

**FORTUNA SILVER MINES INC.**

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2008**

(Unaudited – Prepared by Management)

(Expressed in thousands of Canadian Dollars)

**UNAUDITED FINANCIAL STATEMENTS:** In accordance with National Instrument 51-102 of the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited interim financial statements for the three month period ended March 31, 2008.

FORTUNA SILVER MINES INC.  
INTERIM CONSOLIDATED BALANCE SHEETS  
AS AT MARCH 31, 2008  
(Unaudited)  
(Expressed in thousands of Canadian Dollars)

	<b>March 31, 2008</b>	<b>December 31, 2007</b>
	<u>(unaudited)</u>	<u>(audited)</u>
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash and cash equivalents	\$ 50,396	\$ 47,240
Derivatives (Note 4)	706	1,400
Accounts receivable and prepaid expenses (Note 5)	5,542	2,051
GST and value added taxes	4,524	5,147
Inventories (Note 6)	1,902	1,693
	<u>63,070</u>	<u>57,531</u>
LONG-TERM INVESTMENTS (Note 7)	482	908
PROPERTY, PLANT & EQUIPMENT (Note 8)	13,924	13,669
MINERAL PROPERTIES (Note 9)	55,005	52,338
	<u>\$ 132,481</u>	<u>\$ 124,446</u>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable and accrued liabilities	\$ 4,414	\$ 5,917
Due to related parties, net (Note 10)	26	14
Current portion of obligation under capital lease (Note 11)	718	439
	<u>5,158</u>	<u>6,370</u>
OBLIGATIONS UNDER CAPITAL LEASE (Note 11)	369	433
ASSET RETIREMENT OBLIGATION (Note 12)	1,222	1,916
FUTURE INCOME TAX LIABILITY	8,961	8,069
NON-CONTROLLING INTEREST (Note 9)	8,154	6,593
	<u>23,864</u>	<u>23,381</u>
<b>SHAREHOLDERS' EQUITY</b>		
SHARE CAPITAL (Note 13)	108,215	100,159
CONTRIBUTED SURPLUS	12,275	11,770
DEFICIT	(11,649)	(11,008)
ACCUMULATED OTHER COMPREHENSIVE INCOME (Note 14)	(224)	144
	<u>108,617</u>	<u>101,065</u>
	<u>\$ 132,481</u>	<u>\$ 124,446</u>

**Nature and continuance of operations** (Note 1)

**Commitments** (Note 17)

**Subsequent events** (Note 20)

APPROVED BY THE DIRECTORS:

\_\_\_\_\_  
*"signed"*, Director  
Jorge Ganoza Durant

\_\_\_\_\_  
*"signed"*, Director  
Simon Ridgway

(See accompanying Notes)

FORTUNA SILVER MINES INC.  
INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS  
FOR THE THREE MONTHS ENDED MARCH 31, 2008 AND 2007  
(Unaudited – Prepared by Management)  
(Expressed in thousands of Canadian Dollars, except for share and per share amounts)

	<b>Three months ended March 31, 2008</b>	<b>Three months ended March 31, 2007</b>
Sales	\$ 6,834	\$ 5,739
Cost of sales (including depletion, depreciation and accretion of \$1,076 and \$1,437)	4,522	4,025
<b>MINE OPERATING INCOME</b>	<b>2,312</b>	<b>1,714</b>
Selling, general and administrative expenses (includes depreciation of \$11 and \$0)	1,591	1,201
Stock-based compensation (Note 13)	531	2,309
	2,122	3,510
<b>OPERATING INCOME (LOSS)</b>	<b>190</b>	<b>(1,796)</b>
Interest and other income and expenses	451	280
Interest and finance expenses	(17)	(60)
Net loss on commodity contracts (Note 4)	(589)	-
Loss on disposal of property, plant and equipment	(20)	-
Foreign exchange gain	12	157
	(163)	377
<b>INCOME (LOSS) BEFORE INCOME TAXES AND NON-CONTROLLING INTEREST</b>	<b>27</b>	<b>(1,419)</b>
Income tax provision	612	337
Non-controlling interest	56	-
	(641)	(1,756)
<b>NET LOSS FOR THE PERIOD</b>	<b>(641)</b>	<b>(1,756)</b>
Other comprehensive loss, net of tax Unrealized loss on available for sale long-term investments (Note 14)	(368)	673
<b>COMPREHENSIVE LOSS FOR THE PERIOD</b>	<b>\$ (1,009)</b>	<b>\$ (1,083)</b>
Loss per share - Basic and diluted	\$ (0.01)	\$ (0.03)
Comprehensive loss per share - Basic and diluted	\$ (0.01)	\$ (0.02)
Weighted average number of shares outstanding	81,590,204	63,860,328

