PhotoChannel Networks Inc.

Management's Discussion & Analysis
For the Year Ended September 30, 2008
January 12, 2009

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 our consolidated financial statements and accompanying notes for the year ended September 30, 2008. 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 January 12, 2009 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, risks related to our 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. Our actual results could differ materially from those expressed or implied by such forward-looking statements.

Business Highlights

Financial and operational highlights

- Record revenues of $17,049,587 compared to $7,511,328 in fiscal 2007
- Transactional revenue of $11.6 million, an increase of 141% year-on-year
- Transaction fees representing 68% of total revenue vs. 64% during fiscal 2007
- Non-GAAP adjusted EBITDA loss (defined as net loss, excluding amortization, stock-based compensation expense and goodwill impairment charge) of $859,892, compared to $4,049,032 during fiscal 2007
- 7.6 million orders handled during the year, compared to 3.8 million during fiscal 2007
- Major new business partners announced during the year:
    - Loblaw Companies Limited
    - SAM’s Club USA
    - Costco USA
    - Kmart Australia
    - Hallmark UK
    - Kodak China

- Announced plans to acquire Works Imaging, a leading, UK based provider of kiosk and desktop software
- Major new business partners announced subsequent to September 30, 2008:
    - Kodak Express Stores (Australia)
    - Myer Pty Ltd. (Australia)

Business Overview

PhotoChannel has created and manages the open standard PhotoChannel Network environment. The PhotoChannel Network is currently utilized by major photofinishing retailers to provide their consumers with online routing of digital images for the development of photos and gifting products. There are now thousands of retail locations worldwide accepting and/or fulfilling online orders for prints and gifting items from digital images through the PhotoChannel Network. For more information on the Company, visit www.photochannel.com.

In addition to this, on July 2, 2007, the Company acquired all of the outstanding shares of Pixology PLC ("Pixology"). Pixology has created and manages a network environment similar to ours, but also has developed and manages a kiosk software solution.

The Company provides its photofinishing retailers with a customer branded online and/or kiosk solution. The online solution allows consumers the ability to easily upload and order prints and gifting items from their digital images and pick up these products at the selected retailer location. The Company's kiosk software allows retailers' consumers to offload and print digital images and gifting products from their digital media in-store at retail locations.

PhotoChannel provides all of these services through four third-party hosting facilities, two of which are located in Canada and two in the United Kingdom. The Company's infrastructure and models permit managed growth while keeping authority and responsibility within its operational teams that deliver the services.

Our strategy for growth is to:

- Contract or partner with established retail chains in the photofinishing industry;
- Contract or partner with web portals which offer their customers the ability to order prints and/or gifting products,
- Maintain service and product excellence for strong customer retention and development;
- Maintain a close relationship with our customers by providing marketing solutions that encourage new users to the online solution; and
- Provide a workplace conducive to attracting and retaining talented people.

Market Segmentation

The Company has two operating segments that have similar economic characteristics which are aggregated into a single reportable segment based on the manner in which the Company has organized its operations and provision of financial information to senior management.

Selected Annual Information

The following selected financial information has been prepared in accordance with generally accepted accounting principles in Canada and is presented in Canadian dollars.

	Year ended September 30		
	2008	**2007**	**2006**
Revenue	$17,049,587	$7,511,328	$4,075,151
Loss from operations	($8,276,760)	($4,747,488)	($2,628,867)
Net loss for the year	($8,717,026)	($6,072,236)	($2,632,301)
Basic and fully diluted net loss per common share	($0.26)	($0.20)	($0.12)
Total assets	$20,623,453	$25,758,619	$4,883,304
Net assets (liabilities)	$10,263,657	$17,611,126	$3,434,762
Capital Stock	$65,614,347	$65,293,214	$49,115,790
Weighted average number of Common Shares	33,383,866	29,877,739	22,804,712
Long term obligations and redeemable preferred stock	Nil	Nil	Nil
Cash dividends declared per common share	Nil	Nil	Nil

On July 2, 2007, the Company completed its acquisition of Pixology PLC in the United Kingdom. As a result of this acquisition closing part way through the fiscal year, the financial results for the year ended September 30, 2007 included results from the Pixology operations for only one quarter. The financial results for the year ended September 30, 2008 include results from the Pixology operations for a full twelve month period.

Revenue by geographic region

Prior to the acquisition of Pixology, the Company's sales were primarily in Canada and the United States. The acquisition of Pixology, however, positioned the Company such that it is able to gain exposure to the United Kingdom marketplace through already established business arrangements and customer relationships.

