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Transcript of
Fortuna Silver Mines
Third Quarter 2013 Earnings Call
November 6, 2013/12:00 p.m. EST

Participants

Carlos Baca – Investor Relations
Jorge Ganoza – President, CEO and Co-Founder
Luis Dario Ganoza – Chief Financial Officer

Presentation

Operator
Greetings, and welcome to the Fortuna Silver Mines' Third Quarter 2013 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Carlos Baca. Please go ahead, Mr. Baca.

Carlos Baca – Investor Relations
Thank you, Operator. Good morning, ladies and gentlemen, I would like to welcome you all to Fortuna Silver Mines and to our third quarter financial and operations results call. Jorge Ganoza, President and CEO, and Luis Dario Ganoza, our Chief Financial Officer will be hosting the call from Lima, Peru.

Before I turn over the call 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 facts are forward-looking statements, the words, believes, expect, anticipate, contemplate, target, plan, intend, continue, budget, estimate, will, schedule and similar expressions identify forward-looking statements.

Forward-looking statements aren't 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 uncertainty and contingencies.

Known and unknown factors could cause actual results to differ materially from those projected in the forward-looking statements. We disclaim an 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.

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

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

We have two significant milestones for the Company, which have taken place in the third quarter and this past month of October. First, in September, we announced the successful commissioning of the expansion of our San Jose mine/mill, an increase of 60% in throughput capacity, going from 1,000 tonnes per day to 1,800 tonnes per day.

And second, on October 17 we announced an update research and reserve estimation for our San Jose mine, reporting an increase of 22% in silver reserves and 39% in silver inferred resources. The jump in inferred resources come at a higher grade and is attributable to the early inclusion of drill results from the Trinidad North discovery with only six months of drilling prior to the resource estimation cut date of July 4.

The high grade … remains wide open to the north and to that we're currently drilling, exploring the extension from underground with one rig and will be including a second one this month.

For silver and gold production, year-to-date it's in line to meet annual guidance of 4.4 million ounces of silver and 23,600 ounces of gold or 5.9 million silver equivalent ounces. Silver produced in the quarter was 1.1 million ounces and 4,500 gold ounces. Compared to Q3 2012, silver is up by 8% and gold is down by 16%.

For Caylloma mine, performance in terms of mill throughput and grades are in line with our budget and the comparable quarter. Silver output is 6% above year-to-date guidance.

Something to highlight, our silver recoveries are up to 84% against recoveries of 78% in our budget and 76% in comparable quarters. We believe we can sustain and have opportunities to continue improving on silver recovery at Caylloma.

Our San Jose mine, mill throughput for the quarter was down 8% against budget, due to scheduled stops related to the commissioning of the expansion. Silver grade was slightly below budget at 2%, but gold grade was down by 15% against budget. The combination of less throughput and lower grades resulted in a 10% drop in silver and 22% drop in gold production for the quarter.

With the commissioning of the expansion behind us, we plan to see a stronger quarter at San Jose in Q4 and onwards. We attribute the drop in gold grade to local grade variations within our models and production plans. Long-term research grade to production … at San Jose is acceptable.

Silver accounted for 64% of sales in the period, gold, 12% of sales, led, 11% of sales and zinc, 12% of sales.

Moving on, capital reductions and cost cutting measures implemented at the mines and corporate in mid-year have been successfully implemented with visible results this quarter. At Caylloma, cost per ton is down by 7%, from $95 to $87 per ton, in line with our target, reverting several quarters of cost increments. At San Jose, cost per

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ton was 7% higher than budget at $72.00, mainly impacted by 8% less throughput in the period related to the commissioning of the expansion.

We expect to feel the benefit of the higher throughput capacity starting in Q4 with higher metal output and lower cost. So we reaffirm cost and production guidance from this mine for the year.

On an all-in cost basis, Caylloma was also in line with budget and guidance, with about $21 per ounce versus 2013 guidance of $20.80 per ounce. At San Jose, year-to-date all-in cost was $23.80 against $19 projected for the year. Once again, we expect to see all-in costs coming down in Q4, as the commissioning is behind us and we benefit from higher metal output.