(See accompanying Notes)

FORTUNA SILVER MINES INC.  
INTERIM CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
FOR THE THREE MONTHS ENDED MARCH 31, 2008 AND 2007  
(Unaudited – Prepared by Management)  
(Expressed in thousands of Canadian Dollars, except for share amounts)

	Share Capital		Contributed surplus	(Deficit)	Accumulated Comprehensive Income	Total Shareholders' Equity
	Shares	Amount				
Balance – December 31, 2006 (audited)	46,587,728	\$ 43,341	\$ 6,085	\$ (8,219)	\$ -	\$ 41,207
Cumulative impact of accounting changes, net of tax	-	-	-	-	449	449
Exercise of options	610,000	782	-	-	-	782
Exercise of warrants	2,213,517	3,868	-	-	-	3,868
Private placement for cash	18,000,000	34,200	-	-	-	34,200
Private placement commission non-cash transaction	422,300	802	-	-	-	802
Transfer of contributed surplus on exercise of options	-	491	(491)	-	-	-
Stock based compensation	-	-	2,309	-	-	2,309
Issue costs (non-cash amount \$802)	-	(2,487)	-	-	-	(2,487)
(Loss) for the period	-	-	-	(1,756)	-	(1,756)
Other comprehensive gain, net of tax	-	-	-	-	673	673
<b>Balance – March 31, 2007</b>	<b>67,833,545</b>	<b>\$ 80,997</b>	<b>\$ 7,903</b>	<b>\$ (9,975)</b>	<b>\$ 1,122</b>	<b>\$ 80,047</b>

	Share Capital		Contributed Surplus	(Deficit)	Accumulated Comprehensive Income	Total Shareholders' Equity
	Shares	Amount				
Balance – December 31, 2007 (audited)	80,977,663	\$ 100,159	\$ 11,770	\$ (11,008)	\$ 144	\$ 101,065
Exercise of options	21,400	34	-	-	-	34
Exercise of warrants	4,322,596	7,996	-	-	-	7,996
Transfer of contributed surplus on exercise of options	-	26	(26)	-	-	-
Stock based compensation	-	-	531	-	-	636
(Loss) for the period	-	-	-	(641)	-	(746)
Other comprehensive (loss), net of tax	-	-	-	-	(368)	(369)
<b>Balance- March 31, 2008</b>	<b>85,321,659</b>	<b>108,215</b>	<b>12,275</b>	<b>(11,649)</b>	<b>(224)</b>	<b>108,616</b>

(See accompanying Notes)

FORTUNA SILVER MINES INC.  
INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE THREE MONTHS ENDED MARCH 31, 2008 AND 2007  
(Unaudited – Prepared by Management)  
(Expressed in thousands of Canadian Dollars)

