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Transcript of
Fortuna Silver Mines
2013 Year-End Earnings Call
March 18, 2014

Speakers

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

Presentation

Operator

Welcome to the Fortuna Silver Mines 2013 Year-End Financial and Operations Results conference call. At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Carlos Baca, Investor Relations Manager for Fortuna Silver Mines.

Carlos Baca – Investor Relations Manager

Good morning, ladies and gentlemen. I would like to welcome you all to Fortuna Silver Mines and to our 2013 Year-End Financial and Operations Results Call. Jorge Ganoza, President and CEO, and Luis Ganoza, Chief Financial Officer, will be hosting the call from Lima, Peru.

Before I turn the call over to Jorge I would like to indicate that certain information contained or incorporated by reference in this earnings call, including any information as to our strategy, projects, plans or future financial or operating performance constitutes forward-looking statements. All statements other than statements of historical fact are forward-looking statements. The words believe, expect, anticipate, contemplate, target, plan, intend, continue, budget, estimate, will, schedule and similar expressions identify forward-looking statements.

Forward-looking statements are necessarily based upon a number of estimates and assumptions that while considered reasonable by the company are inherently subject to significant business, economic and competitive uncertainties and contingencies. Known and unknown factors could cause actual results to differ materially from those projected in the forward-looking statements. We disclaim any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise except as required by applicable law.

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I would now like to turn the call over to Mr. Jorge Ganoza, President, CEO and Co-Founder of Fortuna. Thank you once again to everyone for joining us.

Jorge Ganoza – President and CEO
Thank you, Carlos, and good morning to all. I'm joined on the call today by Luis Ganoza, our CFO. I will initiate the conference call and with the assistance of Luis we'll be giving a summary and analysis of our operations and financial results for the fourth quarter and year-end 2013. Once concluded, we will address your questions.

The evolving story around Fortuna in 2013 has been the discovery of the Trinidad North … mine … Well, there is nothing like a higher grade discovery to energize the mining organization and capture the attention and imagination of mining analysts and investors at large. The exploration success has been underpinned by yet another year of solid operational and financial performance in a difficult year.

So 2013, we have seen a continuation in the steady decline of precious metal prices from their peak in mid-2011 where average realized metal prices in 2013 were $23.50 per ounce silver and $1,395 per ounce for gold, lower by 34% and 16% respectively when compared to 2012.

This has been a trying year for the mining industry. Companies in the sector have been implementing change to operate in the lower priced environment and in the process, we have seen personal layoffs, cuts in exploration and capital spending, reserve reductions and balance sheet adjustments to impairment charges. Although we have not been immune, I am pleased to report that our company has been able not only to adjust to this new environment but position ourselves to thrive in the years to come.

At the San Jose mine, as of December 31st we reported a year-over-year increase in reserves of 12% for silver and 15% for gold after production-related depletion and taking into consideration 18% lower silver price used in estimation. Silver reserves now stand at 23 million ounces and gold at 200,000 ounces, almost. Silver reserves grade stayed at 197 grams per ton and gold grade increased by 7% to 1.7 grams per ton.

Silver and inferred resources at San Jose increased year-over-year by 39% to 35 million ounces and gold by 26% to 270,000 ounces. Silver grade increased by 9% to 202 grams per ton while gold stayed without variation. This inferred estimate included for the first time an initial inferred resource for a portion of the Trinidad North discovery. With only six months of drilling at the time, we were able to incorporate at a 70 grams per ton silver equivalent capital, 1.9 million tons containing an estimated 16 million ounces of silver and 100,000 ounces of gold with a silver grade of 269 grams per ton and a gold grade of 1.7 grams per ton.

Mineralization remains wide open and we continue to pursue it in three directions: to the north, depth and to surface for 300 meters above level 1,200. The relevance of this discovery is two-fold, in our view.

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First, these new ounces are located in the immediate area of existing and planned infrastructure, therefore making them low risk in terms of capital permits and time to production. Second, it brings to the forefront the tremendous exploration potential that our solid 60,000 hector package around the nine holes. At San Jose, all of our reserves and resources lay in one vein, in one ore shoot. We are of the view that based on the areas of multiple veins and gold anomalies in our concession holdings we have an excellent chance to source more discoveries through time.

In 2014, we will continue with exploration of Trinidad North with an initial 16,000 meter drill program and aim to produce a new research outlet in the second semester of 2014. At the Caylloma Mine, we reported a year-over-year silver reserve reduction of 24% to 14 million ounces after depletion. The main driver for the reduction in reserves was the 18% reduction in silver price used of $24 for the estimation and a 9% increase in break-even capital to $87 per ton when compared to the capital used the previous year.

