

**Transcript of  
Fortuna Silver Mines  
Second Quarter 2014 Earnings Call  
August 13, 2014**

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## **Participants**

Carlos Baca – Investor Relations Manager  
Jorge Ganoza – President and Chief Executive Officer  
Luis Ganoza – Chief Financial Officer

## **Analysts**

Benjamin Asuncion – Haywood Securities

## **Presentation**

### **Operator**

Greetings, and welcome to the Fortuna Silver Mines' Second Quarter 2014 Earnings conference call. At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. (Operator instructions.) As a reminder, this conference is being recorded.

I would now like to turn the conference over to Mr. Carlos Baca, Investor Relations Manager.

### **Carlos Baca – Investor Relations Manager**

Thank you, Mannie. Good morning, ladies and gentlemen. I would like to welcome you all to Fortuna Silver Mines and to our second quarter 2014 financial and operations results call. Jorge Alberto Ganoza, President and CEO; 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 a 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 publically available SEDAR.

I would now like to turn the call over to Jorge Ganoza, President, CEO and Co-Founder of Fortuna.

### **Jorge Ganoza – President and Chief Executive Officer**

Thank you, Carlos, and good morning to all. Fortuna reported a strong second quarter in terms of production costs and financial results. Looking at our production the company deliver 1.6 million ounces of silver and 8,500 ounces of gold in the quarter; a 52% and 62% increase respectively when compared to the second quarter of 2013. Production for the first half of the year is 3.2 million ounces of silver and 16,600 ounces of gold. Based on production results for the first half of the year, we are in a position to exceed our annual guidance of 6 million ounces of silver and 32,000 ounces of gold.

Additionally, during the quarter at the Caylloma Mine, we produced 6.7 million pounds of zinc and 4 million pounds of lead. The expansion of San Jose Mine from 1,800 tonnes per day to 2,000 tonnes per day was completed in early April. When compared against the second quarter of 2013, San Jose processed 54% more tonnage with 15% and 3% higher silver and gold rates, respectively. This yielded 1.1 million ounces of silver and 7,900 ounces of gold from Q2; 90% and 70% higher silver and gold when compared to the previous year.

[Indiscernible] at San Jose not only increased with respect to the previous quarter, but also against our budget by 14% for silver and 9% for gold. This is a result of mining the inferred resource extension to the South of the Stockwork zone at level 1200. The improvement in grade at San Jose is consistent with the increasing grade profile of the mine at depth. The reserve tonnage and grade reconciliation for the quarter is within acceptable ranges.

Caylloma consistently operated during the quarter at its steady state capacity of 1,300 tonnes per day, delivering 500,000 ounces of silver plus by-products zinc and lead. Silver production at Caylloma was 7% above the prior year as a result of higher metallurgical recovery and slightly higher silver grade. Zinc production increased 9% as a result of higher grade and recoveries, which impacted positively on the cash cost per ounce net of LIFO.

Again on our costs, costs at our mines remain well under control with \$64 per tonne at San Jose and \$91 per tonne at Caylloma. Cost per tonne measured against Q2 2013 dropped by 17% at San Jose and 2% at Caylloma and were both in line with budget. Our consolidated all-in sustaining cash cost net of by-products was \$17.40 of silver, in line with our \$17 guidance for the year.

All-in sustaining cash cost for the quarter at the Caylloma mine was \$15.50 and for San Jose was \$15.70 per ounce of silver. Caylloma reported a drop of \$9 in all-in costs, or 37% when compared to the second quarter of 2013. San Jose is in line the comparable quarter. Our all-in cost guidance for the year at Caylloma is \$17. We expect to be closer to this figure for the year as we catch up with the slow start in the first half on our underground development plan due to a change in mine contractor and a delay in an energy project.

At San Jose, our all-in cash cost per ounce comparable to the first quarter of 2013 saw the benefit of 15% lower costs. All-in cost guidance for the year at San Jose is \$14 and we're on target to meet guided projects. As informed before, we are advancing with engineering for the implementation of filtered tailings and dry-stacks at San Jose. The benefit of implementing this project will be sustaining storage capacity within company grounds for over 10 million tonnes and additional contribution of water to our [indiscernible].