	<b>Three months ended March 31, 2008</b>	<b>Three months ended March 31, 2007</b>
	<b>2008</b>	<b>2007</b>
<b>OPERATING ACTIVITIES</b>		
Net (loss) for the period	\$ (641)	\$ (1,756)
Items not involving cash		
Depletion and depreciation	1,061	1,400
Accretion expense	26	37
Future income tax	168	338
Stock based compensation	531	2,309
Unrealized loss on commodity contracts	616	-
Loss on disposal of equipment	20	-
Foreign exchange loss	658	72
Non-controlling interest	56	-
Changes in non-cash working capital items		
Realized gain on commodity contract	124	-
Accounts receivable and prepaid expenses	(2,611)	(1,669)
Inventories	(206)	(125)
Accounts payable	(1,524)	1,224
Payments from (to) related parties (Note 10)	12	(11)
<b>Net cash from (used in) operating activities</b>	<b>(1,710)</b>	<b>1,819</b>
<b>FINANCING ACTIVITIES</b>		
Proceeds on issuance of common shares	8,031	37,165
Capital lease obligations	(114)	(11)
Repayment of debt (Note 11)	-	(5,730)
<b>Net cash from financing activities</b>	<b>7,917</b>	<b>31,424</b>
<b>INVESTING ACTIVITIES</b>		
Mineral property expenditures	(2,525)	(1,982)
Value added taxes on purchase of property, plant and equipment	(159)	-
Property, plant & equipment expenditures	(375)	(1,397)
Proceeds from disposal of equipment	8	-
<b>Net cash used in investing activities</b>	<b>(3,051)</b>	<b>(3,379)</b>
<b>INCREASE (DECREASE) IN CASH</b>	<b>3,156</b>	<b>29,864</b>
Cash and cash equivalents – beginning of period	47,240	1,641
<b>CASH AND CASH EQUIVALENTS – END OF PERIOD</b>	<b>\$ 50,396</b>	<b>\$ 31,505</b>
<b>Supplementary disclosure of cash flow information:</b>		
Cash (received) paid for interest	\$ (489)	\$ (118)
Cash paid for income taxes	\$ 148	\$ -

Non-cash transactions (Note 16)

(See accompanying Notes)

## **FORTUNA SILVER MINES INC.**

### **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

#### **FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2008**

(All amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

## **1. Nature and Continuance of Operations**

Fortuna Silver Mines Inc. (the “Company”) is engaged in silver mining and related activities, including exploration, extraction, and processing. The Company operates the Caylloma zinc/lead/silver mine in southern Peru and is currently developing the San Jose silver/gold project in Mexico.

The Company’s continuing operations and the recoverability of amounts shown for its exploration stage mineral properties are dependent upon the availability of the necessary financing to complete the exploration and development of such mineral property interests, and upon future profitable production or proceeds from the disposition of its mineral property interests. Future profitable production is primarily dependent on the quality of ore resources, ability to obtain permits, future metal prices, operating and environmental costs, fluctuations in currency exchange rates, political risks and varying levels of taxation.

## **2. Significant Accounting Policies**

### Basis of presentation

In 2006, the Company changed its year-end from September 30 to December 31.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles using the same accounting policies and methods as our most recent annual financial statements except as indicated in note 3 below. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements as at December 31, 2007.

The interim consolidated financial statements include the accounts of the Company’s wholly owned subsidiaries, Minera Bateas SAC (Bateas) and Fortuna Silver (Barbados) Inc. and of the Company’s 76% interest in Compania Minera Cuzcatlan SA, a variable interest entity for which a non-controlling interest has been recorded to reflect the 24% interest of the Company’s partner. All significant intercompany balances and transactions have been eliminated on consolidation.

### Changes in Accounting Policies

Effective January 1, 2008, the Company adopted the following standards previously issued by the Canadian Accounting Standards Board (“AcSB”). In accordance with the transitional provisions of these standards, the changes were adopted prospectively (if applicable), with no restatement of prior periods.

#### Section 1535 – Capital Disclosures

This Section establishes standards for disclosing information about an entity's capital and how it is managed. Disclosures include what is defined as capital, how it is managed, and whether externally imposed restrictions on capital are present.

#### Section 3031 - Inventories

This Section prescribes the accounting treatment for inventories and provides guidance on the determination of costs and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

## **FORTUNA SILVER MINES INC.**

### **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

#### **FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2008**

(All amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

#### Section 3862 – Financial Instruments – Disclosures

This Section, in addition to Section 3863, replaces Section 3861 “Financial Instruments – Disclosure and Presentation” and requires entities to provide disclosure of quantitative and qualitative information in their financial statements that enable users to evaluate the significance of financial instruments for the entity's financial position and performance; and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and management's objectives, policies and procedures for managing such risks. Entities are required to disclose the measurement basis or bases used, and the criteria used to determine classification for different types of instruments.

#### Section 3863 – Financial Instruments – Presentation

This Section, in addition to Section 3862, replaces Section 3861 “Financial Instruments – Disclosure and Presentation”, and provides guidance on presentation of financial instruments as liabilities vs. equity and when offsetting of financial assets and financial liabilities is appropriate. The adoption of this standard did not have a material impact on the Company's presentation of its financial instruments.