Silver grading reserves increased marginally to 137 grams per ton, lead grade increased 11% to 1.7% and zinc grade increased 16% to 2.5%. Silver and inferred resources decreased to 24 million ounces.

Our consolidated production for the year 2013 was 4.6 million ounces of silver and 21,000 ounces of gold, 3% above year guidance for silver and 10% below for gold. Silver accounted for 66% of sales and gold for 15%. The balance was made up by lead and zinc byproduct. For 2014 consolidated product guidance, it's for six million ounces of silver and 32,000 ounces of gold, representing 30% annual growth in silver and 51% in gold production estimates.

In September 2013 we commissioned the expansion of our San Jose mine to a throughput capacity of 1,800 tons per day, on time, on budget only two years after the start of operations at the 1,000 tons per day back in September 2011. During the construction and equipment selection for this expansion we were able to capture opportunities to plan for yet another expansion to 2,000 tons per day, which we plan to materialize by the start of the second quarter 2014.

At this new targeted rate, our consolidated annual silver and gold production is planned at 6.5 million ounces of silver and 35,000 ounces of gold plus byproduct zinc and lead. The pace of discovery and current price of the resource and reserves at the San Jose mine already suggests potential for an operation beyond 2,000 tons per day. During 2014 we will be working to assess the technical and financial viability of an expansion to 3,000 tons per day. For 2014, our Caylloma Mine is planned to remain at steady state, contributing roughly two million ounces of silver a year plus some 10,000 tons of zinc and 7,500 tons of lead.

In mid-2013 the company successfully implemented a series of cost control measures, capital product cuts and refocused exploration programs to higher reward targets. For consolidated, all-in sustaining cash cost net of byproducts for 2013 was $20.40 per silver ounce, in line with revised guidance issued for the year. Capital spending in this expansion year was $60 million, including the $10 million acquisition

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of the Taviche Oeste Concession which hosts the Trinidad North discovery acquired from Pan American Silver.

This capital figure of $60 million is down from the $70 million we guided at the beginning of the year. This reduction was part of our restructuring process that took place mid-year. Q4 all-in sustaining cost at the San Jose Mine was a low $10.80 per ounce net of byproducts. At Caylloma, all-in sustaining cost net of byproducts for the quarter as well was $18.50.

Our guidance for 2014 is for a consolidated all-in sustaining cash cost of $17 per silver ounce net of byproducts. This includes $40 million in sustaining capital spending at both operations. Our lowest cost operation is San Jose where we have issued an all-in sustaining cash cost guidance of $14.40 per ounce for the year net of byproducts. For Caylloma Mine, it's planned to operate in 2014 as an all-in sustaining cash cost of $17 per ounce net of byproducts.

At year-end we had liquidity of $90 million comprised of almost $50 million in cash and short-term investments plus an untapped facility of $40 million. The company is adequately funded to meet its foreseen capital requirements.

I would now let Luis take you through the financial statements.

Luis Ganoza – CFO
Thank you. So for 2013 we recorded a net loss of $19.1 million compared to net income of $31.5 million in 2012. The loss was driven by an impairment charge at the Caylloma Mine in Peru of $30 million pretax, or $20.4 million after tax, and a $7.7 million one-time non-cash income tax provision reflecting the initial recognition of the Mexican tax reform.

Adjusting for the impairments, write-offs and the initial recognition of this Mexican tax reform, our adjusted net income for 2013 was $9.4 million, or $0.08 per share compared to $34.1 million in 2012. The main driver for the reduction in adjusted net income was decreasing sales of 15% with respect to 2012, which was in turn the result of lower realized silver and gold prices of 24% and 15% respectively.

Our recorded sales came down from $161 million in 2012 to $137.4 million in 2013 despite having increased total allowances of silver sold by 16%. Our mine operating earnings decreased 41% to $41.8 million, reflecting the native impact of lower metal prices.

For the fourth quarter of 2013 we recorded adjusted net income of $3 million compared to $8.5 million in 2012. To understand the comparative performance for the fourth quarter, however, it is better to compare adjusted income before taxes, which for 2013 was $6.5 million versus $8 million in 2012. The more modest drop we see in adjusted earnings before taxes in the context of a sharp fall in metal prices is a result of a material increase in ounces sold of silver and gold quarter-over-quarter and a significant reduction of unit cash costs at the San Jose Mine again when compared with the prior year period.

