

*Transcript of  
Fortuna Silver Mines Inc. (FVI.TO)  
First Quarter 2012 Earnings Call  
May 10, 2012*

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## **Participants**

Jorge A. Ganoza, President, Chief Executive Officer, and Director  
Luis Dario Ganoza, Chief Financial Officer  
Carlos Baca, Investor Relations Manager

## **Presentation**

### **Operator**

Greetings and welcome to the Fortuna Silver Mines First Quarter 2012 Earnings Call. At this time, all participants are on a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press \*0 on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Carlos Baca, Investor Relations Manager. Thank you, Mr. Baca. You may begin.

### **Carlos Baca – Fortuna Silver Mines Inc. – Investor Relations Manager**

Good morning, ladies and gentlemen. I would like to welcome you all to Fortuna Silver Mines and to our first quarter 2012 financial and operations results call. We are hosting the call from Lima, Peru. I want to thank you all again for joining us today.

I would now like to turn the call over to the president of the company, Mr. Jorge Ganoza.

### **Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Thank you and good morning.

I am joined in the call today by Luis Ganoza, our CFO. I will initiate the conference and with the assistance of Luis, who will be giving us the summary analysis of our operations and the financial results of the first quarter of the year. Once concluded, we will address your questions.

During the quarter, Fortuna achieved a record net income of \$11.1 million or \$0.09 per share. This is up 132% compared to Q1 of 2011. We also achieved record operating cash flow before changes in working capital of \$14.7 million or \$.012 per share in the period. After adjusting operating cash flow for 2011 income taxes paid in the quarter, the figure increases to \$0.15 per share, which is up 81% to a comparable figure in Q1 2011. This record financial performance was delivered on the back of record silver



and gold production for the quarter of 953,000 ounces of silver and 5137 ounces of gold. This represents an increment of 118% for silver and 754% for gold with respect to the first quarter 2011 figures. Silver comprised 66% of revenue and the net realized silver price was \$28 per ounce. By-product gold accounted for 18% of revenue for a combined 84% precious metals contribution to sales.

Our consolidated cash cost per ounce of payable silver net of by-product credits remains well below the medium for silver producers at \$3.18. At this point, we are not foreseeing factors that can lead to significant variations in our cost projections for the year.

Since the start of commercial operations back in September of 2011 for San Jose Mine, it's driving for growth and will continue to do so as we expand deep to its optimum throughput design capacity of 1500 tonnes per day planned for mid 2013. At that rate, San Jose is scheduled to deliver annually approximately 3 to 3.5 million ounces of silver and some 25,000 ounces of gold. This would take our consolidated annual production rate to approximately 5 million ounces of silver and 27,000 ounces of gold plant-based metal grades by mid 2013.

The company has budget capital of projects amounting to \$56 million this year. These projects will have a direct impact on our growth and efficiency gains, cost reductions, and long-term sustainability for operations. At the San Jose Mine, our main projects including investments for plant expansion to 1500 tonnes per day and the north side, the river production plant that will help us materialize significant reduction cost on treatment and refining charges. At the Caylloma Mine, main projects include tailings facility #3, the bottlenecking of energy transmission, underground infrastructure, and material aggregates to plant and camp infrastructure. The company has executed close to \$5 million of this budget in the first quarter with investments planned to start picking up in the second half of the year.

We are turning the corner with the pending tailings permit in Peru on April 3<sup>rd</sup> for Peruvian subsidiary. We received official notification requesting additional recommendation of surface title for various parcels within the area of influence of the tailings project and minor technical observations as well. Our team has complied with all the additional information requests and observations and these responses are being filed this week. The permit process is now moving at a pace that suggests that we could meet for late June or early July deadline for the project. In parallel, our management team has advanced with contingency plan which includes expansion of a holding capacity of the current tailings facility for an additional five months of operations starting in July. All your technical studies and virtual (ph) engineering for this alternative have been concluded. The project has a budget of \$0.5 million and is scheduled to be operational in late July.

The 2012 exploration budget is \$15 million and includes over 35,000 meters of planned drilling. We have four drills which are working on at Caylloma with 6000 meters of drilling executed in various targets so far this year. At the San Jose project, our drill program is said to start in June with one drill rig first and a second one coming soon after that. And since the beginning of the year, we continued advancing with prospecting of the large land package we control in the area. Drilling at the Mario

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Project is concluded for this phase and the company is currently assessing the results.