During the years ended September 30, 2008 and 2007, the percentage of the Company's revenue earned by geographic segment was as follows:

	2008	2007
United States	26%	19%
Canada	24%	52%
Total North America	50%	71%
United Kingdom	49%	28%
Other	1%	1%
Total	100%	100%

Results from operations

Revenue

Description		2008		2007		Change	% Change
Transaction fees	$	11,635,172	$	4,823,523	$	6,811,649	141%
Installation fees		3,933,413		1,362,452		2,570,961	189%
Membership fees		802,105		866,082		(63,977)	(7)%
Professional fees		467,996		399,261		68,735	17%
Archive fees		210,901		60,010		150,891	251%
Total	$	17,049,587	$	7,511,328	$	9,538,259	127%

Revenue for fiscal 2008 is significantly greater than fiscal 2007, due to a combination of the acquisition of Pixology during the fourth quarter of 2007, the addition of large new retailers during the year and the organic growth of PhotoChannel's existing operations over the past twelve months.

The Pixology operations contributed $8,624,427 of revenue during fiscal 2008, while PhotoChannel's operations contributed $8,425,160.

Transaction fees increased 141% compared to fiscal 2007 and represented 68% of total revenue for fiscal 2008 compared to 64% in fiscal 2007. This increase in overall transactional revenue (as a percentage of overall revenues) has been achieved despite seeing an increase of 189% year on year in installation fees which arose primarily as a result of Pixology charging annual license fees rather than fees based on the level of transactions undertaken. The Company continues to pursue its long-term goal of moving towards a transactional-based revenue model and the results in 2008 demonstrate the success being achieved in this area.

Excluding the results of Pixology for the year, transaction fees represent 78% of the total revenue of the operations that were in existence prior to the acquisition and represent the single largest source of revenue for the Company.

Transaction fee growth during the year came primarily from continued organic growth in the usage of the PhotoChannel network by the customers of our retail partners, along with the launch of new customer sites such as Sam's Club USA, Kmart Australia and Costco USA during 2008.

During fiscal 2008, a total of 7,698,674 orders were placed through the PhotoChannel Network, compared to 3,860,133 during fiscal 2007. Whilst this averages out at more than 21,000 per day over the year, the volumes seen during the fourth quarter of 2008 were significantly greater at an average of 34,000 per day as a number of new sites were launched for our customers.

As the popularity of ordering photos and gift products online increases and our retailer customers take steps to market and improve the popularity of their own sites, the Company is now uniquely positioned to benefit from their growth.

Installation fees increased by $2,570,961, or 189% year on year, primarily as a result of revenue earned through Pixology relating to license fees charged to customers. These license fees are an annual fee for the use of software and are recognized into revenue over the period to which access to services are provided. Installation fees in PhotoChannel were $192,900 lower in fiscal 2008 compared to fiscal 2007. This is a direct result of the majority of its customers having previously connected their stores to the PhotoChannel Network and is in line with management's expectations. Revenue from this source is not expected to be recurring in nature and will fluctuate depending on the level of new connections to our Network over a particular period of time.

Membership fees, representing monthly fixed fees charged to customers based on the number of locations they have connected to the PhotoChannel Network decreased by 7% as compared to fiscal 2007, as certain retailers have chosen to assume responsibility for specific segments of their own customer support.

Professional fees have increased by 17% to $467,996 year on year. Although we offer a number of distinct services to our customers which generate revenue in this category, the main driver of professional fee revenue for us during 2008 has been e-mail marketing campaigns run on behalf of a number of our customers. These campaigns continue to increase in popularity as our retail customers experience increased sales volumes that can be directly linked to the running of individual campaigns. We believe that by tracking the success rates of these campaigns we will be able to demonstrate further the value of these campaigns to our customers in future periods, resulting in continued revenue growth for us not only in this area, but also in transaction fees.

Storage fees of $210,901 were earned during 2008, compared to $60,010 in 2007. This increase was the result of certain customers reaching pre-determined thresholds, after which we charge a monthly storage fee. Our customers remain in charge of the business rules offered to their consumers around storage and therefore future revenue growth in this area could be curtailed should any of our customers stop providing unlimited free storage.

Expenses

Description		2008		2007	Change	% Change
Network delivery	$	7,409,525	$	2,523,174	$ 4,886,351	194%
Software development		6,914,291		4,178,111	2,736,180	65%
General and administration		4,603,450		3,199,727	1,403,723	44%
Sales and marketing		1,140,028		1,134,350	5,678	1%
Amortization		5,259,053		1,223,454	4,035,599	330%
Total	$	25,326,347	$	12,258,816	$ 13,067,531	107%

Expenses for fiscal 2008 are 107% greater than fiscal 2007. 39% of costs were incurred by Pixology, with the remaining 61% incurred by PhotoChannel.

There are a number of factors which have resulted in this significant increase in expenditures year-on-year; including the acquisition of Pixology and the related ongoing cost of those operations which are now included in our results, the increase in amortization experienced as a result of the acquisition through the recognition of intangible assets on our balance sheet, along with additional hardware associated with our new data centre and our success during the year in securing a number of new contracts which resulted in an increase in employee costs, prior to the recognition of associated revenues from these contracts.