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Realized prices for silver and gold fell 37% and 26% while ounces of silver and gold sold increased 49% and 64% respectively when compared to Q4 of 2012. Along the same lines, unit cash cost came down at San Jose and Caylloma by 23% and 7% respectively. Also contributing to improved results quarter versus quarter was the lower selling and G&A of $1.5 million in Q4 of 2013.

The amount of impairment for 2013 was $30 million before tax, of which $50 million was booked in Q2 of 2013. The impairment testing conducted at year-end as opposed to Q2 was based on 2013 updated reserves and resources and somewhat more conservative metal prices. Based on this, an additional $50 million impairment charge was recorded for a total amount of $30 million for the year. The total after tax impairment amount, once again, was $20.4 million and it was entirely related to recurring book value of the Caylloma Mine.

Cash flow from operations before changes in working capital for 2013 decreased 34% to $40.0 million, reflecting as well the impact of lower metal prices. Our total investments throughout the year in mineral properties plant and equipment was $60.5 million, which was comprised of $10 million for the acquisition of Taviche Oeste, $10.2 million of Brownfields exploration and approximately $40 million of equipment and infrastructure.

Our total cash balance, including short-term investments for the year in 2013 was $49.1 million compared to $64.7 million at the end of 2012. This is a reduction in our overall cash position of almost $16 million, explained by the conclusion of certain infrastructure projects at Caylloma and the expansion at San Jose as well as the fall in metal prices in the first half of 2013.

Carlos, back to you. Thank you.

Carlos Baca – Investor Relations Manager
Thank you very much for listening to us. We would now like to turn the call over to any questions that you may have. Please state your name clearly.

Operator
Our first question is from Benjamin Asuncion from Haywood Security.

<Q>: I just have two things here. Just to elaborate on the Caylloma impairment that you took in Q4, can you give me a sense of what your, if you can, on a cost per ton kind of assumption that you had baked in going forward as what you're looking at to drive that impairment charge?

Jorge Ganoza – President and CEO
The cash cost, the forecasted cash cost per ton in both the exercise done in Q2 and the exercise done at year-end are quite similar and are in the range of $88 to $89 per ton moving forward, Ben.

<Q>: It's normally driven by lower future metal prices that you had layered in plus the updated reserves. Is that correct?

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Jorge Ganoza – President and CEO
Yes, yes. We saw a reduction in reserves at Caylloma and at year-end we were using somewhat more conservative metal price projections, yes.

<Q>: Just looking at the fourth quarter cost as San Jose, we saw you deliver sort of the $62 per ton. That improvement in cost, was that solely attributed to the increase in throughput from kind of 1,100 to 1,700 tons?

Jorge Ganoza – President and CEO
You mean the reduction in unit cost Q4 at San Jose as compared to the previous year?

<Q>: Sorry, I'm looking at compared to third quarter you were around $72 a ton and fourth quarter you were around $63.

Jorge Ganoza – President and CEO
Yes, absolutely, absolutely. It reflects the increase in throughput capacity as well as some more, I would say, functional gains in efficiencies also as a result of the measure undertaken throughout Q3 in order to contain operating and capital cost.

<Q>: So can you give us a sense of what at the 2,000 ton per day level when you get there at the end of or the beginning of the second quarter what the sort of normalized cost per ton level that you're going to look at?

Jorge Ganoza – President and CEO
Yes, we're forecasting $65 per ton, $65 per ton for the 2,000 ton per day throughput rate. Cash flow per ton should stay within those ranges throughout most of 2014.

Operator
Our next question comes from Chris Thompson from Raymond James.

<Q>: I just want to understand—maybe you can just provide a bit of color on what's happening as far as surface access in the Magdalena community and how that sort of layers into the company's ability to continue to, I guess, see the strike length extension at Trinidad North.

Jorge Ganoza – President and CEO
Good morning, Chris. We are engaged in the negotiation process with the community of Magdalena to gain access to the surface rights that will allow us to pursue the exploration of the north strike extension of the main Trinidad vein system. This negotiation is taking place with the new authorities, with the new elected authorities that took office in January and we are working with the assistants of the state government representatives, which we view as favorable, and that is how this negotiation took place.

It's the same dynamics and the same structure that took place a couple years ago when we negotiated the pipeline for the water that had to cross the Magdalena town, no? It was the Magdalena representatives, company representatives in the neighborhood from the state government. So, that's taking place.

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There is a working negotiating team. The three parties have agreed on a deadline of late April, early May to negotiate an agreement that will allow us to have access to surface rights and the objective is not only to gain access to do drill platforms but also start looking into building more long-term infrastructure that we could require for the future, no?