Moving forward, the company remains adequately funded to meet its capital projects with approximately \$53 million in cash and short-term investment as of March 31<sup>st</sup>.

I will now let Luis take you through the financial statement and the cost analysis.

**Luis Dario Ganoza – Fortuna Silver Mines Inc. – Chief Financial Officer**

Thank you, Jorge.

As mentioned, this has been a strong period for the company reflecting the positive operational performance in the San Jose Mine in its second full quarter of operations. Sales were 86% above the prior year period driven by the contribution of the San Jose Mine for which recorded sales were \$19.2 million. At San Jose, approximately 90% of silver and gold produced was actually sold during the quarter, where total silver inventory, as of the end of March, is in the range of 170,000 ounces of silver. Sales at Caylloma remained at similar levels as in the prior year in spite of higher silver sold of 15% mainly as a result of lower lead and zinc prices and somewhat lower metal sold.

We have afforded recorded net realized silver price of \$28.31 for the quarter. This is the average real life market price on metal delivered over our provisional sales. After deducting treatment and refining charges and considering the actual percentage of metal (inaudible) out of contained metal and concentrate. The reporting of this figure is consistent with the way we report our revenue which is net of treatment and refining charges.

Moving down the income statement, our mine operating income increased 62% over the prior year period to \$21.1 million. San Jose contributed strong margins which helped offset somewhat lower margins at the Caylloma Mine. Margins at Caylloma compared to Q1 2011 were affected by a higher unit cash cost which increased 31% over the prior year period. Most of this increase, however, was already reflected in the fourth quarter of 2011. The cost for the quarter is in line with our budget and today, as Jorge mentioned as well, we did not expect further upward trends or surges in cost behavior.

As far as San Jose goes in relation to cash cost, the reported figure of cash cost per tonne of processed ore for the period was \$65.46 in line with our budget and, again, we are not anticipating any material sources of contemplation either.

Back to our financials and sales, our operating income that is after deducting selling and G&A and other expenses was a record \$16.53 million, an increment over the prior year period of 106%. Our selling and G&A line item in the financials remain at similar levels quarter over quarter in spite of the expenses associated with our new operation in San Jose. This is due to the effect of mark to market on share-based payment instruments.

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We have recorded income taxes of \$5.43 million dollars out of which \$1.92 million is current taxes generated exclusively at our Caylloma Mine. No current taxes are being recorded yet at our San Jose Mine.

On net income for the quarter, we recorded \$11.11 million, 132% above the prior year period. Earnings per share for that quarter were \$0.09 compared to \$0.09 in Q1 of 2011.

Moving on to the cash flow statement, cash generated by operating activities before changes in working capital for the quarter totaled \$14.69 million, up 144% over the prior year period. When adjusting for 2011 taxes paid out in March of this year, our cash flow for operations is \$18.17 million for \$0.15 per share. Cash used in investing activities was \$7.59 million and, as Jorge mentioned, this is expected to pick up in the second half of the year as our larger projects go into construction phase. Our cash position at the end of the period, including short-term investments, was \$53.85 million and working capital amounted to \$76.06 million.

Thank you.

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

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 and try to keep your questions brief.

**Operator**

Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press \*1 on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press \*2 if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the \* keys. One moment please while we pool for questions.

Thank you. Our first question is coming from the line of Andy Shopick, a private investor. Please state your question.

**Andy Shopick – Private Investor**

Thank you and good morning. I have one question on Caylloma and one on San Jose. First, on Caylloma. It was clear to me upon reviewing the annual 10-K documents that there was going to be a meaningful increase in cost per ounce reflecting in part reduced by-product credits which we have discussed in the prior call. Can you tell us what does the \$7.21, which you have recorded here as your cash cost for Caylloma, is going to affect the peak this year or whether you expect any meaningful variation in the quarters ahead for your cash cost to produce silver at Caylloma?

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**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Thanks for your question. The best way to analyze the cost at the subsidiary, especially at Caylloma, is cost per tonne. We recorded about \$81 cost per tonne which once accounted for is converted to cost per ounce using metal by-product grades becomes a \$7 figure. At this moment, we see no conditions or changes that could lead us to believe that we will see movements in our cost for the remaining of the year.

**Andy Shopick – Private Investor**

At Caylloma.