For the period 2014-2016, we have guided to lower all-in costs of $12 and $11 at San Jose and Caylloma respectively. This reflects the mines of steady state levels of 1,800 tonnes per day and 1,300 tonnes per day.

In light of the Trinidad North Discovery, we are assessing opportunities to increase throughput in the near future. We will be reporting on this initiative, as exploration progresses in these new zones.

Silver price for the quarter was $21.30 per ounce and gold was $1,327 per ounce.

At the end of the quarter, we reported a cash position of $42 million. The Company's adequately funded to meet its capital requirements from cash at hand and cash flow generation.

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

Luis Dario Ganoza – Chief Financial Officer
Thank you, Jorge. We recorded a net loss for the period of $0.3 million and income before tax of $2.2 million. Just to emphasize that, we actually recorded income before taxes but nonetheless recorded a net loss. The reason for this was mostly the high effective tax rate at our operating subsidiaries, resulting in an income tax revision of $2.5 million, which tipped us into a loss for the quarter.

Our income before taxes in the period decreased by $10.1 million when compared to Q3 of 2012, where this decrease is explained mainly by lower realized silver and gold prices of 29% and 21% respectively.

Our sales decreased by 31% as a result mostly of lower prices and to a lesser extend as a result of lower gold sold against the comparable period of 25%. The latter is in turn explained by lower gold production and a slight accumulation of inventory in Q3 of 2012.

Our mine operating income decreased by 58% driven by the drop in sales, mainly the affect of sales was partially offset by improved cost performance at San Jose when compared to the previous year. Unit costs came down by 11% at San Jose, and the Caylloma, the significant improvement in silver recoveries also held and partially offsetting the affect of lower prices.

Our operating income for the quarter was 81% below Q3 2012. However, here we also had a positive factor helping us offset partially the lower sales. Our total selling, general and administrative expenses were $1.8 million lower than 2012. Around half

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of this reduction is explained by our cost cutting measures, the other half is related to lower stock-based compensation.

In terms of our income tax, as described before, our effective tax rate for the quarter was particularly high and unusual in the sense that it was above 100%. On a quarterly basis the effective tax rate can be quite volatile. It is better to look at the year-to-date rates to get a better sense of what is going on, and to make sense of our year-to-date effective tax rate however we have to strip out the effect of the $50 million impairment recorded in Q2. Back then we disclosed related impact on deferred taxes of $4.8 million. So considering this to P&L the effect of impairment, our year-to-date effective tax rate is around 55%.

It is high with respect to the 40% to 45% we would usually expect to see, and this explained by the devaluation of the Peruvian sol against the dollar that we have seen throughout the year. This has had an impact on both our incurred current tax and the deferred tax calculation that shows up in our income statement.

Moving down to the cash flow statement, net cash provided by operating activities for the nine months ended September 30 was $28.2 million and cash consumed in capital expenditures, that is property, plant and equipment was $51.3 million, including the $10 million acquisition of the Taviche Oeste concession.

This corresponds to a net consumption of cash of around $23 million, which explains the decrease in our cash position throughout 2013, which considering short term investments went from $64.7 million at the beginning of the year to $42.7 million at the end of September.

Carlos Baca – Investor Relations
Thank you very much for listening in. We would now like to turn the call over to any questions that you may have. Operator we are ready to take questions.

Operator
Our first question comes from Nicholas Campbell from Canaccord Genuity.

<Q>: I'm just wondering if you can give us a little bit of an indication into how the grade schedule is going at both mines in Q4 and whether or not we should expect to see any sort of deviations from the most recent mine plan from 2014 onwards?

Jorge Ganoza – President, CEO and Co-Founder
Nick, I assume you are asking particularly about gold rates at San Jose. As I stated, Caylloma is meeting guidance. What have identified the San Jose is a bit of … defect, which we have not singled out before. It's to be expected due to the nature of gold.