### **3. Financial Instruments**

All financial instruments are recorded initially at estimated fair value on the balance sheet and classified into one of five categories: held for trading, held to maturity, available for sale, loans and receivables and other liabilities.

Financial assets and liabilities held-for-trading are measured at fair value with changes in those fair values recognized in net income. Financial assets and financial liabilities considered held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized costs using the effective interest method of amortization. Available-for-sale financial assets are measured at fair value with unrealized gains and losses recognized in other comprehensive income. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost.

The long-term investments are classified as available-for-sale and are recorded at their fair value, which is determined with reference to market value of underlying marketable securities. Derivative instruments are recorded at fair value, which is determined with reference to the market value of underlying commodities. All other financial instruments are recorded at cost, which approximates their fair value, due to the short-term maturity and high liquidity.

### **4. Derivatives**

During October 2007, the Company entered into a series of put and call option commodity arrangements to secure a minimum price level on part of its zinc and lead metal production throughout the period November 2007 to December 2008. A long put and a long call refer to put and call options that have been bought by the Company, and a short call refers to call options that have been sold by the Company. Settlement of these options occurs monthly during the period from December 2007 until January 2009. No initial premium associated with these trades has been paid.

The following Zinc Asian Option contracts were entered into:

- 14 Long put options at strike price: USD 2,575/t, for the total of 2,800 tons
- 14 Short call options at strike price: USD 2,750/t, for the total of 2,800 tons
- 14 Long call options at strike price: USD 3,450/t, for the total of 2,800 tons

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2008**

(All amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

The following Lead Asian Option contracts were entered into:

- 14 Long put options at strike price: USD 3,000/t, for the total of 1,750 tons
- 14 Short call options at strike price: USD 3,300/t, for the total of 1,750 tons
- 14 Long call options at strike price: USD 4,300/t, for the total of 1,750 tons

As at March 31, 2008 the Company had 10 open options on each of these arrangements. During January 2008 the Company entered into additional derivative contracts spread out evenly over the period from February 2008 to January 2009.

The following Zinc Forward sale contracts were entered into on a SWAP basis:

- 12 Forward contracts: USD 2,360/t, for the total of 1,700 tons

The contract is settled against the arithmetic average of zinc spot prices over the month in which the contract matures.

The following Lead Asian Option contracts were entered into:

- 12 Long put options at strike price: USD 2,575/t, for the total of 1,025 tons
- 12 Short call options at strike price: USD 2,760/t, for the total of 1,025 tons
- 12 Long call options at strike price: USD 3,300/t, for the total of 1,025 tons

As at March 31, 2008 the Company had 11 open positions on each of these arrangements.

The estimated fair value of the outstanding derivative contracts of \$706 was determined based on using applicable valuation techniques for commodity options and futures with reference to the published market prices for underlying commodities quoted at London Metal Exchange. The change in estimated fair value with respect to the amount recorded at December 31, 2007 has been recorded as a loss on commodity contract of \$589 as at March 31, 2008.

**5. Accounts receivable and prepaid expenses**

	March 31, 2008	December 31, 2007
Trade accounts receivable	\$ 4,126	\$ 409
Advances and other receivables	1,260	1,505
Prepaid expenses and deposits	156	137
	<u>\$ 5,542</u>	<u>\$ 2,051</u>

**6. Inventories**

Inventories consist of the following:

	March 31, 2008	December 31, 2007
Ore stock piles	\$ 562	\$ 466
Concentrate stock piles	152	159
Materials and supplies	1,188	1,068
	<u>\$ 1,902</u>	<u>\$ 1,693</u>



**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2008**

(All amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**7. Long term investments**

At March 31, 2008 and December 31, 2007 the Company owned 3,706,250 shares of Continuum Resources Ltd. As at December 31, 2006 these were stated at cost. With the adoption of financial instruments standards, the Company measures these investments at fair value (Note 3). The fair value was determined based on published share prices of underlying securities on the active market. On adoption of financial instruments standards, a cumulative adjustment was recorded in other comprehensive income to reflect the change in accounting policy.