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

At Caylloma. At Caylloma, we are not seeing... You know the big items that can lead to these changes are material changes, production plan which we are not seeing, material changes in contractor tariffs, and we just went through those adjustments late in 2011 and we are not seeing any significant changes on tariffs and we are not seeing either any material changes on other services that the mine employs which are the main drivers for cost variations usually. At this moment, cost actually was a few dollars below our budget and in terms of dollars per tonne and we expect it to remain at around \$81 to \$85 level.

**Andy Shopick – Private Investor**

Do you expect any improvement in the condition with respect to refining charges?

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Yes, something we did when we engaged in our annual contract for the sale of our commercial products which are the silver-lead concentrate and the zinc concentrate. If we give ourselves the flexibility for the lead only, agreeing to a contract for six months with the expectation that we can find better terms by midyear. So that is something that we are assessing currently. We are looking at several alternatives. First is sending our products somewhere else. Our products are going to China right now and China is setting the benchmark with respect to terms for lead which carry silver which is okay and another alternative is restarting the corporate circuit, having the silver report to the corporate circuit and being able to relocate the copper products outside of China because base metal concentrate carrying precious metals are under the same general conditions in terms of terms if they go to China. China is deterring export of metal and when they purchase the lead, it is for internal market but then they sell the silver outside of the country and then they suffer tariffs and taxes that try to de-incentivate re-exports of metal.

**Andy Shopick – Private Investor**

Okay. One question on San Jose. Regarding the unfortunate incident that occurred months ago, have the conditions begun to improve or your interaction with the community – has there been any change or progress made at that location?

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**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Something that I would like to stress is that our relationship with the community of San Jose, for a couple of years at least, is one of – as a generality with authorities and the broad base of members of the community, is one of support and understanding. So there are fringe groups, not necessarily members of the community at all times, that are reactionary – are opposed development projects, not just mining. So our relationship with the community is strong and is one of support and we will not see in the community any threat to the sustained continuity of our operations. Having said that, Oaxaca is a place of complex and convoluted political scenario. There are a lot of reactionary groups as we found in Chiapas and Oaxaca and we interact with those groups and there was a small manifestation at our gates on Monday. That manifestation gathered around 100 people, 50 of which – almost half were women and children from outside the community, most of them. They protested peacefully for most of the day. It did not impede the normal operations of our team and at the end of the day, they left to Oaxaca to hold conversations and discussions with the state authority. That is part of Oaxaca social dynamic and it is a reality that we are part of. It is a reality we are part of but we do not see a threat to the continuity of our business in any way at this moment.

**Andy Shopick – Private Investor**

Thank you for answering those questions.

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Thank you.

**Operator**

Thank you. Our next question is from the line of George Shea of Chiquita Asset Management (ph). Please state your questions.

**George Shea – Chiquita Asset Management (ph)**

Hello. I'd like you to expand a little bit on the Mario Project that you referred to in your brief remarks.

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Yes, George. Thanks for your question. Our work or initial phase of drilling which started towards the end of last year and carried into the first quarter is done; it is concluded. It is in fact on tomorrow that we have a review meeting with the team and our Vice President of Exploration to assess the results and assess or continue the involvement in the project. We have – I do not want to advance an opinion right now unless I see the report. What I can say is that at Mario, our team successfully identified a large – a potentially favorable environment for a large gold – disseminated gold and silver deposit in a diatreme environment, which is very favorable and a productive environment for significant deposits and we are going to assess – they have prepared a presentation. They're going to present their recommendations to senior management tomorrow and we will be making a decision based on that. We have found some challenges with the metallurgy. That's my understanding so far but,

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again, I don't want to get ahead of myself until I see the presentation of the team tomorrow. We will be reporting accordingly.

**George Shea – Chiquita Asset Management (ph)**

Thank you and is there any sign that the price of lead and zinc have bottomed out? They had quite a drop in the last period.

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

There is a lot of expectation in the market with a short-term outlook for – short to medium term outlook for zinc. Zinc and lead have become – to put this into perspective, our first year of production in 2007, lead and zinc accounted for roughly a little over 50% of our revenue. Today, they account for 15% of revenue combined. So it is – really has become a – as we expanded our precious metals production, the contribution of lead and zinc has become smaller and it is really a 15% combined by-product to us today. I subscribe to the idea that there are arguments to think of higher zinc prices in the near future but, again, for Fortuna today, it is a small by-product.

**George Shea – Chiquita Asset Management (ph)**

Thank you very much. That clears it up.

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Thank you.