The cost structure of Pixology's operations is different to that of PhotoChannel's in a number of cases. Most significantly, Pixology sometimes contracts with the gifting fulfillers and take responsibility for ensuring that orders made through the online photo sites of retailer customers are completed. As a result of this, Pixology recognizes the gross amount of sales made to the end consumer in these instances, together with the associated cost of goods sold. This cost of goods sold is recorded within network delivery costs and amounted to $3,761,946 for fiscal 2008.

This is in contrast to the PhotoChannel operations where responsibility for ensuring orders are fulfilled rests with the retailer resulting in only the transaction fee earned by the Company being recorded in the financial statements.

Network delivery costs increased $4,886,351 or 194% during fiscal 2008, although $3,366,514 or 69% of this increase can be attributed to Pixology. The remaining $1,519,837 of increased costs, which were incurred by PhotoChannel, are primarily as a result of an increase in customer service salaries and temporary contractors of $801,000 as staff numbers were increased to service newly signed customers and the Company's growing customer base; an increase of $30,000 in non-cash stock-based compensation expense; an increase of $770,000 in data storage and hosting costs resulting from the establishment of a second Canadian datacenter in Toronto during the end of the previous quarter together with the expansion of the Company's Vancouver datacenter and an increase in the cost of running e-mail marketing campaigns on behalf of a number of our customers of $113,000. These increased costs were offset by a reduction in the lab installation costs which fell in line with the reduction experienced in Canadian installation revenue during the year.

Development expenses increased $2,736,180 or 65% year on year. $861,348 or 32% of this increase related to costs incurred by Pixology as a result of fiscal 2008 including a full year of costs compared to fiscal 2007 which included only one quarter post acquisition. The remaining

$1,874,832 of increased costs were incurred by operations in Canada, with $1,664,208 due to increased salary and consulting costs incurred as a result of the Company working to develop customized online photo solutions for our new customers, including Sam's Club USA, Costco USA, Loblaws, Kodak Australia and Kodak China as well as continuing to provide ongoing support and development services to our existing client base. The completion of these projects during 2008 will result in the Company earning additional revenue in future periods, offsetting the costs that have been incurred up front. Additional non-cash stock-based compensation expense of $162,462 was also incurred year on year.

General and administration expenses increased $1,403,723 or 44% year on year. $238,691 of this increase related to costs incurred by Pixology, with the remaining $1,165,032 increase being incurred in Canada. Costs incurred year on year by Pixology are primarily as a result of fiscal 2008 including a full year of costs while fiscal 2007 only included 3 months of costs. Steps have been taken since the acquisition of Pixology to drastically reduce the overheads incurred at our United Kingdom operations with very successful results. The year on year increase in costs in Canada was as a result of a small increase in headcount, an increase of non-cash stock-based compensation expense of $337,000, increased audit and Sarbanes-Oxley compliance costs of $334,000 and small increases in travel expenditures and office related costs.

Sales and marketing expenses remained at the same levels year on year at $1,140,000. An increase of $65,000 was incurred by Pixology through the inclusion of United Kingdom specific marketing efforts, while costs in Canada were reduced by $60,000 as a result of decreased salary and consulting costs.

Amortization increased by 330% year on year to $5,259,053. This year on year increase is as a result of the amortization of intangible assets acquired when the Company purchased Pixology, amortization incurred on assets owned by Pixology and a significant increase seen as a result of the large capital investment undertaken during the second and third quarters of the year establishing a second Canadian datacenter in Toronto.

Goodwill impairment

As a result of acquiring Pixology, an amount of $2,777,647 was recognized, representing goodwill. 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. Upon acquisition, 63% of the goodwill recognized was allocated to Pixology, with the remaining 37% allocated to PhotoChannel.

During the year ended September 30, 2008 a review of the carrying value of goodwill was completed and it was determined that the amount allocated to Pixology was impaired and that $1,086,577 should be written off. This impairment arose as a result of; planned development synergies not materializing to the extent assumed at the time of the acquisition; cost reductions implemented subsequent to acquisition resulting in the operations reaching a break-even position, but being insufficient to result in the company being able to sustain profitable operations on a recurring basis; and the loss, subsequent to acquisition of a number of customers.

Cash flows

The Company recorded cash outflows from operations of $598,341 during fiscal 2008 compared to cash outflows of $2,844,591 during fiscal 2007. This improvement was primarily attributable to the current year operating loss, which, whilst being greater than 2007, included larger charges for non-cash items such as amortization and stock-based compensation.

Net cash outflows from investing activities were $4,736,516 during 2008, comprising the net amount of cash used to acquire equipment. During 2007, the investment made in equipment was $1,127,371. This year on year increase in expenditure represents the significant investment made by the Company to establish a second Canadian datacentre located in Toronto, Ontario. The establishment of this second Canadian datacentre which spanned several months provides the Company with the necessary capacity to meet expected growth and redundancy over the foreseeable future.