We aim to start construction in early 2015, and now plan to be placing orders for filters towards the end of this year. We're not concluded with engineering, but we can

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estimate a start-up of first year cap ex of \$27 million at this point. With regard to our feasibility work on the 3,000 tonne per day project for the San Jose mine, we expect to conclude the trade of studies for the crushing and grinding [indiscernible] this month of August, we aim to conclude the study by year-end. The decision to move forward this expansion price should be taken of the first quarter.

On the exploration front, we continue with underground drilling at the Trinidad North discovery with two underground rigs. We have drilled 16,000 meters to-date. The plan for the remainder of the year is to extend our underground exploration another 250 meters further to the North from the core into northern most boundary of drilling. This drill program will start in September, will continue until the year-end. Trinidad North remains open in three directions, to the north and depth and for 300 meters to surface above level of 1,300.

With this, I can now ask Luis to please give us a review of the financial results.

**Luis Ganoza – Chief Financial Officer**

Thank you, Jorge. For the second quarter of 2014, we've recorded sales of \$44.3 million, up 47% from the prior year. Net income of \$2.9 million compared to a loss of \$10.6 million in Q2 of 2013. Cash flow from operations, before changes in working capital and after tax is paid of \$15.1 million, up 157% when compared to a prior year period.

Silver and gold sold in Q2 2014 increased significantly as a result mainly of the commissioning of the expansion of the San Jose mine, as Jorge described. Silver sold was 1.6 million ounces, up 44%; and gold sold was 8,407 ounces, up 55%. Realized prices on our provisional sales for the quarter were \$19.60 per ounce compared to \$22.80 per ounce in Q2 of 2013.

However, we recorded positive sales adjustments of \$1 million in the current quarter versus negative \$5.2 million in Q2 of 2013, which were related to metal prices and assay adjustments at the time. Our mine operating earnings were \$16.3 million, 157% above Q2 of 2013. Our gross margins increased from 22% in the comparative period to 37% in the current quarter.

The higher margins had to do to a large extent with the negative sales adjustments recorded last year. However, there is also an important effect from the higher head rates and lower unit cash cost in particular at San Jose where we saw a 17% reduction in unit cash costs per tonne of processed ore.

On the selling and G&A line item, we've recorded \$8.6 million compared to \$5.6 million in 2013, an increase of \$3 million. The breakdown of this line item is provided in Page 11 of our MD&A and most of this is related to close to \$2.5 million of mark-to-market effect on share-based compensation resulting from a 45% appreciation in the share price during the period.

Moving forward, on a quarterly basis we expect general and administrative expenses to be closer to \$4.5 million and the total amount for the selling and G&A line item around \$5.5 million, that is including stock-based compensation. Our net income for the quarter, as I mentioned, was \$2.9 million and our effective tax rate was 60%, although year-to-date the effective tax rate was 51%, which is only slightly above our expectation for the year. Earnings per share were \$0.02.

On an adjusted net income basis, our results for this quarter remain at \$3 million and the comparative period showed a loss of \$0.1 million. Cash flow from operations

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before changes in working capital and after taxes paid was \$15.1 million, 157% increase over Q2 2013. The same measure cash flow from operations year-to-date was \$32 million, while total capital expenditure was \$23 million, which gives us a free cash flow measure year-to-date of around \$9 million.

We need to bear in mind, however, that our incurred income tax for the period is around \$4 million above actual taxes paid. This figure will lightly increase for the remainder of the year.

When compared to the first quarter of 2014 our performance was slightly down as we actually sold 1.5% less silver in spite of having produced 6% more metal. Realized price for silver in Q2 of 2014 was also 11% below the previous quarter. Compared to Q1 2014 our revenue was 2.6% lower, cash flow from operations was 11% lower, and net income was down 39%. Our total cash position, including short term investments as of the end of the quarter was \$60.2 million, an increase of \$11.1 million over year end 2013.

On trade accounts receivable we saw an increase over the first quarter of the year and year end 2013 of \$10.6 million and \$9.5 million, respectively. This is related to most of the concentrates sold during the quarter having been delivered in the month of June. We should see this increase in accounts receivable flow back into the treasury in July and August.