**Operator**

Thank you. As a reminder, if you would like to ask a question, you may press \*1 from your telephone keypad. The next question is from Marco LoCascio of Equinox Partners. Please state your questions.

**Marco LoCascio – Equinox Partners**

Hi, guys. A couple of questions for you. Firstly, at Caylloma, I wanted to ask about the silver recoveries. I know you've talked in the past about the impact of the oxide ore coming from level 6 at Anamous (ph) dragging down the recoveries. I just want to get a sense of how much of that ore you plan to put through the plant the rest of the year and whether this recovery in the high 70s is what we should expect going forward?

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

To reply to your question, Marco, you should expect recoveries in this range for the remaining of the year and into the first months of the coming year. The oxide for – it's not oxide but the mixed ore reserves that we have are in our Anaparochin (ph) plants into next year. What we are working on – what our team is working on is, one, on fine tuning the metallurgy of that mix ore that's an ongoing effort; two, adjusting mine plants to reduce the contribution of mixed ore to a production mix; and, third, what we are doing right now is trying to – we were blending the mixed ore with fresh ore which is the bulk of our research. To put it into perspective, out of the 4 million tonnes that we report in reserves at Caylloma, mixed sulfide oxide ore is roughly no more than

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200,000 tonnes. I don't have the exact figure on my head but it's less than 200,000 tonnes. The problem is that the mine is going through that – the mine moves. The mine is going through that portion of reserves at this point. So we have some short-term pain that we have to go through in this upper part of the mine and we are trying to mitigate the effect of that mixed ore as much as we can with several technical initiatives that are being implemented and you should expect continued low recovery. Now, there is a trade off because this mixed ore which has or causes these lower metallurgical recoveries and this interference with the floatation of sulfide also is higher grade than the average reserve. So the net desired rate lower reserves. At the end of the day, the metal produced still is the same as in our budget. Even though we are seeing lower reserves than before, it's higher grade ore that we use to run through the mill before. So it is not ideal, it is not optimal but we are meeting the metal guidance and, again, it is a short-term effect of the reserves that we are mining today that will be in the 2012 plan and into 2013 but those are really small finite reserves close to surface where the mine is today.

**Marco LoCascio – Equinox Partners**

Okay. Sure. Next question is on capital expenditures. You guys put out in the MD&A a pretty precise budget on the projects you have at each of the mines but I was wondering if you could give a sense of what your budget is for underground development and sustaining capital at each of the mines.

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Yes. In terms of mine development for San Jose, the deepening of the ramp and mine development related to development of our sloping (ph) levels – our levels, in particular level 1350 and level 1300 for 2012, is \$7.5 million. Most of that really is the ramp and the outlook in 2013 and 2014 is that that should reduce by half. So just looking further in 2012 for San Jose, the mine development is going to be a much lower amount in the range of \$3.5 million. And for Caylloma, the mine development budget for 2012 is \$4.5 million and that's going to be pretty stable looking beyond 2012, the range of \$4.5 million. That is the larger portion really for overall budget. The mine development accounts for the most significant portion of our budget relating to sustaining CapEx.

**Marco LoCascio – Equinox Partners**

Okay. And then just one question on the balance sheet. You guys talked about the extension of the working capital and particularly receivables in the quarter. Just wondering if you could comment on what was behind that and sort of how you think about working capital levels as you go forward.

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

I'm sorry. Your question is in particular the behavior of our accounts receivable?

**Marco LoCascio – Equinox Partners**

Yes and the increase in networking capital we have seen on the balance sheet.

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**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Yes, I mean in particular, our accounts receivable are just reflecting the higher sales from San Jose. For the period, that's – for the quarter, that's in the range of \$4.5 million and we collect – or get paid 15 days after actual show of sales for a period and, in general terms, the larger working capital had to with the coming to production in San Jose and the larger current account items in the balance sheet from inventory to accounts receivable. So I would say that moving forward, you're going to see it appear consistent with what we're seeing for this quarter. Now, as we go through the expansion in 2013, that will change a bit again but I don't think – anything dramatic.

**Marco LoCascio – Equinox Partners**

Okay. And one last question. In terms of the contingency you're looking at Caylloma in the case where their permits don't come through in time, would there be any approvals necessary for that or that's within the existing permits you have for the tailings facility?