Net cash inflows from financing activities were $792,386 for fiscal 2008, as a result of the Company obtaining cash inflows through employees exercising stock options and from a short-term loan of $969,886. These cash inflows were offset by payments made against a capital lease taken out by the Company to finance additional items of equipment. During 2007, the Company's financing activities saw proceeds realized through a private placement and also through the exercising of options and warrants.

At September 30, 2008 the Company had cash and cash equivalents of $2,670,988 compared to $7,405,034 at September 30, 2007.

Contingencies and commitments

As of January 12, 2009, 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.

The contractual obligations and payments due as at September 30, 2008 are as follows:

	Payments due by period			
	Total	**Less than 1 year**	**1-3 years**	**3-5 years**
Property leases	849,915	303,672	457,320	88,923
Other service agreements	5,092,650	1,381,187	3,449,575	261,888
Capital leases	865,947	490,072	375,875	-
Short-term debt obligation	969,886	969,886	-	-
Asset retirement obligations	35,512	-	-	35.512
Purchase obligations	1,487,260	1,487,260	-	-
	9,301,170	4,632,077	4,282,770	386,323

Liquidity and capital resources

As at September 30, 2008, the Company had negative working capital of $2,477,914 compared to positive working capital of $4,117,841 as at September 30, 2007. The cash and cash equivalents on hand, at September 30, 2008 were $2,670,988 (2007 - $7,405,034).

This reduction during fiscal 2008 represents the significant investment that we have made towards our future operations through both the purchase of capital assets and the employment of development staff to work on the large number of new projects that have been secured. As development of a number of these projects is now complete and they have started to generate revenue, operating results are expected to improve resulting in an improvement of working capital generated from operations.

At September 30, 2008, the Company has a short-term loan facility of $969,886 and a capital lease obligation of $865,947 which is due for repayment over the next two fiscal years. The Company currently settles its financial obligations out of cash and cash equivalents, however, the ability to do this relies on the Company collecting its accounts receivable in a timely manner and maintaining sufficient cash on hand.

Management has carefully considered the Company’s current financial situation and is confident, that following on from the major investments made during the year-ended September 30, 2008, it is now in a position to begin realizing improved results on an ongoing basis. A number of significant new customers were obtained and launched during 2008. Although these new customers did not begin to generate revenue until the latter part of the year, the results reported in these financial statements reflect a significant amount of costs associated with their launch without the full benefit of related revenues. Management has prepared a detailed plan which covers the period through the end of fiscal 2009 and beyond. This plan shows a continued emphasis on improving the quality of the products offered to retail partners and their customers with the aim of driving continued strong organic growth, whilst simultaneously focusing on cost control measures which will result in improved operating results.

The Company’s ability to meet its plans is dependent upon its ability to continue to generate revenues sufficient to cover its operating costs and capital requirements in an industry that is characterized by rapid technological change. There is no assurance that the Company will be successful in achieving these objectives.

Although the global economy, and in particular the economic conditions in both North America and the United Kingdom our two most significant markets, has suffered significant downturns in recent months, with consumer confidence being reported to be at record lows, the Company has not, to date, experienced any decline in consumer purchasing through their hosted websites. Further weakening of global economic conditions could impact the achievement of management’s plans to the extent that our retail partners are negatively impacted, resulting in an overall decline of printed photographs and gift products.

In past years, the Company has relied on its ability to raise additional financing through the sale of common shares in order to fund its rapid expansion and growth plans. The recent problems seen in the global credit markets has resulted in a drastic reduction in the ability of companies to raise capital through the public markets and while management does not plan on raising any additional funds through this channel, should circumstances change in the future, its ability to do so may be impaired.

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.

Related Party Transactions

During the year ended September 30, 2008, 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 September 30, 2008 is $18,014, comprising an amount of $17,000 representing a portion of the principal which remains outstanding and $1,014 representing interest accrued on that principal. This amount falls 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 year ended September 30, 2008, the Company incurred legal fees of $134,480 (2007 - $280,094) for services provided by a law firm of which a director of the Company is a partner. Accounts payable and accrued liabilities at September 30, 2008 included $23,217 (2007 - $47,334) related to these services.

During the year ended September 30, 2008, the Company incurred expenses in relation to setting up e-mail marketing campaigns on behalf of a number of our retail customers of $70,685 (2007 - $26,760) with a company of which a director of the Company is Chairman and Chief Executive Officer. Accounts payable and accrued liabilities at September 30, 2008 included $9,844 (2007 - $8,920) 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.

