



**FORTUNA**  
SILVER MINES INC.

**FINANCIAL REVIEW**

**First Quarter Ended March 31, 2010**

**FORTUNA SILVER MINES INC.**

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**First Quarter Ended March 31, 2010**

**As at April 27, 2010**

**(Unaudited - Expressed in thousands of United States Dollars, unless otherwise stated)**

**Notice to Reader of the Unaudited Interim Consolidated Financial Statements  
For the three months ended March 31, 2010**

In accordance with National Instrument 51-102, of the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited interim consolidated financial statements.

The unaudited interim consolidated financial statements of Fortuna Silver Mines Inc. (the “Company”) for the three month period ended March 31, 2010 (“Financial Statements”) have been prepared by management. The Financial Statements should be read in conjunction with the Company’s audited consolidated financial statements for the year ended December 31, 2009, which are available at the SEDAR website at [www.sedar.com](http://www.sedar.com). The Financial Statements are stated in terms of thousands of United States dollars, unless otherwise indicated, and are prepared in accordance with Canadian generally accepted accounting principles.

**FORTUNA SILVER MINES INC.**  
**INTERIM CONSOLIDATED BALANCE SHEETS**  
(Unaudited - Expressed in thousands of US Dollars)

	Notes	March 31, 2010	December 31, 2009
<b>ASSETS</b>			
<b>CURRENT</b>			
Cash		\$ 68,215	\$ 30,763
Short term investments	3	1,041	6,034
Accounts receivable and prepaid expenses	5	8,957	8,635
GST and value added tax		714	601
Inventories	6	2,567	2,329
		<b>81,494</b>	<b>48,362</b>
<b>LONG TERM INVESTMENT AND RECEIVABLE</b>	7	36	16
<b>PROPERTY, PLANT AND EQUIPMENT</b>	8	18,305	17,233
<b>MINERAL PROPERTIES</b>	9	77,389	74,127
		<b>\$ 177,224</b>	<b>\$ 139,738</b>
<b>LIABILITIES</b>			
<b>CURRENT</b>			
Accounts payable and accrued liabilities	10	\$ 7,740	\$ 8,083
Due to related parties, net	11	53	49
Derivatives	4	42	3,055
Current portion of long term liability	12 a), 12 b)	928	1,038
		<b>8,763</b>	<b>12,225</b>
<b>LONG TERM LIABILITY</b>	12 a), 12 b)	1,306	1,454
<b>ASSET RETIREMENT OBLIGATION</b>	13	2,575	2,529
<b>FUTURE INCOME TAX LIABILITY</b>		12,525	10,973
		<b>25,169</b>	<b>27,181</b>
<b>SHAREHOLDERS' EQUITY</b>			
<b>SHARE CAPITAL</b>		136,254	104,701
<b>CONTRIBUTED SURPLUS</b>		14,195	14,315
<b>DEFICIT</b>		(4,061)	(9,357)
<b>ACCUMULATED OTHER COMPREHENSIVE INCOME</b>		5,667	2,898
		<b>1,606</b>	<b>(6,459)</b>
		<b>152,055</b>	<b>112,557</b>
		<b>\$ 177,224</b>	<b>\$ 139,738</b>

Commitments and contingencies

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APPROVED BY THE DIRECTORS:

"Jorge Ganoza Durant", Director  
Jorge Ganoza Durant

"Simon Ridgway", Director  
Simon Ridgway

The accompanying notes are an integral part of these unaudited interim consolidated financial statements

**FORTUNA SILVER MINES INC.**  
**INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited - Expressed in thousands of US Dollars, except for share and per share amounts)

		<b>Three months ended March 31,</b>	
	<b>Notes</b>	<b>2010</b>	<b>2009</b>
Sales		\$ 17,543	\$ 8,980
Cost of sales		5,169	4,095
Depletion, depreciation and accretion		1,609	1,399
<b>MINE OPERATING INCOME</b>		<b>10,765</b>	<b>3,486</b>
Selling, general and administrative expenses (includes depreciation of \$33 (2009: \$15))	11	2,874	1,980
Stock-based compensation	14 c)	-	349
Write-off of deferred exploration costs		-	1,081
		<b>2,874</b>	<b>3,410</b>
<b>OPERATING INCOME</b>		<b>7,891</b>	<b>76</b>
Interest and other income and expenses		136	258
Interest and finance expenses		(37)	(30)
Net gain (loss) on commodity contracts		1,747	(416)
(Loss) on disposal of property, plant and equipment		(3)	-
(Loss) on disposal of mineral property		(100)	-
(Loss) on disposal of investment		-	(462)
Foreign exchange (loss) gain		(255)	26
		<b>1,488</b>	<b>(624)</b>
<b>INCOME BEFORE INCOME TAXES AND NON-CONTROLLING INTEREST</b>		<b>9,379</b>	<b>(548)</b>
Income tax provision		4,083	688
Non-controlling interest		-	(180)
<b>NET INCOME (LOSS) FOR THE PERIOD</b>		<b>\$ 5,296</b>	<b>\$ (1,056)</b>
<b>Earnings (Loss) per Share - Basic</b>		<b>\$ 0.05</b>	<b>\$ (0.01)</b>
<b>Earnings (Loss) per Share - Diluted</b>		<b>\$ 0.05</b>	<b>\$ (0.01)</b>
<b>Weighted average number of shares outstanding - Basic</b>		<b>99,859,302</b>	<b>87,219,992</b>
<b>Weighted average number of shares outstanding - Diluted</b>		<b>104,776,752</b>	<b>87,219,992</b>

The accompanying notes are an integral part of these unaudited interim consolidated financial statements

**FORTUNA SILVER MINES INC.**  
**INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(Unaudited - Expressed in thousands of US Dollars)

	<u>Three months ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
<b>Net income (loss) for the period</b>	<b>\$ 5,296</b>	<b>\$ (1,056)</b>
<b>Other comprehensive income</b>		
Unrealized gain (loss) on available for sale long term investments, net of taxes	-	148
Transfer of unrealized loss to realized loss upon derecognition of available for sale long term investment, net of taxes	-	462
Unrealized gain on translation of functional currency to reporting currency	<b>2,769</b>	1,385
<b>Other comprehensive income</b>	<b>2,769</b>	1,995
<b>Comprehensive income</b>	<b>\$ 8,065</b>	<b>\$ 939</b>

The accompanying notes are an integral part of these unaudited interim consolidated financial statements

**FORTUNA SILVER MINES INC.**  
**INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited - Expressed in thousands of US Dollars)