We believe it is in our plans to achieve guidance; in fact we are starting to see in the month of October gold better in line with what we project for the month. We have taken several measures to help us mitigate the liability we are seeing in gold on the short-term basis.

I like to stress that we have looked deep at the reconciliation of our resource, reserve production models to production, and reconciliation is quite good within 10%, which for models like these would be acceptable. We attribute these to changes to local variations within production sounds, so where the mine is transiting at a given point, so I can report that in this fourth quarter we are seeing gold closely aligned with 1.6 grams that we forecast for the period in our plan.

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To give a bit of background in the first quarter this year we saw gold deviating down 9% from our plan. In the second quarter gold was in-line with our plan, and this third quarter we had seen gold off 15% in terms of grade as I stated. We do expect we will trend towards to be within 10%, which is reasonably to be expected.

<Q>: You mentioned that you are also assessing on an ongoing basis the potential to further expand the San Jose mine, depending on the results at Trinidad North. Can you give us an idea about how, what the limitations are? I understand there are some limitations in terms of water availability in the area. Just how is that all going to fit in with the potential expansion?

Jorge Ganoza – President, CEO and Co-Founder
Yes. We'll not see any bottlenecks in the plant. The plant can be easily expandable. We do not see any bottlenecks on the mine. As it is designed today, it could be scalable significantly. We have enough power.

Water has always been the issue we deal with at this mine. The mine was originally designed for 1,000. We devised water sources for a 1,000. Then we designed an expansion to 1,500. We were able to develop sources for 1,500. We went up to 1,800. We've been able to develop water sources that are now good up to 2,000 tonnes per day.

Our water balance is met for up to 2,000 tons per day, and we're currently in the process of implementing additional solutions particularly on the matter of evaporation control. Our immediate water opportunity is around evaporation control. As you know Nick, we store water in our tailings dam, which is a large water reservoir and where we are subject to very high amounts of evaporation, as a result of the large surface area of the farm.

So we are in the process of implementing our solution. If we can control as much as 80% to 90% of evaporation, and that's still to be seen as we're implementing the solution, the manufacturer claims we can achieve 90% control, we could have a substantial amount of water available.

What we're saying is that we need 2014 for exploration to progress for us to have a better handle on the kind of throughput that we should be modeling for an increase and also to look at more realistic water balance, not just the theoretical water balance based on evaporation control measure that we're implementing. And bringing those two together, come up with a plan for an expansion.

Additional to the evaporation control, we are looking at potentially new sources of water. As you know we already source water from a sewage plant, which is actually a project we're quite proud of. It's been done. It has a great social and environmental impact in the area.

There is a second town in the vicinity where we already have some preliminary discussions and some scope in level engineering regarding the implementation of a second sewage plant to draw water from that processing of sewage like we already do. So we have alternatives at hand. We are also looking to implement/migrate from conventional handling of tailings to baste that would also be an opportunity to get wider … level from the tailings.

So we have opportunities at hand to think about higher throughputs than the current 2,000 tonnes per day that we have in our water balance today. We just need a bit of

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time in order to be able to put all of these ideas and initiatives in paper backed by engineering.

<Q>: Just one more question and I will let somebody else ask one. The realized prices that you guys had for this quarter were pretty low. I assume some of that just has to do with the terms in your … that your selling. How much of it had to do with re-pricing of provisional pricing in a declining price environment?

Luis Dario Ganoza – Chief Financial Officer
I think you are referring, Nick, to the net realized prices we report, and these are all really reported based on provisional sales. So they would not include negative adjustments or positive adjustments from the price or other factors.

We did experience a bit of low-grade concentrated production at San Jose, which affects commercial terms. And that would really be the only driver impacting net realized prices as compared to what we have been reporting in the past and the realized prices we report as well.

<Q>: Is that related to the low grade in the quarter or is that something that's going to happen on a regular basis?

Luis Dario Ganoza – Chief Financial Officer
No, no it really had to do with a particular event to a quarter, moving forward in terms of our net realized prices on silver. So as you know considering the actual payable metal and refining charges, our net realized price is around 90% to 92% of the actual average prices that we are getting in the market for the quarter. So that's what we should expect going forward.