During the year-ended September 30, 2008, the Company was provided with an unsecured loan from a shareholder and Officer totalling £500,000. The loan, which is denominated in Sterling bears interest at a rate equal to the Bank of England base rate, plus 3.2% and falls due for repayment on May 15, 2009. At September 30, 2008, the total amount, including interest, of this loan balance was $969,886.

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.

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, $889,848 is covered by either the Financial Services Compensation Scheme in the

United Kingdom or the Canada Deposit Insurance Corporation, leaving $1,781,140 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. In addition, on an ongoing basis, management monitor the level of accounts receivable attributable to each customer and the length of time taken for amounts to be settled and where necessary, takes appropriate action to follow up on those balances considered overdue.

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. At September 30, 2008, four customers each account for 10% or more of total trade accounts receivable (2007 – four customers).

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. At September 30, 2008, the Company had a provision for doubtful accounts of $145,000.

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 objective to managing liquidity risk is to ensure that it has sufficient liquidity available to meet its liabilities when due.

At September 30, 2008, the Company has a short-term credit facility of £1,000,000, of which £500,000 had been drawn at September 30, 2008 and has utilized a capital lease to acquire items of equipment with a cost of $1,248,464. The Company uses this short-term loan facility and cash and cash equivalents to settle its financial obligations as they fall due. The ability to do this relies on the Company collecting its accounts receivables in a timely manner and by maintaining sufficient cash on hand.

At September 30, 2008, the Company's accounts payable and accrued liabilities were $7,480,801, of which $4,329,635 are denominated in UK£, all of which fall due for payment within twelve months of the balance sheet date.

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.

Traditionally, the quarter ended December 31 each year is the busiest of the year for the Company with a large increase seen in the number of transactions processed through both the online and in-store solutions offered to the Company's retail customers. It is expected that

additional cash generated throughout the period ended December 31, 2008 will result in a strengthening of the balance sheet position and will help fund operations in future periods.

Market risk

Market risk is the risk to the Company of adverse financial impact due to changes in the fair value or 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.

Interest rate risk

The only financial instruments that expose the Company to interest rate risk are its cash and cash equivalents and its loan payable. 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.

The Company's loan payable bears interest at a rate based on the United Kingdom Base Rate plus a premium of 3.2%. The Company does not have in place any financial instruments to mitigate the possible adverse effects of an increase in the underlying Base Rate.

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 September 30, 2008, through its wholly owned subsidiary, the Company had cash and cash equivalents of $2,320,800, accounts receivable of $1,175,880 and accounts payable of $4,329,635 which were denominated in UK £. In addition, at September 30, 2008, the Company had cash and cash equivalents of $309,519, accounts receivable of $2,243,358 and accounts payable of US$910,300 which were denominated in US$ as well as a UK £ denominated loan outstanding of $969,886.

Sensitivity analysis

The Company has completed a sensitivity analysis to estimate the impact on net loss for the period which a change in foreign exchange rates or interest rates during the period ended September 30, 2008 would have had.

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 do not cause a change in foreign exchange rates

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

	Impact on net loss $
Change of +/- 10% in US$ foreign exchange rate	+/- 164,175
Change of +/- 10% in UK£ foreign exchange rate	+/- 685,661

A change of 1% in the United Kingdom Base Rate would have an annual impact of approximately $9,400.

The above results arise primarily as a result of the Company having US$ denominated trade accounts receivable balances, trade accounts payable balances and bank account balances as well as a UK£ denominated loan balance.

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.

Income taxes

Since inception, PhotoChannel has sustained significant tax losses and continues to strive to generate sufficient revenues to cover its operating costs in an industry characterized by rapid technological change. In fiscal 2008, given sufficient uncertainty regarding the realization of future income tax assets, and in line with its current accounting practices, PhotoChannel determined that it was appropriate to take a full valuation allowance against the future income tax assets.

Condensed 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, 2008	Jun 30, 2008	Mar 31, 2008	Dec 31, 2007
Revenue	$ 5,273,502	$ 4,217,992	$ 3,259,499	$ 4,298,594
Net loss for the period	2,714,584	2,297,614	2,622,228	1,082,600
Basic and diluted loss per share	0.08	0.07	0.08	0.03
	Sep 30, 2007	**Jun 30, 2007**	**Mar 31, 2007**	**Dec 31, 2006**
Revenue	$ 3,399,181	$ 1,272,962	$ 1,317,923	$ 1,521,262
Net loss for the period	3,677,850	1,639,651	717,544	37,191
Basic and diluted loss per share	0.11	0.06	0.03	-