	Notes	<b>Three months ended March 31,</b>	
		<b>2010</b>	<b>2009</b>
<b>OPERATING ACTIVITIES</b>			
Net income (loss) for the period		\$ 5,296	\$ (1,056)
Items not involving cash			
Depletion and depreciation		1,596	1,384
Accretion expense		46	30
Future income tax		1,320	265
Stock-based compensation		-	349
Unrealized (gain) loss on commodity contracts		(3,012)	1,896
Non-controlling interest		-	(180)
Write-off of deferred exploration costs		-	1,081
Loss on disposal of equipment		3	-
Loss on disposal of investments		-	462
Loss on disposal of mineral property		100	-
Unrealized foreign exchange (gain) loss		(468)	(3)
		<u>4,881</u>	<u>4,228</u>
Changes in non-cash working capital items			
Accounts receivable and prepaid expenses		(368)	(3,490)
Inventories		(284)	372
Accounts payable		(353)	(651)
Due to related parties		2	(23)
<b>Net cash provided by operating activities</b>		<u><b>3,878</b></u>	<u><b>436</b></u>
<b>INVESTING ACTIVITIES</b>			
Costs relating to the acquisition of Continuum		-	(120)
Short term investments		5,019	-
Mineral property expenditures		(2,662)	(2,172)
Value added taxes on purchase of property, plant and equipment		(61)	1,095
Property, plant & equipment		(1,568)	(898)
Long term receivable		(17)	29
Proceeds on disposal of long term investments		13	-
<b>Net cash provided by (used in) investing activities</b>		<u><b>724</b></u>	<u><b>(2,066)</b></u>
<b>FINANCING ACTIVITIES</b>			
Net proceeds on issuance of common shares		31,412	-
Capital lease obligations		(273)	(180)
<b>Net cash provided by (used in) financing activities</b>		<u><b>31,139</b></u>	<u><b>(180)</b></u>
Effect of exchange rate changes on cash		1,711	(622)
<b>INCREASE (DECREASE) IN CASH</b>		<b>35,741</b>	<b>(1,810)</b>
Cash - beginning of period		30,763	29,454
<b>CASH - END OF PERIOD</b>		<u><b>\$ 68,215</b></u>	<u><b>\$ 27,022</b></u>

Supplemental cash flow information

**FORTUNA SILVER MINES INC.**  
**INTERIM CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(Unaudited - Expressed in thousands of US Dollars, except for share amounts)

	<u>Share Capital</u>		Contributed		Accumulated Other Comprehensive		Total Shareholders' Equity
	Shares	Amount	Surplus	(Deficit)	Income (Loss)		
Balance - December 31, 2008	85,331,659	\$ 98,206	\$ 11,854	\$ (9,980)	\$ (11,112)	\$ 88,968	
Exercise of options	389,000	281	-	-	-	281	
Exercise of warrants	2,475,355	776	-	-	-	776	
Issuance of shares for property	6,786,674	5,192	-	-	-	5,192	
Cancellation of fractional shares	(36)	-	-	-	-	-	
Transfer of contributed surplus on exercise of options	-	246	(246)	-	-	-	
Stock-based compensation	-	-	2,707	-	-	2,707	
Income for the year	-	-	-	623	-	623	
Unrealized gain on available for sale long term investments	-	-	-	-	148	148	
Transfer of unrealized loss to realized loss upon derecognition of available for sale long-term investment, net of taxes	-	-	-	-	462	462	
Unrealized gain on translation of functional currency to reporting currency	-	-	-	-	13,400	13,400	
Balance - December 31, 2009	94,982,652	\$ 104,701	\$ 14,315	\$ (9,357)	\$ 2,898	\$ 112,557	
Issuance of shares under bought deal financing, net of issuance costs	15,007,500	31,287	-	-	-	31,287	
Exercise of options	129,500	126	-	-	-	126	
Issuance of shares for property	7,813	20	-	-	-	20	
Transfer of contributed surplus on exercise of options	-	120	(120)	-	-	-	
Income for the period	-	-	-	5,296	-	5,296	
Unrealized gain on translation of functional currency to reporting currency	-	-	-	-	2,769	2,769	
<b>Balance - March 31, 2010</b>	<b>110,127,465</b>	<b>\$ 136,254</b>	<b>\$ 14,195</b>	<b>\$ (4,061)</b>	<b>\$ 5,667</b>	<b>\$ 152,055</b>	

The accompanying notes are an integral part of these unaudited interim consolidated financial statements



**FORTUNA SILVER MINES INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009**

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

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**1. Nature 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.

**2. Summary of Significant Accounting Policies**

a) Basis of Presentation and Principles of Consolidation

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”), and presented in US dollars, but they do not contain all disclosures required by Canadian GAAP for annual financial statements and, accordingly, they should be read in conjunction with the most recently prepared annual financial statements for the year ended December 31, 2009. They include the accounts of the Company and its significantly wholly owned subsidiaries: Minera Bateas S.A.C. (“Bateas”); Fortuna Silver (Barbados) Inc.; Compania Minera Cuzcatlan SA (“Cuzcatlan”); Continuum Resources Ltd. (“Continuum”); and Fortuna Silver Mines Peru S.A.C.

These unaudited interim consolidated financial statements reflect, in the opinion of management, all adjustments necessary to present fairly the consolidated financial position as at March 31, 2010 and the consolidated statement of income and consolidated cash flows for the three month period presented. Operating results of the interim period are not necessarily indicative of the result that may be expected for the full fiscal year ending December 31, 2010.

All significant inter-company transactions and accounts have been eliminated upon consolidation.

b) Adoption of New Accounting Standards

The Company has not adopted any new accounting standards during the current period.

c) Recently released Canadian Accounting Standards

The Company has assessed new and revised accounting pronouncements that have been issued and determined that the following may have an impact on the Company:

**FORTUNA SILVER MINES INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009**

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

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**2. Summary of Significant Accounting Policies (continued)**

c) Recently released Canadian Accounting Standards (continued)

*i. Convergence with International Financial Reporting Standards (“IFRS”)*

In 2006, the Canadian Accounting Standards Board (“AcSB”) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with International Financial Reporting Standards (“IFRS”) over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canadian GAAP. This date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company will begin reporting its financial statements in accordance with IFRS on January 1, 2011, with comparative figures for 2010.

The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Company for its year ended December 31, 2010, and of the opening balance sheet as at January 1, 2010.

*ii. Business Combinations*

In January 2009, the CICA issued the following Handbook Sections: Section 1582, “Business Combinations”, Section 1601, “Consolidated Financial Statements”, and Section 1602, “Non-controlling Interests”. These new standards are harmonized with International Financial Reporting Standards (IFRS). Section 1582 specifies a number of changes, including: an expanded definition of a business, a requirement to measure all business acquisitions at fair value, a requirement to measure non-controlling interests at fair value, and a requirement to recognize acquisition-related costs as expenses. Section 1601 establishes the standards for preparing consolidated financial statements. Section 1602 specifies that non-controlling interests be treated as a separate component of equity, not as a liability or other item outside of equity. The new standards will become effective in 2011 but early adoption is permitted. The Company is evaluating the impact of adopting these standards.

*iii. Comprehensive Revaluation of Assets and Liabilities and Equity*

In August 2009, the CICA amended Handbook Section 1625, “Comprehensive revaluation of assets and liabilities” as a result of issuing “Business Combinations, Section 1582, “Consolidated Financial Statements”, Section 1601, and Non-Controlling Interests”, Section 1602, in January 2009.

In August 2009, the CICA amended Handbook Section 3251, “Equity” as a result of issuing Section 1602, “Non-controlling Interests”. These amendments only apply to entities that have adopted Section 1602.

These amendments apply prospectively to comprehensive revaluations of assets and liabilities occurring in fiscal years beginning on or after January 1, 2011, but early adoption is permitted. The Company is evaluating the impact of adopting these standards.

**FORTUNA SILVER MINES INC.**

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009

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

**3. Short term investments**

<b>Held-for-Trading</b>	<b>March 31, 2010</b>			<b>December 31, 2009</b>		
	<b>Fair Value</b>	<b>Cost</b>	<b>Accumulated unrealized holding gains (losses)</b>	<b>Fair Value</b>	<b>Cost</b>	<b>Accumulated unrealized holding gains (losses)</b>
Short term investments	\$ 1,041	\$ 1,041	\$ -	\$ 6,034	\$ 6,034	\$ -
	\$ 1,041	\$ 1,041	\$ -	\$ 6,034	\$ 6,034	\$ -

**4. Derivatives**

As at December 31, 2009, the Company had entered into commodity forward and option contracts to secure a minimum price level on part of its Caylloma's zinc and lead metal production throughout the period covering January 2010 to December 31, 2010.