	March 31, 2008		December 31, 2007	
Fair value	\$	482	\$	908
Cost		741		741
Unrealized (loss) gain (cumulative)	\$	(259)	\$	167

**8. Property, Plant & Equipment**

Property, plant and equipment are comprised of the following:

	Cost		Accumulated Depreciation	March 31, 2008 Net book value		
Land	\$	259	\$	-	\$	259
Machinery & equipment		8,221		1,278		6,943
Buildings		3,024		473		2,551
Furniture & other equipment		861		133		728
Vehicles		566		103		463
Equipment under capital lease		1,363		118		1,245
Work in progress		1,735		-		1,735
	\$	16,029	\$	2,105	\$	13,924

	Cost		Accumulated Depreciation	December 31, 2007 Net book value		
Land	\$	259	\$	-	\$	259
Machinery & equipment		8,222		1,034		7,188
Buildings		2,989		409		2,580
Furniture & other equipment		912		104		808
Vehicles		524		75		449
Equipment under capital lease		1,035		71		964
Work in progress		1,421		-		1,421
	\$	15,362	\$	2,105	\$	13,669

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2008**

(All amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**9. Mineral Properties**

Mineral properties are located in Peru and Mexico and are comprised of the following:

				March 31, 2008	December 31, 2007
	Cost	Depletion	Write-off	Net	Net
Peru - Caylloma	\$ 32,408	\$ 5,481	\$ -	\$ 26,927	\$ 26,268
Mexico – San Jose	28,078	-	-	28,078	26,070
	<u>\$ 60486</u>	<u>\$ 5,481</u>	<u>\$ -</u>	<u>\$ 55,005</u>	<u>\$ 52,338</u>

Additions to mineral properties are comprised of development and exploration costs capitalized and consist of \$2,066 at Caylloma and \$2,009 at San Jose properties for the three month period ended March 31, 2008. In addition, there was a revision to the estimate for the asset retirement obligation for Caylloma which resulted in a decrease of \$720 to the cost of the mineral property. Included in additions to San Jose mineral properties are depreciation of equipment involved in construction work of \$44 (2007: \$nil), and general and administrative costs to develop the mine of \$265 (2007: \$nil).

**San Jose Project, Mexico**

The San Jose Project is owned and operated by Compañía Minera Cuzcatlan (“Cuzcatlan”), a company owned 76% by the Company and 24% by Continuum Resources Ltd (“Continuum”). The Company is the operator of the work programs and the Company and Continuum must contribute to the costs thereof in proportion to its ownership percentage in Cuzcatlan.

Cuzcatlan has been accounted for as a variable interest entity, as defined in CICA Accounting Guideline 15 “Consolidation of Variable Interest Entities” and has been consolidated from the date of acquisition. A non-controlling interest of \$8,154 has been recorded as at March 31, 2008 (March 31, 2007 - \$4,214).

**10. Related Party Transactions**

The Company incurred charges from directors, officers, and companies having a common director or officer as follows:

	Three months ended March 31, 2008	Three months ended March 31, 2007
Mineral property costs – geological fees	\$ -	\$ 45
Consulting fees	8	8
Salaries and wages	13	3
Management fees	231	54

These charges were measured at the exchange amount, which is the amount agreed upon by the transacting parties.

At March 31, 2008, due to related parties consists of \$26 (December 31, 2007 - \$14) owing to an officer and to companies with a common director. These amounts were incurred as a result of shared administrative costs. These amounts are unsecured, non-interest bearing and payable in the normal course of business.

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2008**

(All amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**11. Loans and leases**

On November 21, 2006 the Company borrowed \$4,600 at an interest rate of 12% from Quest Capital Corporation in connection with the acquisition of the San Jose property. The loan was due on May 30, 2007, however the \$4,600 plus interest of \$25 was paid back on January 15, 2007.

On October 30, 2006 a revolving credit line of US\$ 950 with a CDN value of \$1,079 as of December 31, 2006 and an interest rate of Libor + 1.5% plus a variable utilization fee, was taken for working capital purposes from Traxys North America. The amount of the credit line of \$1,079, plus interest and fees of \$41 was paid back on February 8, 2007.