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

<Q>: Two quick questions, one on the San Jose, I understand obviously that you're going to be underground drilling I guess two rigs soon to test the underground potential of the discovery there. At what point would you need if at all to get access, surface access to fill the in-fill drilling of that discovery zone?

Jorge Ganoza – President, CEO and Co-Founder
Right now we are in a position to carry the exploration of immediate discovery. We are expecting out as much as 250 to 300 meters via underground access. Now all of the Northern extent for the projection of Trinidad North to the North is covered under Quaternary gravels. So there is no output.

The only hint of continuity is a small out grove located two kilometers away of basically … that stands as a small window within the small island within the Quaternary gravels. That's two kilometers.

We intend to test as much of the Northern extent, and just for reference we can start talking about the coverage of this initial two kilometers. To correlate the two-kilometer extent in any effective manner, we of course would need surface access. The surface property lies within the community of Magdalena.

The community of Magdalena is a community with which we have had previous successful negotiations. There has been an election in Magdalena. There is a new municipal … authority in place, and they are taking office in January.

We have had some early discussions with the new elected officials. They are receptive to the idea of granting us permit to access the surface. We are just waiting for January for them to take office so we can engage in a negotiation with them and discussion.

In the meantime, all the work that we have to do we can carry from the underground, which is an immediate step out from the discovery in an area of 200 meters to 300 meters. With existing infrastructure, now we can continue driving that to the North with underground development. To take kilometers away, 100 meters away, two kilometers away, of course we would like to do rule that in 2014.

Although I wouldn't commit to give dates regarding when we can get a permit, because you guys must know, Oaxaca is challenging, I do believe that based on previous history, we will be successful in achieving those permits with this particular commitment.

<Q>: Just one more question I guess on the cost per ton mill that Caylloma—I mean it's nice to see the cost coming down there. So $87 per ton milled, is that sort of cost sustainable at that sort of level into the near-term? What should we be modeling there, do you think?

Luis Dario Ganoza – Chief Financial Officer
We believe the costs are sustainable. We have gone through the process of optimizing the mine, optimizing the development, optimizing the amount of development and preparation charge to cost to take it steady 1,300 tonnes per day. That is one large source of savings. Another one was reduction in headcount at this operation of roughly 9% and 8%. So the short answer is yes, we believe it's sustainable, Chris.

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

<Q>: Just a question on Trinidad North, when you presented the initial inferred resource recently, you presented a number of cut-off grade scenarios. Based on your early understanding of the discovery, can you discuss your abilities to mine at a higher cut-off of 150 plus in order to provide a real sweetener to the mill? Are there being higher grade in the center and sort of peter off or are there some lower grade grains you would not mine in order to sustain a higher mill fees and transference?

Jorge Ganoza – President, CEO and Co-Founder
That's a good question. Let me elaborate. We did highlight in the release resources at our cut-off of 70 grams, because that's in line what we've been using in demand deposits, but we did provide a range of cut-offs.

There are two ways for you to get a sense of what is that we can achieve here. One is just graphically you can go into our sections in the website and the presentation and look at the grade countering and thickness countering of a grade and thickness. What you will see is a very consistent clustering of high grades, the strong purples and reds in the contouring … a broad … . So that's just one physical first-class view of how the high grades are deteriorated.

And the second one is if you move the cut-off from 70 grams, at 70 grams what we report is 1.8 million tons at a silver equivalent grade of 360 grams for 60 million ounces of silver contained. If we move cut-off to 150 grams, we only lose roughly

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400,000 tonnes, in term of tonnage. Tonnage rose to 1.3 to 1.4 million tonnes, but grade jumps from 350 to 460 grams and total ounces go from 16 million to 15 million. So we only lose 1 million ounces.

So what this indicates is that we are losing when we move the cut-off in the periphery of the resource. We are currently running in durations, even though this is an inferred resource and we treated as such, we internally run durations to see at a higher cut-off what happens. When is it that we start getting that spotted, dark pattern where you see the higher grades dispersing, and what would be sensible to view this as a mining opportunity?