Thank you, back to you Carlos.

**Carlos Baca – Investor Relations Manager**

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

**Operator**

(Operator instructions.) Our first question is from Benjamin Asuncion of Haywood Securities.

<Q>: I just have three questions here. I guess just at San Jose I'm looking at great profile in the back half of the year. Are we looking to similar silver grades as we saw kind of in the first half for the year?

**Jorge Ganoza – President and Chief Executive Officer**

We are certainly slightly above our budget and the explanation for that is that we find ourselves mining in an area that was not originally budgeted, which is a portion of an inferred resource that we have on level 1,200. A variation is not significant, but it's to the upside and we plan to continue mining there. What we are seeing today is consistent with what we've been mining for this first couple of years [indiscernible] even though it's above budget. We are continuing to see those kinds of grades come from this [indiscernible] that we are converting as we are developing the mine. So yes.

<Q>: And just under the comments on Trinidad North, are we still on track for I guess initial ore production in the beginning of the year, and then also on that in terms of the resolution with the community what needs to be in place when you get into initial mining in terms of do you need access to do ventilation or access points, and just any comments on that?

**Jorge Ganoza – President and Chief Executive Officer**

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Yes, with regard to the first one, to your second question, we continue with the plan to deepen the mines and give ourselves access to the Trinidad North zone, the southern boundary to the Trinidad North zone from existing infrastructure, which is mainly the central deep line, the main deep line of the mine. So that work continues according to plan. There have been some slight delays, but basically it's advancing according to plan.

The question is are we are going to start mining there starting in the beginning of the year? The purpose of mining in these area at the beginning of the year 2015 was to help us improve grade profile. Now the new variables that we are seeing is, the one we just touched on with your previous question, which is we're mining 9% to 10% above plan grades from an inferred zone that we're currently converting in level 1,200 where we already have significant mine infrastructure.

So the second half of the year as we do our mine planning for 2015, we will be taking in to consideration the fact that we also have these new alternatives coming from the inferred resources on level 1,200. So the objective is to improve the grade even more, the grade profile of production that we are feeding to the mill at 2,000 tonnes per day. How we do that, it can be with contribution from Trinidad North or contribution from this block of inferred resources that we still have on level 1,200.

So that's something we will be assessing and I cannot tell you what the final answer is going to be there. What I can tell you is that we have alternatives right now and we plan to continue pushing with the development towards Trinidad North. We'll have that flexibility and work production will come starting in 2015; it could come from Trinidad North or this new zone that is helping us already to increase the grade.

With respect to your last question, we had an important breakthrough with the community of Megalania over the course of the last 30 days. Authorities from Megalania did a joint— obviously between you know municipal and [indiscernible] authorities, with our staff they toured our site, [indiscernible] underground mine and that was very positive and we had the opportunity to visit and sample with their authorization along strikes from the current structures where we're mining underground.

So they allowed us to go in and take samples and do some mapping. So that is a very positive breakthrough. We still need the drilling permits, but we are still confident that we're going to get that. This is a process, we've been here before, we were able to resolve it, and I think we're going to resolve it again. It just takes time and patience and I think the team on site is doing it appropriate.

<Q>: And just a last thing from Luis on taxes and the timing, I guess in the last few quarters we've seen the cash component of taxes being lower than the income statement. You did make some comments on seeing this kind of increase, I guess, in third quarter or going forward. I just want to get sense of what proportion we'd been looking at from income tax presentation to what the actual cash tax is paid would be.

**Luis Ganoza – Chief Financial Officer**

Yes, sure. Year-to-date we've incurred earned income tax amongst both subsidiaries of \$4 million above the actual taxes that we have paid, and towards the end of the year, as I mentioned, that figure is likely to increase, likely double towards year-end. So that's the kind of gap we could see between actual taxes incurred and taxes paid.

**Operator**

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Gentlemen, it doesn't appear that we have any further questions. Would you like to make any additional or closing remarks?

**Jorge Ganoza – President and Chief Executive Officer**

It was overall a very good quarter for the company, and I thank all of you for your time this morning.

**Operator**

Thank you. Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

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