

***Transcript of  
Fortuna Silver Mines, Inc.  
Second Quarter 2017 Financial and Operational Results  
August 15, 2017***

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## **Participants**

Carlos Baca - Manager of IR  
Jorge Ganoza - President and CEO  
Luis Ganoza - CFO

## **Presentation**

### **Operator**

Good day, ladies and gentlemen, and welcome to Fortuna Silver Mines Second Quarter 2017 Financial and Operational Results Call. All lines have been placed on a listen-only mode, and the floor will be open for questions and comments following the presentation. [Operator Instructions]

At this time, it is my pleasure to turn the floor over to your host, Carlos Baca, Investor Relations Manager. Sir, the floor is yours.

### **Carlos Baca - Manager of IR**

Thank you. Good morning, ladies and gentlemen. I would like to welcome you all to Fortuna Silver Mines and to our Second Quarter 2017 Financial and Operational Results Call. Today, we will be using a webcast presentation which will be controlled by us. You can download the presentation at our website. Please click on the Investors tab, then click on Financials under Q2, click on Earnings Call webcast.

Jorge Alberto Ganoza, President, CEO and Director; 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 Ganoza - President and CEO**

Thank you, Carlos, and good morning to all.

I will give you a brief introduction to the second quarter results, and then turn the call to Luis, who will take you through financial statements. After that, we'll open the floor for questions and answers.

Our results in the second quarter of 2017 keep reflecting the full impact of the San Jose plant expansion in 2016. On a consolidated basis, we expanded our silver production by 36% to 2.1 million ounces and our gold production by 55% to 14,500 ounces compared to the same quarter of prior year.

In Slide 5, we show that 75% of provisional sales were comprised by precious metals, with lead and zinc contributing the balance.

In Slide 6 of our presentation, we show a strong financial performance. Sales increased 44% and net income increased to \$8.9 million compared to a loss of \$1.4 million from the same quarter of prior year. In terms of cash generation, we increased cash flow from operations before changes in working capital from \$7.4 million to \$16.7 million, an increase of 126%.

In Slide 7, we achieved a consolidated all-in sustaining cash cost per ounce of silver net of byproducts grades of \$8.20, a reduction of 16% compared to the same quarter of prior year and also a reduction of 16% compared to 2017 guidance of \$9.80 per ounce. Our all-in sustaining cost benefited mainly from higher production and base metal prices, despite of slightly higher mine operating costs on both subsidiaries in the period.

Moving on to capital investments in Slide 8, our consolidated capex was \$23.1 million on the first half of the year. This includes \$5.1 million of non-sustaining capex from the Lindero Project and greenfields explorations, \$5.6 million of brownfields explorations, and \$12.4 million of sustaining capex.

In Slide 10, on brownfields explorations, we carried 25,000 meters of drilling in the first half of the year with a cost of 5.6 million. Also in the quarter, we announced that we cease some of the Tlacolula Property within the area of greenfields of San Jose Mine in Oaxaca.

With respect to Lindero, I can report that we are concluded with all of our geologic modeling work our resource estimation, update or optimization of mine plants, our key metallurgical tests. We're still pending some results on confirmatory tests only. We are carrying peer reviews on technical work. We are also concluded with the optimization and modifications to the process design. We're basically concluded as well with quotes of capex and opex, updated quotes on capex and opex figures. We're now putting the result of all the work we carried over the past months together with the aim of being able to take to our board a construction decision in the month of September. Shortly after that, we will be updating the market on our construction decision.

I will now turn the call to Luis, who will take you through the financial statements.