At March 31, 2008 the Company has capital lease obligations of \$1,087 (December 31, 2007 - \$872) including a current portion of \$718 (December 31, 2007 - \$439). These are related to the acquisition of mining equipment, vehicles and buildings. These obligations have terms of 24, 25 months and 36 months, have expiry dates ranging from October 5, 2009 to December 15, 2010 and bear interest at rates ranging from 8.20% to 9.29%. During the three month period ended March 31, 2008, \$39 was paid on the capital leases (three month period ended March 31, 2007: \$11). During the three month period ended March 31, 2008 the Company assumed new capital lease obligations of \$254 (three month period ended March 31, 2007: \$nil)

**12. Asset Retirement Obligation**

The Company has recorded an asset retirement obligation of \$1,222 as of March 31, 2008 consisting of accretion of the previously recorded asset retirement obligation of \$1,916 as of December 31, 2007 by \$26 and a reduction in the estimated amount of the asset retirement obligation of \$720. The accretion expense was calculated over the year using a rate of 9%. The initial amount was based on an estimate prepared by an independent third party at the time of acquisition as to the cost of reclamation associated with the Caylloma property. The Company has reviewed its reclamation obligations at the property in light of changing regulations and on the basis of further data in respect of the mine life and has made a reduction in the estimated amount of the asset retirement obligation of \$720.

In view of the uncertainties concerning environmental reclamation, the ultimate cost of reclamation activities could differ materially from the estimated amount recorded. The estimate of the Company's asset retirement obligation relating to the Caylloma mine is subject to change based on amendments to laws and regulations and as new information regarding the Company's operations becomes available.

Future changes, if any, to the estimated liability as a result of amended requirements, laws, regulations, operating assumptions, estimated timing and amount of obligations may be significant and would be recognized prospectively as a change in accounting estimate. Any such change would result in an increase or decrease to the liability and a corresponding increase or decrease to the mineral property, plant and equipment balance.

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2008**

(All amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**13. Share Capital**

a) Authorized: Unlimited common shares without par value

	Number of shares	Amount
Balance, September 30, 2005	20,083,465	\$ 12,164
Exercise of options	650,000	424
Exercise of warrants	6,124,631	5,601
Private placement for cash	16,700,000	22,050
Private placement commission non-cash transaction	760,261	1,140
Property acquisition non-cash transaction	1,897,621	2,714
Property finders fee non-cash transaction	50,000	68
Property acquisition non-cash transaction	168,417	285
Loan fee	153,333	276
Transfer of contributed surplus on exercise of options	-	214
Less issue costs (non-cash amount \$1,140)	-	(1,595)
Balance, December 31, 2006	46,587,728	43,341
Exercise of options	1,753,600	1,957
Exercise of warrants	14,214,035	21,057
Private placement for cash	18,000,000	34,200
Private placement commission non-cash transaction (Note 16)	422,300	802
Transfer of contributed surplus on exercise of options	-	1,289
Less issue costs (non-cash amount \$802)	-	(2,487)
Balance, December 31, 2007	80,977,663	100,159
Exercise of options	21,400	34
Exercise of warrants	4,322,596	7,996
Transfer of contributed surplus on exercise of options	-	26
Balance, March 31, 2008	<u>85,321,659</u>	<u>\$ 108,215</u>

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2008**

(All amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**13. Share Capital (continued)****b) Stock Options**

A summary of stock options granted and exercised under the Company's stock option plan is as follows:

	Three months ended March 31, 2008		Year ended December 31, 2007	
	Number of Options	Weighted Average Exercised Price	Number of Options	Weighted Average Exercised Price
Outstanding, beginning of period	6,686,400	\$ 2.24	3,765,000	\$ 1.62
Granted	250,000	2.52	4,355,000	2.82
Exercised	(21,400)	1.61	(1,321,100)	1.48
Expired/cancelled	-	-	(112,500)	2.56
Outstanding, end of period	<u>6,915,000</u>	<u>\$ 2.41</u>	<u>6,686,400</u>	<u>\$ 2.24</u>

The following stock options were outstanding and exercisable at March 31, 2008:

Number of shares	Exercise Price \$	Expiry Date
39,000	0.37	December 2, 2009
30,000	0.80	July 24, 2010
270,000	1.35	February 5, 2016
451,000	2.29	March 30, 2016
60,000	1.75	May 8, 2016
200,000	1.75	May 22, 2016
280,000	1.55	July 5, 2016
860,000	1.66	July 10, 2016
225,000	1.61	September 13, 2016
20,000	1.90	November 20, 2016
50,000	1.96	November 23, 2016
1,385,000	2.22	January 11, 2017
80,000	2.75	February 6, 2017
15,000	3.09	April 22, 2017
50,000	3.10	May 31, 2017
50,000	3.10	June 17, 2017
50,000	3.05	June 27, 2017
2,025,000	3.22	July 2, 2017
250,000	2.97	September 23, 2017
250,000	2.82	October 9, 2010
25,000	3.10	October 24, 2017
250,000	2.52	February 5, 2018
<u>6,915,000</u>		

6,702,500 options have vested as at March 31, 2008. The average remaining life of the outstanding options at March 31, 2008 is 8.5 years.