We can carry the work we plan to do for 2014 and for 2015 from the existing underground access, so the 2014 program does not require any additional permits for surface rights, but yes, of course we would like to have, we would like to gain the surface rights to continue, if we could, extending the exploration beyond the immediate 500 meters that we can currently cover from underground access.

We have identified potential strike length of roughly a kilometer-and-a-half to two kilometers from the existing boundary of resources to the north. There is a solidified outgrowth that we have recognized two kilometers along strike. This is well within Magdalena surface rights and that's why it is key to gain access from Magdalena. I'm hopeful that we will be able to reach an agreement. We just have to go through the process with them.

Operator
Our next question comes from Chris Lichtenheldt from Dundee Capital Markets.

<Q>: I'll actually just follow-up on Chris' last question there about the surface rights. You mentioned a deadline late April, early may. If that comes and goes, does that mean that the option or the possibility of getting land access is over or you start over with a new negotiation? How does that work?

Jorge Ganoza – President and CEO
What I have conveyed to you regarding a suggested date for the completion of the negotiations is what this three party group has produced with the three party group being confirmed by Magdalena representatives, company representatives and the state government representatives. Of course, this can stretch for longer. Yes, it could. That does not mean that there is a break and we start from zero again, but they believe that within a couple of months, a few weeks we can have a reasonable agreement.

Past performance is no measure of future success, but if we look at our past dealings with Magdalena again, it took us six, seven months the first time we engaged them to gain access to build two kilometers of pipeline through the property once we engaged in negotiations like we are now. At the time, what we agreed to was to contribute in the range of $50,000 to $100,000 in infrastructure projects and assist them with the purchase of one vehicle for the municipality as part of the agreement.

So, we have dealt with them in the past successfully in a win-win situation for all and I expect that this time it will be the same. I have no reason to believe that we should not be able to reach a reasonable agreement for all parties.

<Q>: If the negotiation is successful, is that enough to allow you to then put a drill hole like a kilometer-and-a-half out to test what you think might be the boundary? You'd have enough access to do that?

Jorge Ganoza – President and CEO
I can tell you what we aspire to get out of this one negotiation, and now depending on how this plays out at the end, it can be structured in different ways, so I don't want to get ahead of myself. I can tell you what we would like to get in this negotiation with our neighbors here. We would like to get access not only to drill holes but gain access to drill holes and eventually build some permanent supporting infrastructure. For example, ventilation … and things like that.

The main, the core of our infrastructure will always be in the area of the San Jose mine where we control the surface rights, but potentially, we continue pursuing the north extent with underground workings. It will be helpful to have ventilation … bores and other small infrastructure as we stretch further to the north, not just drill platforms, right?

<Q>: Then just lastly for me, outside of this negotiation, can you just remind us when we would expect to see more assay results from the separate drilling that you're continuing to do, what the timing is of that?

Jorge Ganoza – President and CEO
News flow will be steady throughout the year. We're drilling from underground, so that goes a bit slower. Every three months at least I would expect that every three months we can be releasing information.

Operator
Our next question comes from Marco LoCascio from Equinox Partners.

<Q>: My question relates to the estimated cap ex at San Jose for 2014. I'm wondering how much of that is earmarked for drifting towards the Trinidad North discovery and working towards bringing that into the mine plant.

Jorge Ganoza – President and CEO
If you look at our budget, we have a mine development budget of $7 million for 2014. The capital budget allocated to incorporate, to build infrastructure to initially incorporate Trinidad North to the existing infrastructure is roughly $5 million over two years.

<Q>: So the 2014 portion is included in that $7 million of mine development.

Jorge Ganoza – President and CEO
Hello?

Operator
Excuse me, speakers. Are you still there?

Carlos Baca – Investor Relations Manager

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Yes, they seem to have lost the line.

Operator
They might have muted themselves.

Jorge Ganoza – President and CEO
Hello?

<Q>: Yes, I'm here. Sorry about that. I was just asking—so in the $7 million of mine development for this year, that includes the portion of that $5 million that will be spent in 2014.

Jorge Ganoza – President and CEO
The $7 million mine development fee for 2014 includes roughly $2 million to $2.5 million that are ticketed to the work related to incorporating Trinidad North into existing network of underground infrastructure.

Operator
At this time we have no further questions. I would like to turn the call back over to our speaker for closing comments.

Carlos Baca – Investor Relations Manager
If there are no further questions I would like to thank everyone for listening to today's earnings call. We look forward to you joining us next quarter. Thank you very much.

Operator
Thank you. This does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation.