

***Transcript of
Fortuna Silver Mines, Inc.
Third Quarter 2016 Earnings Call
November 8, 2016***

Participants

Carlos Baca – Investor Relations Manager
Jorge Alberto Ganoza - President and CEO
Luis Dario Ganoza - CFO

Analysts

Chris Thompson - Raymond James
Jessica Fung - BMO Capital Markets
Mark Magarian - UBS
Craig Johnston - Scotiabank

Presentation

Operator

Good day, everyone, and welcome to today's Fortuna Silver Mines Third Quarter 2016 Earnings Call. At this time, all participants are in a listen-only mode. Later you will have the opportunity to ask questions during the question and answer session. [Operator instructions].

It is now my pleasure to turn the conference over to you, Mr. Carlos Baca. Please go ahead, sir.

Carlos Baca – IR

Thank you, Robbie. Good morning, ladies and gentlemen. I would like to welcome you all to Fortuna Silver Mines and to our third quarter 2016 financial and operations results call. Jorge Alberto Ganoza, President and CEO and Luis Dario Ganoza, CFO, will be hosting the call from Lima, Peru.

Before I turn over the call to Jorge, I would like to indicate that this earnings call contains forward-looking information that is based on the company's current expectations, estimates and beliefs. This forward-looking information is subject to a number of risks, uncertainties and other factors. Actual results could differ materially from our conclusion, forecast or projection in the forward-looking information. Certain material factors or assumptions were applied in drawing a conclusion or making a forecast or projection, as reflected in the forward-looking information.

Additional information about the material factors that could cause actual results to differ materially from the conclusion, forecast or projection in the forward-looking information and the material factors or assumptions that were applied in drawing a conclusion or making a forecast or projection as reflected in the forward-looking information is contained in the company's Annual Information Form, which is publicly available on SEDAR.

I would now like to turn the call over to Jorge Ganoza, President, CEO and Co-Founder of Fortuna.

Jorge Alberto Ganoza - President and CEO

Thank you, Carlos, and good morning to all. It is gratifying to see the results of a group effort sustained over the years. I am referring to the growth of our business and this being the first quarter of the newly expanded

production rate at our flagship San Jose mine in Mexico. Compared to a year ago, we show 67% growth in sales, 176% growth in mine operating earnings, 177% growth in EBITDA, 354% growth in net income. On a consolidated basis, we expanded our silver production by 20% and gold production by 29% compared to a year ago. We also benefited from 31% higher silver and 18% higher gold prices.

At current production, throughput capacities were in a position to process approximately 8 million to 9 million ounces of silver and 50,000 to 55,000 ounces of gold annually. For the quarter, we achieved a consolidated all-in sustaining cash cost per ounce of silver, net of byproducts, of \$7.60 and \$8.80 for the nine months. We not only brace ourselves for growth in production, but equally important we're focused on being a low cost miner.

Our low cost operations is explanation for a higher margin business. Our margin on mine operating earnings for the quarter stands at 63% and our EBITDA margin stands at 48% on sales of \$65 million.

Looking ahead now, our focus is on adding a third low cost operating mine to our portfolio with the development of the Lindero project in Argentina. We're in the process of taking first-hand ownership of several key aspects of the project before a construction decision is to be made. We have an advance of 60% on the reloading and interpretation of the geologic model with no material difference identified.

We have constructed and tested our own block model with no material differences identified. Review of the process design is the item that will require more work and time, which we expect to conclude late in the first quarter of next year. Here, we identify areas of opportunities. I know where more work is required to better support the existing process design. With respect to the pit, we believe this represents a great opportunity for an efficient low cost operation at a low strip ratios indicated in the feasibility study with room to achieve even further efficiencies.

All-in-all, work on Lindero is advancing well and on schedule, where we expect to be in a position to conclude our required tasks that would lead to a construction decision in the second quarter of next year.

So with that, I'll let Luis take you through the financial statements.

Luis Dario Ganoza - CFO

Thank you. So we have recorded sales of \$65.2 million, net income of \$11.8 million and earnings per share of \$0.09. The main impacts to our financial statements comes from the expansion at our San Jose mine, which as Jorge mentioned had its first quarter of production at the 3,000 tonne per day rate and 50% expansion after commissioning at the end of Q2. Sales were 67% above Q3 of 2015 as a result of both higher metals sold and higher prices. Silver and gold sold were 19% and 25% above the prior year, while realized prices on provision of sales were \$19.50 per ounce for silver and \$1,327 per ounce for gold. That is 31% and 18% above the prior year.

Also contributing to the increase in sales was higher base metal production of 17% for lead and 5% for zinc along with higher prices, in particular for zinc, which was up 22% over the prior year. Worth noting as well were the improved commercial terms in the second half of the year, which resulted in added revenue of \$1.5 million.

Our mine operating earnings was \$28.4 million, 53% above Q3 of 2015, reflecting sales growth and stronger margins at both operations, San Jose and Caylloma. Significantly contributing to our margins were the lower unit costs achieved at both our operating mines, 19% below the prior year at Caylloma and 12% below at San Jose.

Our selling and G&A was \$7.2 million compared to \$2.3 million in Q3 of 2015. You can see a breakdown of this item in page 11 of our presentation. Excluding share-based payments and the workers participation component, G&A increased 8% compared to Q3 of 2015. The same measure of G&A for the year-to-date period however is in line with the prior year.

We had strong EBITDA and cash flow from operations before changes in working capital of \$33.3 million and \$26.1 million respectively, reflecting our solid production and financial results. Our largest CapEx item for 2016 were concluded in the first half of the year, and as a result, we already saw strong cash build up from our existing operations in Q3 of 2016 and we expect this trend to continue at current prices.

Thank you. Back to you, Carlos.

Carlos Baca – IR

We would now like to turn the call over to any questions that you might have.

Operator

[Operator instructions]. And we'll take our first question from Chris Thompson with Raymond James. Please go ahead.

Q: Good morning, guys. Congratulations on a great quarter. Just interested in the costs obviously on a unit dollar per tonne basis at both operations. Nice little drop, I guess. Would these costs be sustainable at these sorts of levels on a forward-looking basis?

Luis Dario Ganoza - CFO

Thank you, Chris. We expect a small pickup in costs at Caylloma as we catch up with some preparation work. But our costs in the low-70s is what we budgeted for and what we expect, and at San Jose, pretty much the same. Our costs in the mid-50s is also what we can see for the year end.

Q: Perfect. Thanks. And Jorge, can you just give us a little bit of color as to what's happening on the expiration side of things at San Jose at the moment?

Jorge Alberto Ganoza - President and CEO

Yes. As some of you who have been following, we've been giving ourselves access, further access to explore the north extent of the [indiscernible] north zone by developing a 1,500 meter drift that will give us access to this extension. The drift has got two months delay for conclusion. We expect that drift to be concluded in January now, but that should not impede the start of the drilling. We're planning to initiate drilling from some of the chambers, in fact we're already drilling from one of the first chambers [indiscernible] and we expect to be testing that north extent of Trinidad North before the end of the year as it was originally planned.

Q: Thanks. And then just finally on Lindero, quickly, obviously, you were saying a development decision I guess second quarter of next year. Are you planning on putting out a revised technical study for the project, so we can look at the economics?

Jorge Alberto Ganoza - President and CEO

We do not anticipate that, because we don't expect material changes with respect to existing feasibility study. I think we already noted that as part of the review, we're seeing the convenience or not of bringing early sign to start a plant, that's something where we have not made a decision yet, but we believe, at this stage, it's something that needs to be looked at seriously.

But apart from that, we don't anticipate at this stage any change in the design that will prompt us to trigger another feasibility study, the current feasibility study is also this year, early this year. We'll look to optimize a few things here and there, perhaps bring the third plant for year one. The feasibility study for example calls for the use of the stackers for the heat in year two, I believe. That's something that we might want to bring forward to

year one and issues like that that I don't believe merits the production of a new document, at least at this stage, that's our view.

Operator

We'll take our next question from Jessica Fung with BMO Capital Markets. Please go ahead.

Q: Great. Thank you. Good morning, guys. A question to continue on Lindero, I note in the press release, you guys did say that all the permits are in place for development. Can you remind us if you need additional permits for operating there and then what that might entail?

Jorge Alberto Ganoza - President and CEO

Yes. Jessica, the main permit that covers all of our current and future activities involving construction and operation is a main environmental permit, is a provisional permit that we currently have in place. The only permit that will be required to initiate construction, and this is a permit that we would get once construction date is set up, start of construction date, it's at the municipal level, with the municipality of [indiscernible] and it's just a municipal permit. I would rank it as a secondary permit and is your typical municipal permit for any kind of construction that we need to take place.

And then there are other minor things, for example transport of explosives and things like that, that would have to be gotten in due course. But the main permit is environmental permit that's in place; we're currently drilling on site. And we're fostered by the existing environmental permit.

Q: And then at San José, can you give us sensitivity around the Mexican peso—I know it's difficult because you guys did also undergo extensions—but how's the Mexican peso also benefited you guys from a cost perspective?

Jorge Alberto Ganoza - President and CEO

So, our sensitive really at both operations is—cost structure is around 40% in local currency. So costs incurred will be around 40% in local currency, both Mexico and Peru are having the same sensitivity to the exchange rate. So it is certainly helping us and that is partly of course reflected in our cost performance.