#### **Luis Ganoza - CFO**

Thank you, Jorge. On Slide 12, for 2016, as Jorge has highlighted, we recorded net sales of \$63.9 million, up 44% from the prior year, driven mostly by higher metal volumes sold. We reported net income of \$8.9 million compared to a loss of \$1.4 million in 2016 and earnings per share of \$0.06 compared to a loss of \$0.01. The loss in 2016 was driven by mark-to-market effects on stock-based compensation charges related to the performance of share price. Higher cash provided by operating activities is a reflection of strong revenue and margins, in spite of elevated costs in the quarter. And cash equivalents and short-term investments as of the end of June 2017 were \$188 million, which includes the proceeds from the equity financing closed on February 2017.

On the next slide, Slide 13, when breaking down our sales performance, we had higher total sales of \$19.4 million. Higher metal volumes sold contributed the bulk of the increase in sales with \$12.4 million followed by treatment and refining charges with \$4.9 million, and zinc and lead metal prices with \$4.2 million.

On Slide 14, our operating income and adjusted EBITDA reflect a strong performance and operating results over the second quarter of 2016 and are grounded in solid increases in sales and mine operating income. Both operating income and adjusted EBITDA in 2016 were impacted by a higher stock-based compensation charge consisting of \$8 million in 2016 compared to \$0.7 million in 2017, related for the most part to the mark-to-market effects for the performance of our share price. Excluding this effect, the increasing consolidated EBITDA would be 46% with similar margin over sales.

In Slide 15, in the case of San Jose, EBITDA increased 48% on the back of higher production. Higher head grades and improved commercial terms did not fully translating into higher EBITDA margins of San Jose due to the impact of a foreign exchange charge of \$1.1 million and negative sales adjustments. In the case of Caylloma, we recorded a higher EBITDA of 30%, driven by stronger base metal prices and partially offset by higher unit costs. Cash cost at Caylloma was 20% higher than the previous year and 13% higher than annual guidance. The higher cost compared to our plan is mostly related to higher ground support, energy and auxiliary services at the mine and labor costs. There is a structural component to these increases which is relatively minor, but there is a medium-term impact in some of these items which we will continue to see for a few quarters. We expect cash cost per ton to remain in the range of \$80 for the remainder of the year.

On Slide 16, on expenses, total SG&A was \$5.9 million, down 52% from Q2 2016 as a result of lower stock-based compensation charges. With respect to the increase in corporate G&A, we have a similar effect as in Q1 as we are still seeing the impact of certain items related to our stock remediation initiatives.

On Slide 17, the company maintains a strong balance sheet position, which, as I mentioned previously, includes total cash and short-term investments of \$188 million, which along with our unused debt capacity gives us a flexibility required to meet a construction decision at Lindero.

Finally, on Slide 18, we provide a bridge graph of our cash position in the first half of the year, including short-term investments. As can be appreciated, free cash flow estimate, starting from EBITDA of \$56.4 million and excluding changes in working capital of \$14.3 million was in the \$10 million to \$11 million range. At current metal prices, we expect to see cash accumulation in the second half of the year as some of the items related to changes in working capital are related to payments occurring in the fiscal two quarters.

Thank you, and back to you, Carlos.

**Carlos Baca - Manager of IR**

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

**Operator**

The floor is now open for questions. [Operator instructions]. Our first question comes from Justin Stephen. Please state your question.

**Q:** Most of my questions are to do with Lindero. I was just wondering what the sort of timeline for potential construction ramp-up is. I'm assuming things are probably going to be pretty quick. You've probably done a lot of the ground work added by now?

**Jorge Ganoza - President and CEO**

Yes, with respect to timeline, right now we're now working on a construction plan. So our initial estimate still moves around 18 months of construction. Those timelines can be impacted by some work that we still need to fine tune. And right now one of the items that need to be addressed is the ability to initiate construction and the

minimum facilities needed at Lindero to start hosting the kind of workforce that's needed. So we need to be able to ramp up the building of camp facilities. So the long lead item here would not be equipment delivery or anything like that to meet our 18-month deadline or timeline right now, but the ability to start and initiate camp sequencing to hold the construction population. Lindero is a remote location.