The counterparties are Macquarie Bank Limited and Scotia Bank.

**Forward Sales Contracts - Swap Basis**

The contracts are spread evenly over the periods shown below with settlement occurring on a monthly basis. No initial premium associated with these trades has been paid.

The forward sale contracts, entered into on a SWAP basis, are defined below.

*August 2009* - settlements throughout January 2010 to June 2010:

Lead forward contracts:	\$1,910/t, for the total of 1,800 tons
Zinc forward contracts:	\$1,787/t, for the total of 1,050 tons

The SWAP basis contracts are settled against the arithmetic average of zinc and lead spot prices over the month in which the contract matures.

**4. Derivatives (continued)**

*Put and Call Option Commodity Arrangements*

As at December 31, 2009, the Company had entered into a series of put and call option commodity arrangements. A long put refers to put options that have been bought by the Company, and a short call refers to call options that have been sold by the Company. The option commodity arrangements settle monthly during the period of January 1, 2010 to December 31, 2010 as defined below.

*Period January 2010 - Jun 2010*

The following Zinc Option contracts were entered into :

- 6 Long put options at strike price: \$2,000/t, for the total of 2,100 tons
- 6 Short call options at strike price: \$3,010/t, for the total of 2,100 tons

The following Lead Option contracts were entered into and outstanding:

- 6 Long put options at strike price: \$2,000/t, for the total of 1,200 tons
- 6 Short call options at strike price: \$2,975/t, for the total of 1,200 tons

*Period July 2010 - December 2010*

The following Zinc Option contracts were entered into :

- 6 Long put options at strike price: \$2,000/t, for the total of 3,150 tons
- 6 Short call options at strike price: \$3,010/t, for the total of 3,150 tons

The following Lead Option contracts were entered into :

- 6 Long put options at strike price: \$2,000/t, for the total of 2,850 tons
- 6 Short call options at strike price: \$2,974/t, for the total of 2,850 tons

The estimated fair value of the outstanding liability in derivative contracts of \$42 (2009: \$3,055) was determined with reference to the published market prices for underlying commodities quoted at the London Metal Exchange.

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009

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

**5. Accounts receivable and prepaid expenses**

	<b>March 31, 2010</b>		<b>December 31, 2009</b>	
Trade accounts receivable	\$	<b>6,792</b>	\$	7,154
Advances and other receivables		<b>1,788</b>		1,168
Prepaid expenses and deposits		<b>377</b>		313
	\$	<b>8,957</b>	\$	8,635

Accounts receivable and prepaid expenses include prepaid income tax of \$12 (2009: \$9), \$122 (2009: \$121) short term portion of the long term receivable, \$50 (2009: \$34) in guaranteed deposits. Trade accounts receivable includes receivables from the sale of concentrates of \$6,792 (2009: \$7,154) and are aged less than 30 days.

**6. Inventories**

Inventories consist of the following:

	<b>March 31, 2010</b>		<b>December 31, 2009</b>	
Stockpile ore	\$	<b>147</b>	\$	204
Concentrate inventory		<b>444</b>		651
Materials and supplies		<b>1,976</b>		1,474
	\$	<b>2,567</b>	\$	2,329

**7. Long term investment and receivable**

	<b>March 31, 2010</b>		<b>December 31, 2009</b>	
Receivables		<b>36</b>		16
	\$	<b>36</b>	\$	16

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009

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

**8. Property, Plant and Equipment**

Property, plant and equipment are comprised of the following:

	March 31, 2010			December 31, 2009		
	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value
Land	\$ 324	\$ -	\$ 324	\$ 316	\$ -	\$ 316
Buildings	6,008	1,434	4,574	4,740	1,040	3,700
Machinery & equipment	9,348	2,995	6,353	10,152	3,023	7,129
Equipment under capital lease	3,246	761	2,485	3,249	568	2,681
Furniture & other equipment	1,534	525	1,009	1,627	438	1,189
Transport units	438	269	169	430	239	191
Work in progress	3,391	-	3,391	2,027	-	2,027
	<b>\$24,289</b>	<b>\$ 5,984</b>	<b>\$ 18,305</b>	<b>\$ 22,541</b>	<b>\$ 5,308</b>	<b>\$ 17,233</b>

Machinery & equipment includes costs of \$526 (2009: \$526) and accumulated depreciation of \$143 (2009: \$131) resulting from the estimate for the asset retirement obligation.

**9. Mineral Properties**

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

	March 31, 2010				December 31, 2009			
	Cost	Depletion	Write-off	Net Book Value	Cost	Depletion	Write-off	Net Book Value
Caylloma, Peru	\$44,084	\$ 12,735	\$ -	\$ 31,349	\$ 42,209	\$ 11,685	\$ 160	\$ 30,364
San Jose, Mexico	45,980	-	-	45,980	44,745	-	1,091	43,654
Tlacolula, Mexico	60	-	-	60	-	-	-	-
Predilecta, Mexico	115	-	115	-	109	-	-	109
	<b>\$90,239</b>	<b>\$ 12,735</b>	<b>\$ 115</b>	<b>\$ 77,389</b>	<b>\$ 87,063</b>	<b>\$ 11,685</b>	<b>\$ 1,251</b>	<b>\$ 74,127</b>

## a) Caylloma Project, Peru

For the three months ended March 31, 2010, additions to the Caylloma mineral property includes development and exploration costs of \$1,820.

**FORTUNA SILVER MINES INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009**

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

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**9. Mineral Properties (continued)**

b) San Jose Project, Mexico

For the three months ended March 31, 2010, additions to the San Jose mineral property consist of development and exploration costs capitalized of \$909 and future income tax of \$121 related to the acquisition of Continuum. Included in the additions for the San Jose property is \$15 relating to the accretion of the payable for the Monte Alban II concession. This property was acquired for a total of \$1,900 and consists of a payment of \$1,100 made in May 2008 and a future payment of \$800 is to be made in May 2012 (Note 12. b)). The present value of the \$800 was \$589 and this is being accreted monthly with the accretion amount being capitalized to the mineral property.

Also included in additions to the San Jose mineral property is depreciation of equipment involved in construction work of \$76 (2009: \$220), general and administrative costs to develop the mine of \$297 (2009: \$1,425), and \$1 (2009: \$141) received as interest on VAT recovered.

c) Tlacolula Project, Mexico

In September 2009, the Company, through its wholly owned subsidiary, Cuzcatlan, was granted an option (the "Option") to acquire a 60% interest (the "Interest") in the Tlacolula silver project ("property") located in the State of Oaxaca, Mexico from Radius Gold Inc.'s wholly owned subsidiary, Radius (Cayman) Inc. ("Radius") (a related party by way of directors in common with the Company).

The Company can earn the Interest by spending \$2,000, which includes a commitment to drill 1,500 meters within three years, and making staged annual payments of \$250 cash and \$250 in common stock of the Company to Radius according to the following schedule:

- \$20 cash and \$20 cash equivalent in shares upon stock exchange approval;
- \$30 cash and \$30 cash equivalent in shares by the first year anniversary;
- \$50 cash and \$50 cash equivalent in shares by the second year anniversary;
- \$50 cash and \$50 cash equivalent in shares by the third year anniversary; and,
- \$100 cash and \$100 cash equivalent in shares by the fourth year anniversary.