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

That is within the existing permits comprised within the tailings closure plan. We can make some adjustments with the tailings closure plan for that tailings facility and we're making use of that opportunity to add a few more meters and this increases the capacity to four to five months. We have the flexibility to go to four to five months and we're going to be doing it in stages, pretty much a meter gives us a month – a meter of height increase. So we have that flexibility and we're going to make use of it.

**Marco LoCascio – Equinox Partners**

Okay. Thank you, guys.

**Operator**

Thank you. Our next question is from Anthony Hammond, a private investor. Please state your questions.

**Anthony Hammond – Private Investor**

Congratulations, guys, on such a spectacular quarter. My question is with respect to the progress that the expansion of the plant at San Jose. Do you think that you're going to meet the schedule in the coming year?

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Yes. Thanks for your question. Really, the lone lead item for the expansion of the San Jose Mine is in the plant and it's in the equipment of the plant and the key equipment here is a second bow (ph) mill that will have to be purchased, procured, and – I mean, sold. It is not a large bow (ph) mill. We currently are scouting the market for alternatives in the second-hand market. We have already identified a couple of bow (ph)mills that could be of use to us. We are assessing them. Our engineering team is advancing with a granting of the PECM or the detail engineering is getting started with the detail engineering for the projects but when the plants, what design and conceived, we already made the adjustment and left the necessary room

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and accommodations for this expansion to 1500 tonnes per day. So there are no dramatic engineering projects or anything for this expansion. The main equipments are, as I said, the bow (ph) mill and a couple of benches for additional floatation capacity but the thickeners and all the equipment is really sized for 1500 tonnes per day.

With regard to the mine, as we already mentioned, the key here is a continued advance of the ramp and the ramp is already at level 1300 and as we develop level 1300, we are already advancing with getting the mine ready to source 1500 tonnes per day as early as first quarter 2013. So I mean the mine is on tract and we are basically saying that within a year and that is on the back of the potential long lead delivery of a bow (ph) mill. We should be delivering the expansion towards the second quarter of next year.

**Anthony Hammond – Private Investor**

Thanks for the update.

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Thank you.

**Operator**

Our next question is from the line of Lila Murphy of Federated Investors. Please state your questions.

**Lila Murphy – Federated Investors**

Hi, Jorge. This is Lila. Hope all is well. A couple of questions for you. First, can you talk a little bit about what you're seeing on the labor turnover front at Caylloma?

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Yes. Hello, Lila. We measure worker rotation and contractor rotation very, very closely and that became an issue last year and it is one of the reasons for the increases in wages and contractor tariffs. At the start of the year, we're not seeing any anomalous figures in worker rotation. We have changed one mine contractor. So that I think has also had an effect. We brought a second contracting company with a bit more administrative capabilities. So we have not – I cannot report that we are seeing anything anomalous with regard to worker rotation at this moment.

With regard to key engineering personnel and staff, we did see towards the end of the year as well a few key positions leave the company but by now, we have been able to replace those positions.

**Lila Murphy – Federated Investors**

Okay. Very good. And then the second question I had was related to the curtailment of the second bow (ph) mill and what you're seeing on the cost side there whether that is going to be close to what you were projecting during the feasibility or whether or not you've seen any cost increase there? Thanks so much.

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**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Thank you. We're working on our figures. We budgeted for the expansion back when we did the original engineering for the start of the 1000 tonnes per day. When we did the budget for the launch at 1000 tonnes per day with the engineering firm, at that moment, we budgeted the expansion to 1500 tonnes per day at the plant and, again, here, I'm just talking about the plant at about \$3 million. We believe that today, with the information we have today, although we do not have detailed engineering yet but at the level where we are today, we believe that figure will double to roughly \$6 million.

With regard to the mine, we're not seeing any material changes. I mean it's part of our ongoing – if anything, we're only accelerating development and that is in our budget and our budgets are in line with projections, what we are seeing.

And with regard to the expansion of the tailings facility, we're not seeing any changes.

So the main driver for change is in the plant where we can see as much as a double from the original estimated \$3 million which was estimated back in late 2010.

Again, \$6 million putting it into a big picture for a 500 tonne per day expansion which is doubling incrementing capacity by 50% with respect to 1000 tonnes. It is still what we consider a very modest figure.

Hello?

**Operator**

Thank you. There are no further questions at this time. I will now turn the floor back to management for closing comments.

**Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director**

Well, I'd like to thank everyone for listening in to today's earnings call. We look forward to you joining us next quarter. Have a good day.

**Operator**

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

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