**Q:** That makes sense. Yes, somewhere in that 18-month ballpark is still the plan then, assuming things go well?

**Jorge Ganoza - President and CEO**

Yes, as I say, we're working on the construction plan as we speak, and that is the timeline that we have right now.

**Q:** Sounds good. So the next question I had, I know you guys are doing some metallurgical optimization tests. Are you expecting those to yield sort of cost per ton process similar to those in the feasibility study? Or are you expecting to sort of spend a little more on reagents or something in order to get those higher recoveries that you guys mentioned?

**Jorge Ganoza - President and CEO**

Our metallurgical test show the opportunity to capture higher recoveries with not any material increase in cyanide consumption with respect to feasibility study. The benefit of the HP [ph] we are crushing and implementing a cyanide cure on the ore before placing on the path are opportunities that we're capturing in our work. So those items do not necessarily carry any reagents cost that are material to the project.

**Q:** Got it. Yes, the opex, pretty low opex impact then. It's probably just a little more capex to pay for the equipment then.

**Jorge Ganoza - President and CEO**

Yes.

**Q:** And then, so following on that, if the Lindero test work does show these new improved recoveries, are there any lower-grade halos that might become economic material given the better recovery as the stuff that was previously excluded from the mine plan?

**Jorge Ganoza - President and CEO**

Yes, this is a porphyry system. It's a large system, and this I believe makes sense to us, which was at a point where they had close to 100 million tons, decided to move away from the exploration and more into building a case for a mine. But we do see opportunity to grow the research beyond what's currently in inventory in the near vicinity. This is a porphyry system. It's a large system. And we have the opportunity in Arizaro, which is a nearby porphyry as well. We are investigating that opportunity. It's not currently even in our research, even though [indiscernible] reported as more research at Arizaro, we have not included that in current research as part of our inventory. We believe it requires further work, not only on exploration but also on metallurgy.

But as you pointed out, and I stress again, porphyry systems are big, and I believe there is a lot of opportunity to capture some of those organic growth opportunities along the 10-, 14-year mine life that is a possible potential we have.

**Q:** You guys have plenty of room there in order to expand these facilities right?

**Jorge Ganoza - President and CEO**

We have no infrastructure limitations.

**Operator**

Our next question comes from Raghu Guram [ph]. Please state your question.

**Q:** I have three simple questions. Please bear with me. The first one is regarding new exploration project acquired from Radius. It looks very interesting. Would you please kindly let us know something how it is significant or how close it is to our existing operations? Thank you.

**Jorge Ganoza - President and CEO**

Well, Tlacolula is a property within the area of influence of our San Jose Mine. It's a property that has significant gold showings and an identified vein actually that we have explored. It's a property that we held under an option agreement for many years, and we decided to go ahead and just acquire that property. It didn't make any more sense to us to just keep holding it under an option. Now we do not have surface access to Tlacolula at this time. We did have an agreement with the community to carry surface work, but when we decided to move into a drill program, the community of Tlacolula refused the permit for us to drill. Since then, we have had several sessions through assemblies with the community. We believe that long term we remain hopeful that in the medium to long term we can gain access to carry the work we need to in Tlacolula. Short term, it is not in our plans to access Tlacolula. But it's just a consolidation of our highly prospective target within the area of influence of San Jose. And as I stated medium/long term, we're going to be working with Tlacolula to gain surface access to carry on drill work. Basically a property is drill ready from the technical prospective.

**Q:** Thank you, and good explanation there. And the continuation to the same question, my second question is can you give some color on brownfield exploration and the mine exploration near San Jose and our other mine in Peru? We're expecting some kind of news past couple of months, but there is nothing. Are there any plans for the company to release exploration data? Thank you.