Upon completion of the cash payments and share issuances, and incurring the exploration expenditures as set forth above, the Company will be deemed to have exercised the Option and acquired a 60% interest in the property, whereupon a joint venture will be formed to further develop the property on the basis of the Company owning 60% and Radius 40%.

On January 15, 2010, the transaction was approved by the TSX Venture Exchange. The Company has issued 7,813 common shares of the Company, at a fair market value of \$2.56 per share and paid \$20 cash according to the terms of the option agreement. Included in the cost is future income tax of \$11.

d) Predilecta, Mexico

During the first quarter of 2010, the Company sold its interest in the Predilecta mineral property, for cash consideration of \$13 resulting in a loss of \$100.

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009

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

**10. Accounts payable and accrued liabilities**

	<b>March 31, 2010</b>	December 31, 2009
Trade accounts payable	\$ 3,210	\$ 2,577
Income taxes payable	1,915	2,949
Payroll and other payables	2,615	2,557
	<b>\$ 7,740</b>	<b>\$ 8,083</b>

Payroll and other payables includes \$616 (2009: \$1,084) attributable to workers' participation under Peruvian law.

**11. Related Party Transactions**

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

<b>Transactions with related parties</b>	<b>Three months ended March 31,</b>	
	<b>2010</b>	2009
Consulting fees <sup>1</sup>	\$ 43	\$ 31
Salaries and wages <sup>2,3</sup>	29	23
Other general and administrative expenses <sup>3</sup>	80	-
	<b>\$ 152</b>	<b>\$ 54</b>

<sup>1</sup> Consulting fees includes fees paid to two directors, Simon Ridgway and Mario Sztolender.

<sup>2</sup> Salaries and wages includes employees' salaries and benefits charged to the Company based on an estimated percentage of the actual hours worked for the Company.

<sup>2,3</sup> Radius Gold Inc. ("Radius") has directors in common with the Company and shares office space, and is reimbursed for various general and administrative costs incurred on behalf of the Company.

In September 2009, the Company was granted an option to acquire a 60% interest in the Tlacolula silver project located in the State of Oaxaca, Mexico from Radius. Refer to Note 9. c).

<b>Amounts due to/(from) related parties</b>	<b>March 31, 2010</b>	December 31, 2009
Owing (from)/to a director and officer <sup>4</sup>	\$ -	\$ (1)
Owing to a company with common directors <sup>3</sup>	\$ 53	\$ 50
	<b>\$ 53</b>	<b>\$ 49</b>

<sup>4</sup> Owing from a director includes a non-interest bearing loan to Jorge A. Ganoza Durant with no specific terms of repayments.

The transactions with related parties are measured at the agreed upon exchange amount, which is the amount of consideration established and agreed upon by the parties. The balances with related parties are unsecured, non-interest bearing, and payable in the normal course of business.



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**12. Leases and Long Term Liabilities**

## a) Obligations under capital lease

The following is a schedule of the Company's capital lease obligations. These are related to the acquisition of mining equipment, vehicles, and buildings.

	Interest Rate	Maturity Date	March 31, 2010	December 31, 2009
Scotia Bank	8.66%	2010	68	101
Scotia Bank	8.20%	2010	178	252
Scotia Bank	8.49%	2010	44	57
Scotia Bank	8.34%	2010	11	14
Scotia Bank	8.49%	2011	84	100
Scotia Bank	6.75%	2011	14	16
Scotia Bank	6.75%	2011	18	20
Interbank	4.00%	2011	172	198
Interbank	9.12%	2011	150	170
Interbank	9.75%	2012	82	91
Interbank	9.75%	2012	754	829
Lease payments			\$ 1,575	\$ 1,848
Less current amount			(928)	(1,038)
			\$ 647	\$ 810

## b) Long term liability

In May 2008, Cuzcatlan acquired the Monte Alban II concession (Note 9. b)) for which a payment of \$800 is due May 2012. This payment is non-interest bearing and all debt relating to the acquisition of the mineral resource property has been recognized as at March 31, 2010.

	March 31, 2010	December 31, 2009
Face value of long term liability	\$ 644	\$ 970
Less: adjustment to amortized cost	-	(225)
Opening fair value of liability measured at amortized cost	644	745
Cancellation of contract	-	(156)
Add: accretion to period end	15	55
Liability at period end	659	644
Less: current portion of long term liability	-	-
	\$ 659	\$ 644

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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

**12. Leases and Long Term Liabilities (continued)**

## b) Long term liability (continued)

Principal minimum repayment terms will be :

2010	\$	-
2010		-
2012		<b>800</b>
	\$	<b>800</b>

## c) Contingent liability

The Caylloma mine closure plan was approved in November 2009 with the total closure costs of \$3,346 of which \$1,756 is subject to annual collateral in the form of a letter of guarantee, to be awarded each year in increments of \$146 over 12 years, and is based on the life of the mine.

Banco Bilbao Vizcaya Argentaria, S.A., a third party, has established a bank letter of guarantee on behalf of Bateas in favor of the Peruvian mining regulatory agency in compliance with local regulation associated with the approved Bateas' mine closure plan, for the sum of \$146. This bank letter of guarantee expires 360 days from December 2009.

Interbank, a third party, has established a \$2 bank letter of guarantee on behalf of Bateas in favor to the Peruvian Ministry of Energy and Mines to guarantee a temporary concession for performing studies on electric power generation. The letter of guarantee expires on May 3, 2010.

**13. Asset Retirement Obligation**

A summary of the Company's provision for asset retirement obligation is presented below.

	<b>March 31, 2010</b>		December 31, 2009	
Asset retirement obligation - beginning of year	\$	<b>2,529</b>	\$	1,066
Revisions in estimates		-		1,286
Accretion expense, included in depreciation, depletion and accretion		<b>46</b>		150
Foreign exchange impact		-		27
Asset retirement obligation - end of period	\$	<b>2,575</b>	\$	2,529

The accretion expense was calculated over the period using a risk free interest rate of 7.46% (2009: 7.46%). The Company had 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 had made an increase to the estimated amount of the asset retirement obligation of \$nil (2009: \$1,286).

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.

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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**13. Asset Retirement Obligation (continued)**

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.

**14. Share Capital**

a) Authorized: Unlimited common shares without par value

b) Stock Options

The following is a summary of option transactions:

	Number of Shares	Weighted Average Exercise Price Per Share in CAD\$
Balance, December 31, 2008	7,734,000	\$ 1.87
Granted	2,915,000	1.56
Exercised	(389,000)	0.81
Expired	(970,000)	2.35
Forfeited	(1,075,000)	3.22
Balance, December 31, 2009	8,215,000	\$ 1.50
Exercised	(129,500)	<b>1.00</b>
<b>Balance, March 31, 2010</b>	<b>8,085,500</b>	<b>\$ 1.51</b>

During the period, 129,500 share purchase options with exercise prices ranging from CAD\$0.85 to CAD\$1.25 per share were exercised. As at March 31, 2010, 2,665,000 share purchase options are subject to shareholder approval.

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009

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

**14. Share Capital (continued)**

## b) Stock Options (continued)

The following share purchase options were outstanding at March 31, 2010:

Number of shares	Exercise Price CAD\$	Expiry Date	Weighted Average Remaining Contractual Life - Years
30,000	\$ 0.80	July 24, 2010	0.3
270,000	\$ 1.35	February 5, 2016	5.9
250,000	\$ 2.29	March 30, 2016	6.0
60,000	\$ 1.75	May 8, 2016	6.1
200,000	\$ 1.75	May 22, 2016	6.1
7,500	\$ 0.85	July 5, 2016	6.3
225,000	\$ 1.55	July 5, 2016	6.3
860,000	\$ 1.66	July 10, 2016	6.3
225,000	\$ 1.61	September 13, 2016	6.5
90,000	\$ 0.85	January 11, 2017	6.8
700,000	\$ 2.22	January 11, 2017	6.8
50,000	\$ 2.75	February 6, 2017	6.9
15,000	\$ 0.85	April 22, 2017	7.1
5,000	\$ 0.85	May 31, 2017	7.2
38,000	\$ 0.85	June 27, 2017	7.2
30,000	\$ 0.85	July 2, 2017	7.3
25,000	\$ 0.85	October 24, 2017	7.6
250,000	\$ 2.52	February 5, 2018	7.9
100,000	\$ 1.25	August 25, 2018	8.4
1,100,000	\$ 0.85	October 5, 2018	8.5
640,000	\$ 0.85	November 5, 2018	8.6
250,000	\$ 0.83	July 6, 2019	9.3
2,150,000	\$ 1.60	October 27, 2019	9.6
490,000	\$ 1.70	November 8, 2019	9.6
25,000	\$ 2.23	November 23, 2019	9.7
<b>8,085,500</b>			<b>8.05</b>

As at March 31, 2010, 8,085,500 share purchase options have vested with 2,665,000 share purchase options subject to shareholder approval.

**FORTUNA SILVER MINES INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009**  
(All amounts expressed in thousands of US Dollars, except for share and per share amounts)

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**14. Share Capital (continued)**

b) Stock Options (continued)

Subsequent to March 31, 2010 to April 27, 2010, 35,000 share purchase options were exercised at CAD\$0.85 per share.

c) 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 \$nil recognized for the three months ended March 31, 2010 (2009: \$349) is associated with options granted to a directors, officers, and employees. These compensation charges have been determined under the fair value method using the Black-Scholes option pricing model with the following assumptions:

	<b><u>Three months ended March 31,</u></b>	
	<b><u>2010</u></b>	<b><u>2009</u></b>
Risk-free interest rate	<b>n/a</b>	<b>2.74% - 3.07%</b>
Expected stock price volatility	<b>n/a</b>	<b>70% - 78%</b>
Expected term in years	<b>n/a</b>	<b>5 &amp; 10</b>
Expected dividend yield	<b>n/a</b>	<b>0%</b>

There were no stock options granted during the three months ended March 31, 2010 and 2009.

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.

**FORTUNA SILVER MINES INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009**  
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**15. Segmented Information**

a) Industry Information

The Company operates in one reportable operating segment, being the acquisition, exploration, development, and operation of mineral properties.

b) Geographic Information

The following is the summary of operations and summary of certain assets on a geographical basis.

	Canada	Peru	Mexico	Other	Total
<b>Three months ended March 31, 2010</b>					
Sales	\$ -	\$ 17,543	\$ -	\$ -	\$ 17,543
Operating income (loss)	\$ (1,010)	\$ 8,911	\$ -	\$ (10)	\$ 7,891
Three months ended March 31, 2009					
Sales	\$ -	\$ 8,980	\$ -	\$ -	\$ 8,980
Operating (loss) income	\$ (1,007)	\$ 2,009	\$ (921)	\$ (5)	\$ 76
<b>As at March 31, 2010</b>					
Mineral Properties	\$ -	\$ 31,349	\$ 46,040	\$ -	\$ 77,389
Property, plant and equipment	\$ 10	\$ 12,645	\$ 5,647	\$ 3	\$ 18,305
Total assets	\$ 52,405	\$ 72,722	\$ 52,084	\$ 13	\$ 177,224
As at December 31, 2009					
Mineral Properties	\$ -	\$ 30,364	\$ 43,763	\$ -	\$ 74,127
Property, plant and equipment	\$ 11	\$ 12,298	\$ 4,922	\$ 2	\$ 17,233
Total assets	\$ 25,120	\$ 67,978	\$ 46,614	\$ 26	\$ 139,738

c) Major Customers

For the three months ended March 31, 2010 and 2009, there was one customer accounting for 69% and 100% of total sales of the Company, respectively.

**16. Commitments and Contingencies**

The Company has a contract to guarantee power supply at its Caylloma mine. Under the contract, the seller is obligated to deliver a "maximum committed demand" (for the present term this stands at 2,800 Kw) and Bateas is obligated to purchase subject to exemptions under provisions of "Force Majeure". The contract is automatically renewed every two years for a period of 10 years. Renewal can be avoided without penalties by notifying 10 months in advance of renewal date. Tariffs are established yearly by the energy market regulator in accordance with applicable regulations in Peru.

The Company acts as guarantor to capital lease obligations held by two of its mining contractors. These capital lease contracts are related to the acquisition of mining equipment deployed at the Caylloma mine. As at March 31, 2010, these obligations amounted to \$1,201 and mature in 2010.

**FORTUNA SILVER MINES INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009**

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

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**16. Commitments and Contingencies (continued)**

a) Environmental Matters

The Company's mining and exploration activities are subject to various laws and regulations governing the protection of the environment. These laws and regulations are continually changing and are generally becoming more restrictive. The Company conducts its operations so as to protect the public health and environment and believes its operations are in compliance with applicable laws and regulations in all material respects. The Company has made, and expects to make in the future, expenditures to comply with such laws and regulations, but cannot predict the full amount of such future expenditures.

Estimated future reclamation costs are based principally on legal and regulatory requirements. As of March 31, 2009, \$2,575 (2009: \$2,529) was accrued for reclamation costs relating to mineral properties in accordance with Section 3110, "Asset Retirement Obligations". See Notes 12. c) and 13.

b) Income Taxes

The Company operates in numerous countries around the world and accordingly it is subject to, and pays annual income taxes under the various income tax regimes in the countries in which it operates. Some of these tax regimes are defined by contractual agreements with the local government, and others are defined by the general corporate income tax laws of the country. The Company has historically filed, and continues to file, all required income tax returns and to pay the taxes reasonably determined to be due. The tax rules and regulations in many countries are highly complex and subject to interpretation. From time to time, the Company is subject to a review of its historic income tax filings and in connection with such reviews, disputes can arise with the taxing authorities over the interpretation or application of certain rules to the Company's business conducted within the country involved.

c) Title Risk

Although the Company has taken steps to verify title to properties in which it has an interest, these procedures do not guarantee the Company's title. Property title may be subject to, among other things, unregistered prior agreements or transfers and may be affected by undetected defects.

**17. Capital Disclosure**

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.

**FORTUNA SILVER MINES INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009**

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

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**17. Capital Disclosure (continued)**

The capital of the Company consists of shareholders' equity and the line of credit, net of cash. The Board of Directors does not establish a quantitative return on capital criteria for management. The Company manages the capital structure and make adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets.

The management of the Company believes that the capital resources of the Company as at March 31, 2010, are sufficient for its present needs for the next 12 months. The Company is not subject to externally imposed capital requirements.

The Company's overall strategy with respect to capital risk management remained unchanged during the year.

**18. 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. The Company's Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework and reviews the Company's policies on an ongoing basis.

a) Fair value of financial instruments

The carrying value of cash, short term investments, accounts receivable, accounts payable and accrued liabilities, due to related parties, net, approximate their fair value due to the relatively short periods to maturity and the terms of these financial instruments.

Fair value estimates are made a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and, therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The analysis of financial instruments that are measured subsequent to initial recognition at fair value can be categorized into Levels 1 to 3 based upon the degree to which the fair value is observable.

- Level 1 - inputs to the valuation methodology are quoted (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - inputs to valuation methodology include quoted market prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value of measurement.

The Company has classified the determination of fair value of accounts receivable and derivatives as level 2, as the valuation method used by the Company includes an assessment of assets in quoted markets with significant observable inputs.



**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009

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

**18. Management of financial risk (continued)**

## a) Fair value of financial instruments (continued)

<b>Financial assets (liabilities) at fair value as at March 31, 2010</b>				
	Level 1	Level 2	Level 3	Total
Short term investments	\$ 1,041	\$ -	\$ -	\$ 1,041
Accounts receivable	-	8,580	-	8,580
Derivatives	-	(42)	-	(42)
	\$ 1,041	\$ 8,538	\$ -	\$ 9,579

  

<b>Financial assets (liabilities) at fair value as at December 31, 2009</b>				
	Level 1	Level 2	Level 3	Total
Short term investments	\$ 6,034	\$ -	\$ -	\$ 6,034
Accounts receivable	-	8,322	-	8,322
Derivatives	-	(3,055)	-	(3,055)
	\$ 6,034	\$ 5,267	\$ -	\$ 11,301

Accounts receivable includes accounts receivable from provisional sales. The fair value of accounts receivable resulting from provisional pricing reflect observable market commodity prices. Resulting fair value changes accounts receivable are through sales. Transactions involving accounts receivable are with counterparties the Company believes are creditworthy.

Derivatives are carried at their fair value, which is determined based on internal valuation models that reflect observable forward market commodity prices. Resulting fair value changes to derivatives are through net gain (loss) on commodity contracts. Transactions involving derivatives are with counterparties the Company believes to be creditworthy.

During the three months ended March 31, 2010, there has been no changes in the classification of financial assets and liabilities in level 3 of the hierarchy.

## b) 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 Canadian dollars, Nuevo Soles, and Mexican Pesos. A significant change in the currency exchange rates between the United States dollar relative to the other currencies could have a material effect on the Company's results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

As at March 31, 2010, the Company is exposed to currency risk through the following assets and liabilities denominated in Canadian dollars, Nuevo Soles and Mexican Pesos (all amounts are expressed in thousands of Canadian dollars, thousands of Nuevo Soles or thousands of Mexican Pesos):

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FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009

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

**18. Management of financial risk (continued)**

## b) Currency risk (continued)

	March 31, 2010			December 31, 2009		
	Canadian Dollars	Nuevo Soles	Mexican Pesos	Canadian Dollars	Nuevo Soles	Mexican Pesos
Cash	\$ 43,007	S/. 946	\$ 4,575	\$ 21,283	S/. 302	\$ 1,283
Short term investments	1,061	-	-	560	-	-
Accounts receivable	-	1,237	8,722	5	880	6,565
Accounts payable and accrued liabilities	(54)	(14,016)	(1,182)	(194)	(17,150)	(623)

Based on the above net exposure as at March 31, 2010, and assuming that all other variables remain constant, a 10% depreciation or appreciation of the US dollar against the above currencies would result in an increase or decrease, expressed in US dollars, as follows:

Impact to other comprehensive income (loss)	\$ 4,798		
Impact to net income (loss)		\$ (463)	\$ 108

## c) 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 and short term investments are held through large Canadian, international and foreign national financial institutions. These investments mature at various dates within one year. All of the Company's trade accounts receivables are held with large international metals trading companies.

The Company holds derivative contracts with financial institutions and in this regard is exposed to counterparty risk. The Company mitigates this risk by transacting only with reputable financial institutions to minimize credit risk.

As at March 31, 2010, the Company has a Mexican value added tax of \$482 and Peruvian value added tax of \$215. The Company expects to recover the full amounts from the Mexican and Peruvian Governments.

## d) 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 by continuing to monitor forecasted and actual cash flows. The Company has in place a planning and budgeting process to help determine the funds required to support the Company's normal operating requirements on an ongoing basis and its development plans. The Company strives to maintain sufficient liquidity to meet its short term business requirements, taking into account its anticipated cash flows from operations, its holdings of cash, short term investments, and its committed liabilities.

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009

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

**18. Management of financial risk (continued)**

## d) Liquidity risk (continued)

The Company expects the following maturities of its financial liabilities (including interest), operating leases, and other contractual commitments:

	<b>Expected payments due by period as at March 31, 2010</b>					Total
	Less than			After		
	1 year	1 - 3 years	4 - 5 years	5 years		
Accounts payable and accrued liabilities	\$ 7,740	\$ -	\$ -	\$ -	\$ 7,740	
Due to related parties, net	53	-	-	-	53	
Derivatives	42	-	-	-	42	
Long term liability	928	1,306	-	-	2,234	
Total <sup>1</sup>	\$ 8,763	\$ 1,306	\$ -	\$ -	\$ 10,069	

<sup>1</sup> Amounts above do not include payments related to the following: (i) the Company's anticipated asset retirement obligation of \$2,575 associated with mine closure, land reclamation, and other environmental matters.

## e) 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 is limited because the balances are generally held with major financial institutions in demand deposit accounts.

## f) Metal price risk

The Company is exposed to metals price risk with respect to silver, gold, zinc, lead, and copper 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.

A 10% change in zinc, lead, silver, gold, and copper prices would cause a \$247, \$254, \$471, \$40, and \$58 change in net earnings on a quarterly basis, respectively.

**FORTUNA SILVER MINES INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE MONTH PERIODS ENDED MARCH 31, 2010 AND 2009

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

**19. Supplemental cash flow information**

		<b>Three months ended March 31,</b>	
	<b>Notes</b>	<b>2010</b>	<b>2009</b>
<b>Cash received or paid for interest and income taxes:</b>			
Cash received for interest		\$ 50	\$ (63)
Cash paid for income taxes		\$ 270	\$ 93
<b>Non-cash Transactions:</b>			
Future income tax liability on Continuum purchase	9	\$ 124	\$ -
Issuance of shares on purchase of resource property	9	\$ 21	\$ 5,194
Future income tax liability on Tlacolula property option	9	\$ 11	\$ -
Reassessment of asset retirement obligation		\$ -	\$ 288
Cancellation of Minera Condor liability		\$ -	\$ 156
Equipment purchased through capital lease		\$ (3)	\$ 101
Fair value of options exercised		\$ 120	\$ 10



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**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE**  
**FIRST QUARTER ENDED MARCH 31, 2010**

*As at April 27, 2010*

*(Dollar amounts expressed in US dollars, unless otherwise indicated)*

**FORTUNA SILVER MINES INC.**  
**Management's Discussion and Analysis**  
**For the first quarter ended March 31, 2010**  
**(Dollar amounts expressed in US dollars, unless otherwise indicated)**

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*Management's Discussion and Analysis ("MD&A") is intended to help the reader understand the significant factors that have affected Fortuna Silver Mines Inc. and its subsidiaries' ("Fortuna" or the "Company") performance and such factors that may affect its future performance. For a comprehensive understanding of Fortuna's financial condition and results of operations, this MD&A should be read in conjunction with the Company's unaudited consolidated financial statements for three months ended March 31, 2010 and the related notes contained therein. The Company reports its financial position, results of operations and cash flows in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). In addition, the following should be read in conjunction with the Consolidated Financial Statements of the Company for the year ended December 31, 2009, the related MD&A, and Fortuna's Annual Information Form (available on SEDAR at [www.sedar.com](http://www.sedar.com)). This MD&A refers to various non-GAAP measures, such as cash cost per tonne of processed ore, cash cost per ounce of payable silver, adjusted net income (loss), cash generated by operating activities before changes in working capital, used by the Company to manage and evaluate operating performance and ability to generate cash and are widely reported in the silver mining industry as benchmarks for performance. Cash costs are presented as they represent an industry standard method of comparing certain costs on a per unit basis. The Company believes that certain investors use these non-GAAP measures to evaluate the Company's performance. Non-GAAP measures do not have standardized meaning. Accordingly, non-GAAP measures should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP. To facilitate a better understanding of these measures as calculated by the Company, we have provided detailed descriptions and reconciliations where applicable.*

**Forward Looking Information**

Certain statements contained in this MD&A and elsewhere constitute forward-looking statements. Such forward-looking statements involve a number of known and unknown risks, uncertainties and other factors which may cause the actual results, and performance of achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, changes in project parameters to deal with unanticipated economic factors, risks related to technological and operational nature of the Company's business, the speculative nature of exploration and development, and changes in local and national government legislation.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statements were made, and readers are advised to consider such forward-looking statements in light of the risks set forth in the section Risks and Uncertainties.

This MD&A also contains references to estimates of mineral reserves and mineral resources. The estimation of reserves and resources is inherently uncertain and involves subjective judgments about many relevant factors. The accuracy of any such estimates is a function of the quantity and quality of available data, and of the assumptions made and judgments used in engineering and geological interpretation, which may prove to be unreliable. There can be no assurance that these estimates will be accurate or that such mineral reserves and mineral resources can be mined or processed profitably. Mineral resources that are not mineral reserves do not have demonstrated economic viability. Except as required by law, the Company does not assume the obligation to revise or update these forward looking statements after the date of this document or to revise them to reflect the occurrence of future unanticipated events.

In particular, forward-looking information and statements include:

- "The Company anticipates to commission San Jose in the second semester of 2011." (page 7)

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**Business of the Company**

Fortuna Silver Mines Inc. (the "Company") is a mining company focused on producing silver and developing silver projects in Latin America. The Company's principal assets are the Caylloma Polymetallic Mine in southern Peru and the San Jose Silver-Gold Project in southern Mexico.

**Recent Developments and 2010 Highlights**

*Financial Results*

During the first quarter of 2010, the Company generated record net income of \$5.30 million, along with record sales and operating income of \$17.54 million (Q1 2009: \$8.98 million) and \$7.89 million (Q1 2009: \$0.08 million), respectively.

Silver metal production during the first quarter of 2010 was 479,821 ounces, 30% above the corresponding quarter of 2009. This increase is attributable to higher throughput, higher silver head grades, and higher metallurgical recoveries.

The Company's price protection program generated a gain on commodity contracts of \$1.75 million during the first quarter of 2010. Adjusting for the mark-to-market effect on the gain on commodity contracts, a non-GAAP measure, the first quarter of 2010 resulted in adjusted net income of \$4.38 million (Q1 2009: loss \$0.79 million).

	<b>Expressed in millions</b>	
	<b>Three months ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>NET INCOME (LOSS) FOR THE PERIOD</b>	<b>\$ 5.30</b>	<b>\$ (1.06)</b>
Items of note, net of tax:		
<b>Mark to Market effect on derivatives</b>	<b>(0.91)</b>	<b>0.27</b>
<b>ADJUSTED NET INCOME (LOSS) FOR THE PERIOD <sup>(1)</sup></b>	<b>\$ 4.38</b>	<b>\$ (0.79)</b>

<sup>(1)</sup> **A non-GAAP measure**

Cash generated by operating activities before changes in working capital, a non-GAAP measure, for the first quarter ended March 31, 2010 was \$4.88 million up from \$4.23 million in the same period in the prior year.

*Release of Pre-feasibility Study at San Jose*

On April 26, 2010 the Company released the results of the Pre-feasibility Study for the San Jose Project in Mexico. The technical report will be filed no later than 45 days after the news release. Highlights of the prefeasibility study include the following:

- 3.5 million tonnes of Probable Reserves with 23.2 million ounces of contained silver and 181,000 ounces of contained gold (average head grades of 205 g/t of silver and 1.6 g/t of gold);
- 2.7 million tonnes of Inferred Resources\* with 17 million ounces of contained silver and 133,500 ounces of contained gold not included in the Reserves or the economic model;
- After-tax Net Present Value (NPV) of \$36.4 million at an 8% discount rate;
- After-tax Internal Rate of Return (IRR) of 18%;
- Estimated Pre-production Capital Expenditures (CAPEX) of \$55.7 million;

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- Average Cash Cost per silver equivalent (Ag Eq) ounce over life of Reserves of \$6.90;
  - 9 year production plan based on existing Reserves; and,
  - Incremental throughput rate starting at 750 tonnes per day (tpd), scaling to 1,000 tpd in 2014 and to 1,500 tpd in 2016.
- \* This figure refers to resources above the breakeven cut-off grade.

### Quarterly Information

The following table provides information for the eight fiscal quarters ended March 31, 2010:

Expressed in \$000's, except per share data

	31-Mar-10	31-Dec-09	30-Sep-09	30-Jun-09	31-Mar-09	31-Dec-08	30-Sep-08	30-Jun-08
<b>Sales</b>	<b>17,543</b>	16,356	13,230	12,862	8,980	2,795	7,492	7,772
<b>Mine operating income (loss) *</b>	<b>10,765</b>	10,376	7,074	6,792	3,487	(2,986)	1,734	2,848
<b>Net income (loss)</b>	<b>5,296</b>	1,037	(556)	1,196	(1,054)	(2,468)	(297)	2,493
<b>Earnings (loss)</b>								
per share - <b>basic</b>	<b>0.05</b>	0.01	(0.01)	0.01	(0.02)	(0.03)	0.00	0.03
- <b>diluted</b>	<b>0.05</b>	0.01	(0.01)	0.01	(0.02)	(0.03)	0.00	0.03

\* Mine operating income (loss) is a non-GAAP measure used by the Company as a measure of operating performance

Sales have consistently increased quarter over quarter since the fourth quarter of 2008 with the first quarter of 2010 reaching a record high at \$17.54 million. The upward trend in sales throughout 2009 is mainly attributable to increases in metal prices. Higher sales in 2009 compared to the corresponding quarters of 2008 have been significantly driven by higher silver head grades, higher production, and lower treatment charges.

When compared to the fourth quarter of 2009, revenue and operating results in the first quarter of 2010 were further improved by the first full quarter of copper production.

### Financial Results

During the first quarter of 2010 the Company generated record **net income** of \$5.30 million (Q1 2009: loss \$1.06 million). This increase is attributable to a higher price environment as well as increased silver output and the recently added copper production, as reflected by the strong operating income in the quarter of \$7.89 million (Q1 2009: \$0.08 million).