Quarterly revenue breakdown

	Sep 30, 2008	Jun 30, 2008	Mar 31, 2008	Dec 31, 2007
Transaction fees	$ 3,905,724	$ 2,806,146	$ 1,904,819	$ 3,018,482
Installation fees	973,011	1,002,267	985,073	973,063
Membership fees	240,456	235,961	155,365	170,322
Professional fees	84,160	127,266	119,844	136,727
Archive fees	70,151	46,352	94,398	-
	$ 5,273,502	$ 4,217,992	$ 3,259,499	$ 4,298,594
	Sep 30, 2007	**Jun 30, 2007**	**Mar 31, 2007**	**Dec 31, 2006**
Transaction fees	$ 2,252,270	$ 809,469	$ 717,589	$ 1,044,195
Installation fees	787,581	151,752	280,056	143,063
Membership fees	199,045	199,395	235,163	232,479
Professional fees	145,286	97,342	70,115	86,518
Archive fees	14,999	15,004	15,000	15,007
	$ 3,399,181	$ 1,272,962	$ 1,317,923	$ 1,521,262

2008 Fourth Quarter Results

Revenue for the fourth quarter of fiscal 2008 increased by $1,055,510, or 25% from the third quarter and $1,874,321, or 55% compared to the fourth quarter of fiscal 2007. The primary reason for the increase between the third and fourth quarters of 2008 is the inclusion of transaction fee revenue from a number of new customer sites which were launched during the third quarter. Transaction fees for the fourth quarter were reduced by non-recurring discounts issued to a customer, totaling $680,000.

The net loss for the fourth quarter was $2,714,584, compared to $2,297,614 which was realized during the third quarter of 2008 and $3,677,850 in the fourth quarter of 2007. Included within this loss of $2,714,584 is amortization of $2,289,069 and non-cash stock-based compensation of $445,584. Amortization recorded during the fourth quarter of 2008 is approximately $851,000 greater than the normal quarterly charge that would be expected as a result of the finalization of the purchase price allocation relating to the Pixology PLC acquisition which was

completed during the quarter. The finalization of this allocation resulted in a reduction of $2,357,835 in goodwill and a corresponding increase in intangible asset balances, which in turn resulted in a larger than normal quarterly intangible asset amortization charge being recorded to arrive at the revised full annual expense.

In addition, during the fourth quarter of 2008, the Company completed its annual impairment review of the goodwill carried on its books, which resulted in an impairment charge being recognized of $1,086,577.

Excluding the goodwill impairment charge and the additional intangible asset amortization expense that was booked, the loss for the quarter was $777,007.

From an operations perspective, the fourth quarter was very positive, with a significant amount of work completed on ongoing projects for our customers, resulting in improved site features and products being added for them as well as an improvement in the number of orders being processed through our platform from an average of 21,302 per day in the third quarter to an average of 34,037 during the fourth quarter. This quarter on quarter increase was as a result of the inclusion, for the entire quarter, of a number of the sites recently launched on behalf of our customers, as well as the inclusion of the summer months of July and August which traditionally see more activity than some of the earlier months in the year.

Management believes that the fourth quarter represented a significant milestone for the Company as it marked the end of a large period of development undertaken on behalf of a number of our customers and saw the beginning of a strengthening revenue stream as a result of this. The Company also began preparations during the fourth quarter for the beginning of fiscal 2009, which includes the traditionally busy holiday period of November and December.

Outstanding share information

The following table provides outstanding share information for the Company as at September 30, 2008 and December 16, 2008.

	January 12, 2009	September 30, 2008
Authorized		
Common shares	Unlimited	Unlimited
Preferred shares	Unlimited	Unlimited
Issued and outstanding		
Common shares	33,493,182	33,464,432
Preferred shares	-	-
Options		
Outstanding	2,776,562	2,883,869
Exercisable	2,086,262	1,967,882
Warrants		
Outstanding	4,857,147	4,857,147
Exercisable	4,847,147	4,857,147

Changes in accounting policies

During the year ended September 30, 2008, the Company adopted a number of new accounting standards.

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. The additional disclosures, required as a result of the adoption of these standards, have been included in Note 19, Capital management.

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.

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.

Determining whether a contract is routinely denominated in a single currency

Effective October 1, 2007, the Company adopted CICA Emerging Issues Committee (EIC) 169, Determining whether a contract is routinely denominated in a single currency. EIC 169 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. The adoption of this EIC had no impact on the Company's consolidated financial statements.

Inventories

Effective October 1, 2007, the Company adopted CICA Handbook Section 3031, Inventories, which has replaced Section 3030 with the same title. This Section aligns Canadian GAAP with International Financial Reporting Standards and 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. The adoption of this Handbook Section had no impact on the Company's consolidated financial statements.

Recent Canadian GAAP pronouncements

CICA Handbook Section 1400, Going Concern

In June 2007, the CICA amended Handbook Section 1400, Going Concern, to include additional requirements to assess and disclose an entity's ability to continue as a going concern. Section 1400 is effective for interim and annual reporting periods beginning on or after January 1, 2008. The adoption of this standard will have no impact on the Company's operating results or financial position and management expects that there will be no material impact on the Company's financial statement disclosure.