At what cut-off would it be sensible to see this as an opportunity for high grades, because what we are saying is that short-term how do we benefit from the discovery? What we are saying is we have here the opportunity by early 2015 to start sourcing all from Trinidad North. This discovery is so close to existing infrastructure that we could be in a position to have this area mine accessible, the area of inferred resource mine accessible by 2015.

We are in a position to start sourcing rock from that zone in 2015. So if we can source higher grade rock than what we are currently mining in the upper levels, we can replace we believe initially potentially as much as 30% of throughput from this lower zone and have an impact on overall grade that should lead to increased metal output.

Again the inferred resource at Trinidad North, we currently have an inferred resource. We are going to in parallel or concurrent with the exploration further to the North that I just spoke about, we are going to be infilling Trinidad North through 2014, that's part of our budget already for 2014, with the idea that we can have our measured indicated and reserves through the year so we can include it in our mine plans by early 2015.

The objective, the target will be to achieve higher grades. We believe that by playing around with the cut-offs and the distribution of grades at the inferred level you see the consistency to support the idea of being able to mine at higher cut-offs. I couldn't be in a position right now to tell you that it will be 150 grams, a 175 a 125, but I can tell you that we can presumably see an opportunity for that.

<Q>: So quick follow up on that, if you look at the exploration you are doing now, do you think maybe by mid 2014 you have a more certain answer around the intended …?

Jorge Ganoza – President, CEO and Co-Founder
The idea is that we start drilling, do in-fill drilling in the first half of the year. We advance with I-fill drilling the first half of the year. We do our resources usually with our current date, unless there are some particular circumstances. We use a cute date of late June or early July with the purpose of having reserves for the third quarter. So I would expect by third quarter 2014 we're in a position to give projections based on our engineering work.

<Q>: I just have one question and I'll follow-up with respect to the earlier comments on realized pricing in the quarter. You said 90% to 92% availability on silver going forward. Is that just a payable level and there are further treatments in finding deductions or is that sort of your all-in payable?

Luis Dario Ganoza – Chief Financial Officer

No, just to be 100% clear on that, we report the realized silver price, which is pretty much in line with what most companies have their report, and it's basically the average price other than markets as you realize based on the timing of your sales.

We also report what we refer to as net realized price, which is the price after refining charges and considering the actual payable metal off out of total metal in concentrate and premium charges of course. So I did say 90% to 91%. That's net realized price for silver based on current commercial terms, and that's the range we would expect going forward, yes.

Operator
Our next question comes from George Shea from Cicada.

<Q>: Some of the press has discussed a new tax regime in Mexico. The upper house of Congress is said to have approved the proposal by the government of Enrique Nieto. Does this change any of your plans or do you have to have contingency plans to deal with the possible increase in tax?

Jorge Ganoza – President, CEO and Co-Founder
Regarding to what this tax means to our long-term strategy more than the short term, we continue to view Mexico as a mining reduction where we can look forward to grow our business. More taxes just put a higher bar on the quality of projects we look at.

We believe that San Jose is a mine and a deposit that is both robust enough to still perform quite well under the new tax regime. And again, moving forward, we continue looking at Mexico favorably for the development of our mining business. On a relatively basis for our business really no jurisdiction is getting easier. So on relative terms, Mexico continues to be a place we look with good eyes.

<Q>: Are you finding any other opportunities in, say, Canada, Peru or other jurisdictions that you want to discuss?

Jorge Ganoza – President, CEO and Co-Founder
Well, I can say that we are actively looking for growth opportunities. The Trinidad North discovery clearly provides for the Company the best growth opportunity and the cheapest ounces we can bring to our inventories and to our future production.
Our discovery cost per ounce on Trinidad North is negligible. It's cents per ounce even including the acquisition cost, the $10 million acquisition cost of the concession we paid this year. So the cost per ounce here is going to be measured in cents.