**Jorge Ganoza - President and CEO**

I'll start with Caylloma. We did release a few weeks ago results from the Caylloma drilling. Caylloma, we short-cutted Caylloma exploration funding for the last few years as we focused our funding towards Jose for its expansion. Over a year ago, we started funding again more aggressively exploration at Caylloma, and results are showing. We publish results on the consolidation of a new area in the Northeast of the Animas Vein, which is becoming the new center of gravity for the Caylloma operations. We currently have three drilled rigs turning at Caylloma on exploration, and we look forward to continuing publishing results in the year.

With respect to San Jose, we have three drill rigs carrying work from the underground. In the first half of the year, we were carrying some surface drilling on the very south end of mineralization of the out-cropping vein system at San Jose with poor results on the drilling. We did encounter structure but nothing where we believe we could build a resource. So our drilling has moved back to the underground to the northeast where we concluded the underground infrastructure that allows us to carry exploration from the underground and without surface access limitation. We currently have three drill rigs turning. One is focusing on the Ocotlan Vein, which is a blind discovery we made in 2016. It's an exciting opportunity. It's a vein that runs oblique to the main north/south Trinidad Bonanza system which hosts the resource and the mining at San Jose. This vein is 400 meters due east and will eventually run against in the north and with north/south Trinidad system.

We are currently drilling there and we look forward to publish results on Ocotlan drilling in the coming weeks. We have another drill rig working on the close proximity of existing resources on the north end of Trinidad from underground as well. This is more conservative drilling, not really getting too bold, but just trying to increase resources in the margins of existing resource by tightening grip [ph]. And last we have a third drill rig in the very

north end of Trinidad drilling from the underground exploration rig that we developed through 2016 and early 2017. We have one drill returning there, and as we come up with results, for sure we will be publishing them.

**Q:** I have last question. I thank you allowing me to clarify a few things. This is regarding dividend. I'm assuming at this time Fortuna is going to build a new project to Lindero. I have no doubt there because I'm a long term follower of the company and the management, and I have great respect. Still, we need to differentiate our company from other so-called silver companies, and for that we need to I think address this dividend issue. We have significant free cash flow, and we have cash to build a new mine, and there is no issue there. And we have a strong balance sheet, and I think time has come in my opinion that management has to address this dividend issue, kind of something like \$0.05 per share or some nominal is needed, I believe. I appreciate your thoughts on that, and I thank you again for allowing me to ask questions.

**Jorge Ganoza - President and CEO**

I concur with the view on dividends or a smart way to give back to shareholders. I don't think it's a question of if for us, it's a question of when. I believe that Lindero is strategic for us in many ways, and one of them is that it's a project that with its long mine life allow us to better address the question and the issue of giving back to shareholders. And as you clearly pointed out, it's going to be a bringing that mine into construction, a big financial commitment for the company. So what I would expect is that with the board, the discussion of a dividend becomes current once we conclude the construction of Lindero.

**Operator**

[Operator instructions]. Our next question comes from Mark Najarian [ph]. Please state your question.

**Q:** Hi, guys. Good quarter again. I had a question regarding whether there's been any more clarity developed on potential additional funding needed for the Lindero project, whether you're thinking about getting a credit line or any issuing a small amount more debt. I know between cash flows and your cash on hand you probably can cover it, but I'm assuming you're going to want some flexibility there as well without having to tap the equity market.

**Luis Ganoza - CFO**

Thank you. This is Luis. We do have a corporate facility in place on which we have currently drawn \$40 million, which we carry on our balance sheet, and which can be expanded without much difficulty up to around \$100 million. That would still keep us within very conservative leverage ranges or ratio. So that's a component which we will seek to implement as we move towards the funding, the design and implementation of the funding for the construction of Lindero, which along with our cash generation, we expect to see over the remaining of 2017 and into 2018 will give us all the funding sources we need.

**Operator**

[Operator instructions]. Okay, and it doesn't look like we have any further questions coming in.

**Carlos Baca - Manager of IR**

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

**Operator**

Thank you. This does concludes today's teleconference. We thank you for your participation. You may disconnect your lines at this time and have a great day.