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. The adoption of this standard is not expected to have a material impact on the Company's operating results or financial position.

Recent US GAAP pronouncements

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 Staff Position 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13

Issued in February 2008, this FASB Staff Position (FSP) amends FASB Statement No. 157, Fair Value Measurements, to exclude FASB Statement No. 13, Accounting for Leases, and other

accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under Statement 13. However, this scope exception does not apply to assets acquired and liabilities assumed in a business combination that are required to be measured at fair value under FASB Statement No. 141, Business Combinations, or No. 141 (revised 2007), Business Combinations, regardless of whether those assets and liabilities are related to leases. The Company is currently evaluating the impact of FSP FAS No. 157-1 on its consolidated financial position and results of operations

FASB Staff Position 157-2, Effective Date of FASB Statement No. 157

Issued in February 2008, this FASB Staff Position (FSP) delays the effective date of FASB Statement No. 157, Fair Value Measurements, for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years.

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.

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. The Company has not yet evaluated this statement for the future impact of FAS 141(R).

FASB 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. 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.

FASB 162 – The Hierarchy of Generally Accepted Accounting Principles

In May 2008, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 162, The Hierarchy of Generally Accepted Accounting Principles ("FAS 162"). The new standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. generally accepted accounting principles (GAAP) for non-governmental entities. For non-governmental entities, the guidance in FAS 162 replaces that prescribed in Statement on Auditing Standards (SAS) No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles and becomes effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Company does not expect the adoption of FAS No. 162 to have a significant impact on its consolidated financial position and results of operations.

FASB Staff Position 142-3, Determination of the Useful Life of Intangible Assets

This FASB Staff Position (FSP) amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets. The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141 (revised 2007), Business Combinations, and other U.S. generally accepted accounting principles (GAAP).

This FSP shall be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The guidance for determining the useful life of a recognized intangible asset in paragraphs 7–11 of this FSP shall be applied prospectively to intangible assets acquired after the effective date. The disclosure requirements in paragraphs 13–15 shall be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. The Company does not expect the adoption of this staff position to have a significant impact on its consolidated financial position and results of operations.

International Financial Reporting Standards

On February 13, 2008, the Canadian Accounting Standards Board confirmed that International Financial Reporting Standards will replace Canada's current generally accepted accounting principles for publicly accountable profit-orientated enterprises for interim and annual financial statements effective January 1, 2011. The Company is presently considering the effect these standards will have on its financial statements.

Critical accounting estimates

PhotoChannel prepares its financial statements in accordance with Canadian Generally Accepted Accounting Principles ("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.

Stock-based compensation

The Company grants stock options to directors, employees and consultants of the Company as an element of compensation. The cost of the service received as consideration is measured based on an estimate of fair value at the date of grant. The grant-date fair value is recognized as compensation expense over the related service period with a corresponding increase in contributed surplus. On exercise of stock options, consideration received together with the compensation expense previously recorded to contributed surplus is credited to share capital. The Company uses the Black-Scholes option pricing model to estimate the fair value of each stock option.

Goodwill and intangible assets

Intangible assets acquired both individually or with a group of other assets are initially recognized and measured at cost. The cost of a group of intangible assets acquired in a transaction, including those acquired in a business combination that meet the specified criteria for recognition apart from goodwill, is allocated to the individual assets acquired based on their relative fair values. Intangible assets with finite useful lives are amortized over their estimated useful lives. The amortization methods and estimated useful lives of intangible assets are reviewed annually. Intangible assets with indefinite useful lives are not amortized and are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test compares the carrying amount of the intangible asset with its fair value, and an impairment loss would be recognized in income for the excess, if any.

Intangible assets with finite useful lives, including acquired software and customer relationships, are amortized over their estimated useful lives of three years.

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the assets acquired, less liabilities assumed, based on their fair values. Goodwill is allocated as of the date of the business combination to the Company's reporting units that are expected to benefit from the synergies of the business combination. Goodwill is not amortized and is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Goodwill of the reporting unit is considered to be impaired when the carrying amount of the reporting unit exceeds its fair value. An impairment loss, if any, is recognized as a separate line item in the statement of earnings.

The process of determining the nature and amount of the individual intangible assets and for carrying out annual impairment tests, calls for considerable use of judgment, and requires all parties involved to make estimates and assumptions regarding future cash flow projections, future operating costs and appropriate discount rates to be used in the calculations. These determinations impact the amount that is initially recorded as goodwill or other intangible assets and the amortization expense to be recognized in future periods over the estimated useful lives of the intangible assets. Changes in estimates and assumptions can affect the reported value of goodwill and other intangible assets with indefinite useful lives.

Future income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are recognized for the expected future tax consequences attributable to differences between the tax basis of assets and liabilities and their respective reported amounts, and tax losses carried forward. The resulting changes in the net future income tax asset or liability are included in income. Future income tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is included in income when a change in tax rates is substantively enacted. Future income tax assets are evaluated periodically and if realization is not considered “more likely than not” a valuation allowance is provided.