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2008**

(All amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**13. Share Capital (continued)**

## c) Warrants

A summary of share purchase warrants issued and exercised is as follows:

	Three months ended March 31, 2008		Year ended December 31, 2007	
	Number of Warrants	Weighted Average Exercise Price	Number of Warrants	Weighted Average Exercise Price
Outstanding, beginning of period	16,479,375	\$ 1.89	20,566,185	\$ 1.23
Issued	-	-	10,559,725	2.30
Exercised	(4,322,596)	1.85	(14,646,535)	1.44
Outstanding, end of period	<u>12,156,779</u>	<u>\$ 1.90</u>	<u>16,479,375</u>	<u>\$ 1.89</u>

The following share purchase warrants were outstanding at March 31, 2008:

Number of warrants	Exercise Price \$	Expiry Date
862,117	0.345	June 27, 2010
1,613,238	0.345	November 17, 2010
960,969	2.300	July 11, 2008
8,720,455	2.300	July 11, 2008
<u>12,156,779</u>		

## d) Stock-Based Compensation

The Company uses the fair value based method of accounting for share options granted to consultants, directors, officers and employees. The non-cash compensation charge of \$531 recognized for the three month period ended March 31, 2008 (three month period ended March 31, 2007: \$2,309) is associated with the granting of options to a consultant, directors and employees. These compensation charges have been determined under the fair value method using the Black-Scholes option pricing model with the following assumptions:

	Three month period ended March 31, 2008	Three month period ended March 31, 2007
Risk-free interest rate	3.78%	4.03% - 4.13%
Expected stock price volatility	72.83%	67.0% - 68.0%
Expected term in years	5	5 & 10
Expected dividend yield	0%	0%

Option pricing models require the input of highly subjective assumptions including the estimate of the share price volatility, risk-free interest rate and expected life of the options. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options.

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(All amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**14. Accumulated other comprehensive income**

	March 31, 2008
Balance at December 31, 2007	\$ 144
Unrealized (loss) on available-for-sale long term investment, net of tax	(368)
Balance at March 31, 2008	\$ 224

**15. Segmented Information**

The Company is currently engaged in mining and the development of mineral properties. Details on a geographical basis are as follows:

	Canada	Peru	Mexico	Other	Total
Three months ended March 31, 2008					
Revenue	\$ -	\$ 6,834	\$ -	\$ -	\$ 6,834
Operating (loss) income	\$ (1,151)	\$ 1,346	\$ -	\$ (5)	\$ 190
Three months ended March 31, 2007					
Revenue	\$ -	\$ 5,739	\$ -	\$ -	\$ 5,739
Operating (loss) income	\$ (2,653)	\$ 857	\$ -	\$ -	\$ (1,796)
As at March 31, 2008					
Property, plant & equipment	\$ 6	\$ 9,594	\$ 4,321	\$ 3	\$ 13,924
Total assets	\$ 43,670	\$ 49,022	\$ 39,755	\$ 34	\$ 132,481
As at December 31, 2007					
Property, plant & equipment	\$ 7	\$ 9,252	\$ 4,407	\$ 3	\$ 13,669
Total assets	\$ 40,273	\$ 49,297	\$ 34,155	\$ 721	\$ 124,446

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2008**

(All amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**16. Supplementary Disclosure of Non-cash Transactions**

Investing and financing activities that do not have a direct impact on current cash flows are excluded from the statements of cash flows.