Operator

[Operator instructions]. We'll take our next question from Mark Magarian with UBS. Please go ahead.

Q: Some of my questions on Lindero have already been answered by some of the previous folks. I did have one other thing regarding exploration around the site, I remember when you first acquired the project there was adjacent to the proven ore body there was potential for additional minerals to be added to the resource. Is that something you guys would be looking at doing during the construction phase or next year or is that sort of further out once you've got the thing up and running with the original plan?

Jorge Alberto Ganoza - President and CEO

We have some peer opportunities to resources, the more obvious one right now apart from expanding the existing resource, our logging suggests to-date that there are some opportunities to expand mineralization. We have identified through the relogging that we are currently doing extensions of the favorable lithologies that would suggest there's an argument to continue pursuing the stop work zones and disseminated goals of mineralization in some areas as part of the Lindero ore body. So there is some opportunity there that we're seeing.

There is also a big opportunity at the Arizaro, gold copper porphyry which is within our property. Arizaro holds currently a small gold copper resource; that's about 10 million tonnes if I'm not mistaken right now. But more importantly it's an exploration project that starts to make a lot of sense as we build infrastructure for Lindero. What we will effectively do is lower the threshold for discovery; Arizaro is well within tracking distance of Lindero,

and we see that as an immediate area of opportunity on the exploration front and potentially a significant one for the mine plant, and life of resources and research. Our plant right now we're budgeting for 2017 and what we are budgeting for first is carrying some metallurgical testing on Arizaro.

Arizaro appears to have a bit higher copper than Lindero, so we intend to understand the behavior of that copper and see if we have the opportunity to bring it in or explore it. As we intend to bring a third plant into the process design for Lindero that would certainly help us deal with an ore at Arizaro.

So, I think there is a clear exploration opportunity, the first think we intend to do at Arizaro and the first thing we intend to do is run some metallurgical testing into 2017. Apart from that we're quite excited about the opportunities for discovery in that entire [indiscernible] region and we're budgeting for a generative [ph] program for 2017 in that general area.

Q: And also just one other thing, are you still planning, assuming metal price at these prices or probably a little bit higher maybe next year that you can fund everything through your existing cash flow and your current treasury?

Jorge Alberto Ganoza - President and CEO

We're running sensitivities—could you repeat your question? You broke down, I didn't get your question fully.

Q: Just on, you are still expecting between treasury and current cash flow assumptions or current metal prices that you're expecting to have to raise debt or issue equity or anything else like that to pay for the initial Lindero rollout.

Jorge Alberto Ganoza - President and CEO

We do expect we'll have to take some level of debt to fund the construction of Lindero. We currently have a strong treasury but debt does play a role in our funding needs for Lindero. And the question for us is, how much debt as we run the deal sensitivities at different prices.

Operator

[Operator instructions]. And we'll take a question from Craig Johnston with Scotiabank. Please go ahead.

Q: Couple of questions, first one, just a follow-up to the previous gentleman's question with regards to taking on debt to build Lindero. What would you say is your minimum say cash balance you'd like to see or minimum working capital balance you'd like to have when considering those sensitivities?

Jorge Alberto Ganoza - President and CEO

I guess, I mean we typically fit to maintaining the balance sheet a cushion in the range of \$30 million to \$50 million, I would say that's a minimum with which we tend to feel that comfortable for the business we're in. It's a relatively short build. We reckon that 18 months is kind of time that it will take from start to finish, so there will be a low point in the treasury for maintaining in that low point something in that range is something that we would be comfortable with.

Q: And then just maybe even a housekeeping question on the Lindero acquisition. Correct me if I'm wrong but when the announcement or the acquisition was announced, Goldrock had about \$11 million in cash, if I'm not mistaken. Just wondering looking at the financial statements, I guess we had incorrectly assumed that there would be some cash coming over from the Goldrock acquisition, but it looks like there wasn't. Any commentary just around say the use of those \$11 million?

Jorge Alberto Ganoza - President and CEO

I mean ultimately we reflected net cash received from Goldrock of a bit over \$0.5 million but that's the way the accounting will reflect the fact that certain of the cash costs of the transaction were actually paid out by Goldrock. And that takes away a portion of that cash balance. I would say that including those amounts the actual net cash that we should consider we did receive from Goldrock was more in the range of \$3.5 million.

Q: And then maybe one just final question staying with Lindero, any guidance you guys can give us on costs from say now until construction decision is made, how much you plan to spend there?

Luis Dario Ganoza - CFO

We have a budget of \$7.5 million to take us to the second quarter of next year with all of the engineering work and drilling the work in there.

Operator

And it appears we have no further questions at this time.

Jorge Alberto Ganoza - President and CEO

Thank you, Robbie. I would like to thank everyone for listening to today's earnings call; we look forward to you joining us next quarter. Have a good day.