At September 30, 2008, the Company had net operating loss carry-forwards for Canadian tax purposes of approximately $17,665,000 that are available for carry forward to reduce taxable income in future years. In addition, the Company had $23,975,000 (£12,706,000) of losses for tax purposes in the United Kingdom which are available to reduce taxable income in future periods. The Company believes there is sufficient uncertainty regarding the realization of future income tax assets such that a full valuation allowance is appropriate.

Business risks

PhotoChannel is subject to various risks and uncertainties that can significantly affect its financial performance. Key risks include the following:

Market and competition

There are inherent risks in the market for technological solutions. With the recent mass acceptance of the digital camera and camera cellular phone, the photography industry is quickly moving to employ an online technology, such as that offered by the Company. PhotoChannel’s primary competition consists of very large, established corporations which can afford to meet the ever changing demands of this marketplace. To the extent that PhotoChannel does not continue to expand its market offering or to penetrate this market in a timely and cost effective manner, or achieve cost-effective pricing for its services, the Company’s business growth could be adversely affected.

Changes in technology

The markets in which PhotoChannel operates are characterized by changing technology and evolving industry standards. The Company's ability to anticipate changes in technology, technical standards and service offerings is a significant factor in its ability to compete or expand into new markets. With limited experience in meeting customer requirements, there can be no assurance that the Company will be successful in continuing to identify, develop and market service offerings that will respond to technological change, evolving standards or individual customer standards and requirements.

Dependence on key people

PhotoChannel's growth and continued success depend on its ability to attract, retain, train and motivate highly skilled people. There can be significant competition for such people. There can be no assurance that the Company can retain its current key employees or attract and retain additional employees at acceptable rate, as needed. The loss and/or inability to attract certain key employees could have an adverse impact upon the Company's growth, business and profitability.

Potential for liability

There is a risk that the Company's systems may contain errors or defects or fail to perform. The Company currently contractually limits its liability for damages arising from its provision of services. While this is true of the vast majority of the Company's contracts today, such limitations of liability may not have been included in all of the Company's contractual arrangements in the past. Where such limitations have been included, there can be no assurance that they will be enforceable in all circumstances and will protect the Company from liability for damages. Furthermore, litigation regardless of contracts could result in substantial cost to the Company, divert management's attention and resources from the Company's operation, and result in negative publicity that may impair the Company's ongoing marketing efforts.

Currency exchange risk

The Company has customers in the United States and the United Kingdom and is therefore exposed to fluctuations in the value of the U.S. dollar and U.K. pound against the Canadian dollar. At this time the Company does not employ a hedge program. However, if there is a material change in circumstances and if the Company's expansion into either the U.S. or U.K. marketplaces place results in either a significant increase in revenues or expenses, then the level of the Company's risks to changes in the exchange rate could become important. Monetary assets and liabilities denominated in a currency that is not the primary or functional currency of the related subsidiary are translated to the functional currency of the subsidiary at the rate of exchange in effect at the balance sheet date with any resulting gain or loss included in the statement of loss. 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. Gains and losses resulting from these translation adjustments for self-sustaining foreign operations are recorded in accumulated other comprehensive income, a component of shareholders' equity, until there is a realized reduction in the net investment in the foreign operation.

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 in Canada 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.

The Company's 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 the Company 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.

In response to management's assessment of internal control over financial reporting as of September 30, 2007 and the identification at that time of certain weaknesses, as documented in 'Management's Report on Internal Control Over Financial Reporting', which was included in the Company's consolidated financial statements for the year ended September 30, 2007, the Company took steps during fiscal 2008 to employ additional resources with financial reporting experience, reporting directly to the Chief Financial Officer. The addition of this resource allowed the Company to improve its internal controls over financial reporting.

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 three directors, two of whom are not involved in the daily operations of the Company. 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.

Forward looking statements

This Management's discussion and analysis contains statements about expected future events and financial and operating results of PhotoChannel Networks Inc. that are forward-looking. By their nature, forward-looking statements require the Company to make assumptions and are subject to inherent risks and uncertainties. These forward-looking statements are based on current expectations. There is substantial risk that forward-looking statements will not prove to be accurate. Readers are cautioned not to place undue reliance on the Company's forward-looking statements as a number of factors including, but 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 could cause actual future results, conditions, actions or events to differ materially from targets, expectations, estimates or intentions expressed in the forward-looking statements; many of which are beyond the Company's control.

Future events and results may vary significantly from what the Company currently foresees. We are under no obligation to update or alter the forward-looking statements whether as a result of new information, future events or otherwise. For a more detailed discussion of factors that may affect actual results, see the section entitled "Business Risks".

Additional information

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