The following non-cash transactions occurred:

	Three months ended March 31, 2008	
	<u>Number of shares</u>	<u>Amount</u>
Fair value of options exercised	-	26

  

	Three months ended March 31, 2007	
	<u>Number of shares</u>	<u>Amount</u>
Shares issued for commission on private placement	422,300	\$ 802
Purchase of equipment on a deferred payment plan	-	2,030

**17. Commitments**

The Company has a thirteen month contract with one customer who purchases the full production from the Company's operating Caylloma mine. Under the contract, the Company is committed to supply 4,800 tons of lead concentrate and 7,200 tons of zinc. As at March 31, 2008, the Company fulfilled this commitment.

A processing plant was purchased in Mexico in the first quarter of 2007 for US\$2,250 to be paid in three installments of US\$750. The first two installments were paid on February 1, 2007 and August 1, 2007. The final installment was paid on February 1, 2008.

**18. Management of capital risk**

The Company's objectives when managing capital are to provide shareholder returns through maximization of the profitable growth of the business and to maintain a degree of financial flexibility relevant to the underlying operating and metal price risks while safeguarding the Company's ability to continue as a going concern.

The Company is not subject to externally imposed capital requirements.

**19. Management of financial risk**

The Company's financial instruments are exposed to certain financial risks, including currency risk, credit risk, liquidity risk, interest risk and price risk.

**(a) Currency risk**

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada, Peru, Mexico and Barbados and a portion of its expenses are incurred in US dollars, Nuevo Soles, and Mexican Pesos. A significant change in the currency exchange rates between the Canadian dollar relative to the other currencies could have an effect on the Company's results of operations, financial position or cash flows. The Company has not



**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2008**

(All amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**19. Management of financial risk continued**

hedged its exposure to currency fluctuations. At March 31, 2008, the Company is exposed to currency risk through the following assets and liabilities denominated in US dollars, Nuevo Soles and Mexican Pesos (all amounts are expressed in thousands of US dollars, thousands of Nuevo Soles or thousands of Mexican Pesos):

	March 31, 2008		
	<u>US Dollars</u>	<u>Nuevo Soles</u>	<u>Mexican Pesos</u>
Cash and cash equivalents	6,292	2,447	3,153
Derivatives	690	-	-
Accounts receivable	4,037	-	444
Accounts payable and accrued liabilities	(1,838)	(2,184)	-
Obligations under capital lease	(176)	-	-

Based on the above net exposures as at March 31, 2008, and assuming that all other variables remain constant, a 10% depreciation or appreciation of the Canadian dollar against the US dollar would result in an increase/decrease of \$921 in the Company's net earnings. Likewise, a 10% depreciation or appreciation of the Canadian dollar against the Nuevo Soles would result in an increase/decrease of \$10 in the Company's net earnings and a 10% depreciation or appreciation of the Canadian dollar against the Mexican Pesos would result in an increase/decrease of \$34 in the Company's net earnings.

**(b) Credit risk**

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The Company's cash equivalents are held through large Canadian and international financial institutions. These investments mature at various dates over the current operating period. All of the Company's accounts receivables are held with a large international metals trading company.

**(c) Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages liquidity risk through the management of its capital structure and financial leverage as outlined in Note 18 to the unaudited consolidated financial statements. Accounts payable and accrued liabilities, amounts due to related parties and the current portion of obligations under capital lease are due within the current operating period.

**(d) Interest rate risk**

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The risk that the Company will realize a loss as a result of a decline in the fair value of the amounts in investments with maturities of 90 days or less included in cash and cash equivalents is limited because these investments, although available for sale, are generally held to maturity.

**FORTUNA SILVER MINES INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2008**

(All amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**19. Management of financial risk continued**

(e) Price risk

The Company is exposed to metals price risk with respect to silver, gold, zinc, and lead sold through its mineral concentrate products. The Company mitigates this risk by implementing price protection programs for some of its zinc and lead production through the use of derivative instruments. As a matter of policy the Company does not hedge its silver production.

**20. Subsequent Events**

Subsequent to March 31, 2008, the Company received \$4 from the exercise of 10,000 options.

On May 6, 2008, after renegotiating the existing option agreement on the Monte Alban II concession surrounding the San Jose project, Compañía Minera Cuzcatlan SA closed the purchase of a direct 100% interest on this property. Purchase price consists of US\$1,100 paid upon closing, and an additional US\$800 payment due by May 2012.

**21. Comparative Figures**

Certain comparative figures have been reclassified to conform to the current year's presentation.