I don't believe there are other places out there where we can acquire the quality of ounces and at that price. So we will aggressively continue pursuing organic growth now that we have the tiger by the tail at Trinidad.

Having said that, we are always looking for good opportunities. We are better suited than before to move faster if we need to when we identify an opportunity, and we're looking mainly in Mexico, mainly in Peru, mainly throughout Latin America, trying to stay within the times always.

Operator
Our next question comes from Andy Schopick, who is a Private Investor.

<Q>: I have two questions. First, I would like to direct a finance related question on taxes to Luis. Is there anything you are doing to try to mitigate this high volatility in your tax provisions, which is largely unpredictable from quarter-to-quarter? Are you

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doing anything to perhaps hedge the situation vis-à-vis the Peruvian sol or is there anything else that could be done to mitigate this?

Luis Dario Ganoza – Chief Financial Officer
No, the answer is really no. I mean as far as the effect of the exchange rate on the income tax provision, there is a component that has to do with the deferred tax, which is, I would say for all practical purposes, of little relevance. There is a component of course that has to with the actual current taxes, and in the case of our operations it tends from the cash balances we carry locally in U.S. dollars.

That effect is real of course. Local devaluation of a currency will increase our current taxes, yes, due to those cash balances in foreign currency held at our subsidiaries. That is something that is manageable more from the side of currency, which you elect to hold your treasury. It wouldn't make much sense to really conduct any large shift in terms of those surpluses we hold locally again. Really the devaluation we are seeing, even though it hit us on the side of income taxes, has a positive effect on real costs.

So we in general terms today do not have a national policy in place with respect to hedging foreign exchange effect. We would look on a yearly basis at our cash generation requirements based on capital expenditure commitment and based on that would look at opportunities in terms of securing the minimum cash requirements.

If we deemed that foreign exchange presented a risk with respect to achieving those minimum cash requirements to address our local capital expenditure commitment, we might consider hedging. Otherwise, we wouldn't, and so far we generally haven't.

<Q>: Jorge, I just wonder if you could also explain to me why you are using, for purposes of calculating silver equivalent ounces and production cash cost, the current $23.11 U.S. silver and $14.13 for U.S. gold per ounce? I am not sure I understand how you come to reaffirming your production guidance of 4.5 million ounces of silver and 23,600 ounces of gold based on those particular numbers and why you are using those numbers at this stage?

Jorge Ganoza – President, CEO and Co-Founder
There are two parts to the question. One, I guess is regarding to our guidance and the one is regarding to the all-in production guidance, and the one is regarding the all-in cost. We reaffirm our ability or our plan to deliver the amount of ounces stated in the guidance, in terms of silver and in terms of gold. Now the prices we are using for the purpose of estimating the all-inclusive cost, $1,200 gold and—

Luis Dario Ganoza – Chief Financial Officer
Yes, our revised guidance for cash cost per ounce for the year is based on $1,200 gold, price for gold as it affects … credit. The silver price is really a bit of relevance to the actual guidance of—

Jorge Ganoza – President, CEO and Co-Founder
For the inclusive, yes—

<Q>: Well, I'm just questioning what I see on page two of the press release and trying to understand the footnote, the asterisk and why you calculate using those particular silver and gold equivalent numbers?

Luis Dario Ganoza – Chief Financial Officer

We are looking at the reference. That could be actually an unnecessary footnote and something that should have not been there. So if you allow us to review that and if necessary, we'll clarify that.

Jorge Ganoza – President, CEO and Co-Founder
Well actually the gold price of the guidance.

<Q>: Yes. I mean, we are reporting our cash cost per ounce in terms of our guidance, in terms of with the $1,200 price for gold and our actual cash cost per ounce. Our actual cash cost per ounce for the period will reflect the credit of gold, the realized price for the period. So yes, I apologize for the confusion, and we need to review that.

Andy Schopick – Private Investor
Very good, all right, thank you.

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

Jorge Ganoza – President, CEO and Co-Founder
Okay, 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. Have a good day. Bye.

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

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