Company's first quarter cost of operations were \$1,260,275, as compared to \$6,351,036 during the same period last year. This reduction is attributable to major cost cutting as the result of the Company's restructuring in March 2001.

General and administration expenses for the three months ended December 31, 2001 decreased 76.2% or \$2,903,540 over the comparable period in 2000. This was due to a significant reduction in expenses related to accounting and legal, investor relations, office, travel, salary and consulting expenses and general corporate administration. During this quarter the Company expended \$11,208 on investor relations.

Sales and marketing expenses for the first quarter ended December 31, 2001 decreased \$1,285,837 to \$73,900, a reduction of 94.3% from the comparable quarter of 2000. This reduction was mainly due to extensive reductions in printing, advertising and promotion as the Company had eliminated its online, consumer based, photo print service.

During the quarter ended December 31, 2001, the Company expensed approximately \$164,426 on research & development costs, as compared to \$547,452 during the same period last year. The reduction is the result of, amongst other things, the substantial completion of the Company's software and the associated reduction in staffing and consultants.

Amortization decreased substantially to \$112,981, as compared to \$631,339 for the comparable period quarter of 2000. This reduction was due to the disposition and write-off of various assets associated with the consumer based photo print service.

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. Expense recovery for the quarter ended December 31, 2001 was \$2,746,944 resulting from a reduction of the Company's liabilities due to the bankruptcy of PhotoChannel, Inc.

The Company recorded a quarterly gain of \$1,459,039 (\$0.03 per share) compared to a loss of \$6,280,428 (\$0.40 per share) in the same quarter last year. The gain at December 31, 2001 was the result of the expense recovery associated with the filing under Chapter 7 of PhotoChannel, Inc. The Company recorded a quarterly loss from operations of \$1,288,399 before the one time expense recovery of \$2,746,944, compared to a loss of \$6,341,829 for the same period of 2000. The reduction in the loss from operations was due to significant reductions in general and administrative, sales and marketing and research and development. In particular, significant costs were incurred during the three months ended December 31, 2000, as the result of the commercial launch of PhotoChannel's online photo print service. The online photo print service is no longer part of the Company's business strategy.

Legal Proceedings

Other than as set out below, as of March 1, 2002, 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.

1. On February 24, 1999, Thomas Jackson, a former President and Chief Executive Officer of the Company, commenced proceedings against the Company in the Supreme Court of British Columbia. Mr. Jackson has claimed damages for unpaid services not exceeding \$150,000. Management is of the view that the claim is without merit and is vigorously defending these proceedings. There have been no further proceedings in this matter since the Company filed its statement of defence. An amount of approximately \$58,000 has been provided for in the consolidated financial statements for this contingent liability.
2. On January 13, 2000, Arthur Tesser, the former Chief Operating Officer of PhotoChannel Inc., commenced arbitration proceedings against PhotoChannel Inc. for (US)\$317,000. He is claiming being owed a severance under an employment contract dated July 26, 2000. Mr. Tesser's employment with PhotoChannel Inc. was terminated in November 2000. Mr. Tesser is also seeking payment from the Company for a purported guarantee of the terms of the employment contract by the Company. The Company, PhotoChannel Inc. and Mr. Tesser negotiated the proposed terms of a settlement of this dispute, but negotiations have broken down. The matter is currently before the arbitrator, but has been placed in abeyance pending guidance from the bankruptcy court in the matter of PhotoChannel, Inc. Management is of the view that the maximum exposure to the Company is (US)\$106,000 (the previously negotiated amount), if the arbitrator subsequently rules in favor of all of Mr. Tesser's claims and rules under the purported guarantee of the Company.
3. On July 4, 2001 Groome Capital.com Inc. of 1, Place Ville-Marie, Suite 2707, Montreal, Quebec commenced an action against the Company in the Quebec Superior Court, claiming \$33,613.28 for legal costs incurred in connection with a proposed financing of the Company in January of 2001 which did not complete. The Company has disputed this claim and February 28, 2002 the claimant and the Company came to an out of court settlement of \$15,000, if paid by the Company by March 31, 2002.
4. On July 11, 2001 Thomas Public Relations Inc. of 775 Park Avenue, Huntington, New York, commenced an action in the Supreme Court of British Columbia, claiming \$46,748.55 plus interest at the rate of 18% per annum, for the provision of public relations services. The Company is disputing the claim and filed a statement of defence on August 2, 2001.
5. On March 3, 1999, the Company received a letter from DATT Japan indicating that they had proceeded with legal action in the Japanese courts and for an order for payment. On September 10, 2001, the Company's legal representative received a telephone call from a Vancouver lawyer, stating that he represented DATT Japan. He indicated that his client had received a judgment from a Japanese court against PhotoChannel for approximately \$99,000. The Company intends to defend itself against the enforcement of this judgment.

6. On October 29, 2001 Mr. Geoffrey Briant, the former Chairman and Chief Executive Officer of the Company commenced an action in the Supreme Court of British Columbia, claiming \$113,713.17 for reimbursement of expenses allegedly incurred by Mr. Briant while he was an officer of the Company. On November 21, 2001 the Company filed a statement of defence disputing this claim and a counterclaim against Mr. Briant and 328707 B.C. Ltd. The counterclaim against Mr. Briant was for breach of fiduciary duty, unauthorized payments in the amount of \$205,000 and reimbursement of personal expenditures in the amount of \$15,720.80. The counterclaim against 328707 B.C. Ltd. was for unauthorized payments in the amount of \$20,000. On December 4, 2001, Mr. Briant filed a defence and counterclaimed against two of the Company's directors, by virtue of their positions, that they each also breached their fiduciary duties to the Company.
7. On October 31, 2001 Mr. Melvin Reeves, the former Executive Vice President, Chief Strategy Officer and General Counsel of the Company commenced an action in the Provincial Court of British Columbia (Small Claims Court), claiming \$8,323.45 for reimbursement of expenses allegedly incurred by Mr. Reeves while he was an officer of the Company. The Company is disputing this claim.
8. On November 5, 2001 Donald Sutherland of P.O. Box 345, Staten Island, New York, New York, commenced an action in the Supreme Court of British Columbia, claiming \$132,770.63 plus interest, for the provision of text and photographs and services. The Company is disputing the claim.
9. On November 6, 2001 Compugen Logistics Limited commenced an action in the Supreme Court of British Columbia, claiming \$31,665.45 for computer equipment and related products allegedly supplied to the Company between May 2000 and December 2000. The Company has not disputed this claim.
10. On December 21, 2001 Mr. Geoffrey Briant, the former Chairman and Chief Executive Officer of the Company commenced an action in the Supreme Court of British Columbia, claiming US\$1,000,000 under a guarantee from the Company for wrongful dismissal by PhotoChannel International Limited. The Company is disputing the claim.
11. On December 31, 2001 Northern California Collection Service Inc. of Sacramento, California, commenced an action in the Superior Court of California, claiming US\$118,204.11 plus interest of US\$21,662.82 to December 31, 2001 under a contract between the Company and Interwoven, Inc. for the provision of computer software. On February 28, 2002, the claimant and the Company came to an out of court settlement of US\$17,500, if paid by the Company by March 29, 2002.

Subsequent Events

On February 26, 2002 the Company announced that it had granted to PhotoChannel Networks Limited Partnership ("PhotoChannel LP") a software license to commercially exploit PhotoChannel's Network in specified market segments. PhotoChannel LP was formed on February 14, 2002, with PhotoChannel as its general partner and as one of its initial limited partners.

PhotoChannel LP has commenced a private placement of limited partnership units under which it proposes to raise up to Cdn.\$1,000,000, at a price of Cdn.\$1,000 per unit, and has to date received commitments for 420 units, or Cdn.\$420,000. PhotoChannel and PhotoChannel LP are subject to approval by the CDNX and all other securities regulatory authorities having jurisdiction over the affairs of PhotoChannel.

The amounts received from PhotoChannel from PhotoChannel LP under a software license and operating services agreement (in respect of the services, facilities and equipment that PhotoChannel has agreed to provide to PhotoChannel LP) will enable PhotoChannel to continue development and its own exploitation of its leading edge digital imaging network software.

On February 25, 2002, the British Columbia Securities Commission issued a Cease Trade Order against the Company for failure to file annual financial statements within 140 days of the financial year end. On February 27, both the Ontario Securities Commission and the Quebec Securities Commission also filed Cease Trade Orders against the Company for failure to file financial statements. The Company is working towards filing its annual financial statements in a timely manner. Management expects that the Cease Trade Orders will be lifted, once the annual financial statements are filed.

Liquidity and Solvency

As at December 31, 2001, the Company had a working capital deficiency of \$2,357,219 compared to a working capital surplus of \$511,322 at December 31, 2000. The cash and cash equivalents on hand at December 31, 2001 were \$13,751. The Company does not have sufficient working capital to meet its ongoing obligations as they come due. The Company continues to be dependent on the forbearance of its creditors as it works towards revenue generation with the network strategy. There can be no guarantee that creditors will continue to forbear in collecting amounts due and owing by the Company. As a start-up company without any predictable revenue stream, the Company's main source of funds has been, and will continue to be for some time, the sale of equity capital.

“Peter Scarth”

Peter Scarth
Chairman & CEO

“Kyle Hall”

Kyle Hall
COO & President

March 1, 2002