When compared to the fourth quarter of 2009, net income in the first quarter of 2010 increased by \$4.26 million. This increment is driven mainly by higher mine operating income of \$0.39 million, no stock-based compensation charges compared to a charge of \$2.22 million, and commodity contracts gain of \$1.75 million compared to a loss of \$2.12 million. All of this offset by the tax provision increase of \$1.93 million.

Mark-to-Market effect: Included in the \$1.75 million gain recorded on commodity contracts in the first quarter of 2010, is a mark-to market effect of \$0.91 million, net of tax, related to open contracts as at March 31, 2010 expiring between the months of April 2010 and December 2010.



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**Total cost of sales, including depletion, depreciation and accretion ("cost of sales")**, in the first quarter of 2010 totalled \$6.78 million (Q1 2009: \$5.49 million) and represents an increase of 23% over same period in the prior year. This increment is explained by higher tonnage sold of 5%, higher unit costs of 9% and slightly lower head grades for lead and zinc. Other things being equal, a decrease in head grades will deliver lower concentrate production for equal or similar production costs.

**Selling and administrative expenses** in the first quarter of 2010 increased 45% to \$2.87 million (Q1 2009: \$1.98 million). The increase is due mainly to higher general and administrative expenses both at the corporate and subsidiary level. Corporate general and administrative expenses increased by \$0.48 million to \$1.36 million (Q1 2009: \$0.88 million); selling and administrative expenses at the subsidiary level increased by \$0.32 million to \$1.35 million (Q1 2009: \$1.02 million); and government royalty paid by Minera Bateas increased by \$0.09 million to \$0.17 million (Q1 2009: \$0.08 million).

**Stock-based compensation** charge was \$nil for the first quarter of 2010 compared to \$0.35 million in the same period of the prior year.

**Interest and other income and expenses** in the first quarter of 2010 amounted to \$0.14 million (Q1 2009: \$0.26 million) and the decrease is attributable to a reduction in interest rates and the prior year's reversal of \$0.09 million in costs related to the acquisition of Continuum.

**Interest and finance expenses** in the first quarter of 2010 amounted to \$0.04 million (Q1 2009: \$0.03 million) and relate primarily to capital lease operations at our operating subsidiary.

**Net gain (loss) on commodity contract** in the first quarter of 2010 amounted to \$1.75 million compared to a net loss of \$0.42 million in the same period of the prior year. This amount reflects the change in fair value of derivative contracts between the opening of the reporting period and either the expiry of the contracts or the closing of the period, whichever happened first. Included in the \$1.75 million gain recorded on commodity contracts, is a mark-to market effect of \$1.46 million (\$0.91 million, net of tax) related to open contracts as at March 31, 2010 expiring between the months of April 2010 and December 2010. The Company has entered into commodity forward and option contracts to secure a minimum price level on part of Caylloma's zinc and lead metal production for 2010. Additionally, for the unhedged balance of production, the Company enters regularly into short term forward lead and zinc contracts to fix the final settlement price of metal delivered in concentrates, where the final settlement price is yet to be set at a future quotational period according to contract terms. The Company does not use hedge accounting.

The \$4.08 million **Income tax provision** recorded for the first quarter of 2010 (Q1 2009: \$0.69 million) comprises current and future income tax expense. Current income tax for the period, including the worker profit sharing plan regulated by Peruvian law was \$2.76 million (Q1 2009: \$0.39 million). Future income tax expense, amounting to \$1.32 million (Q1 2009: \$0.30 million) is attributed to temporary differences arising on amounts of mineral properties at Peruvian operations where exploration and development are expensed for tax purposes.

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**Results of Operations**

Peru - Caylloma Ag-Pb-Zn Mine

<b>Caylloma Mine</b>	<b>Quarters ended</b>							
	<b>31-Mar-10</b>	<b>31-Dec-09</b>	<b>30-Sep-09</b>	<b>30-Jun-09</b>	<b>31-Mar-09</b>	<b>31-Dec-08</b>	<b>30-Sep-08</b>	<b>30-Jun-08</b>
<b>Tonnes milled</b>	101,503	97,989	105,241	100,881	91,449	91,025	89,827	80,121
<b>Average tons milled per day</b>	1,167	1,101	1,182	1,146	1,051	1,023	1,009	910
<b>Head Grade</b>								
Silver (g/t)	167.23	164.26	146.54	160.42	147.81	114.83	97.73	85.49
Lead (%)	2.87	3.14	2.95	3.20	3.11	2.97	2.58	2.29
Zinc (%)	3.44	3.43	3.58	3.82	3.83	3.75	3.64	3.75
Copper (%)	0.25	0.24	0.26	0.26	-	-	-	-
<b>Recoveries</b>								
Silver (%)*	87.89	86.32	84.20	86.48	84.58	82.43	80.07	78.12
Lead (%)	92.19	93.29	93.23	92.56	92.97	93.41	92.19	88.94
Zinc (%)	89.17	89.18	88.58	88.60	90.02	87.25	88.11	87.58
Copper (%)	53.06	18.12	7.29	8.60	-	-	-	-
<b>Production (metal contained)</b>								
Silver (oz)**	479,821	446,970	417,571	450,019	367,986	277,081	226,596	172,070
Lead (lbs)	5,920,139	6,327,267	6,391,201	6,587,412	5,831,227	5,564,467	4,715,688	3,600,149
Zinc (lbs)	6,868,810	6,600,640	7,365,644	7,526,582	6,948,970	6,560,957	6,342,699	5,795,953
Copper (lbs)	295,854	94,799	44,092	50,706	-	-	-	-
<b>Average Selling Price</b>								
Silver (US\$ per oz)	16.92	17.58	14.70	13.73	12.61	10.20	15.03	17.17
Gold (US\$ per oz)	1,110.00	1,102.00	960.00	922.00	908.00	927.00	896.00	869.00
Lead (US\$ per lb)	1.01	1.04	0.87	0.68	0.52	0.56	0.87	1.05
Zinc (US\$ per lb)	1.04	1.00	0.80	0.67	0.53	0.54	0.80	0.96
Copper (US\$ per lb)	3.28	3.02	2.66	2.12	-	-	-	-
<b>Unit cash cost and Net smelter return</b>								
Unit cash cost (US\$/oz ag)	(11.41)	(10.80)	(5.34)	(2.98)	0.10	-	-	-
Unit Net Smelter Return (US\$/tonne)	174.00	173.00	120.00	114.00	91.00	60.00	80.40	97.79

\* Silver recovery in lead and copper concentrates

\*\* Silver production contained in lead and copper concentrates

During the first quarter ended March 31, 2010, the Company achieved record silver production of 479,821 (Q1 2009: 367,986) ounces with a negative cash cost per ounce of payable silver of \$11.41, net of by-product credits. In the first quarter of 2010, 101,503 tonnes of ore were treated compared to 91,449 tonnes in the prior year and the cash cost per tonne of treated ore was \$48.33 (Cash cost is a non-GAAP measure). See page 8 for reconciliation of cash cost to the cost of sales in the consolidated statement of operations).

The 30% increase in silver production over the corresponding period of 2009 is attributable to a 13% increase in silver head grade, an increase in throughput by 11%, and an increase in silver recoveries of 4%..

The first quarter of 2010 was the first full quarter of production for the copper circuit, which is now operating within design parameters.

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Cash cost per tonne of treated ore for the first quarter ended March 31, 2010 increased by 9% to \$48.33 (Q1 2009: \$44.37). This increase is mainly attributable to the commencement of ore control drilling, higher labor costs, and local currency appreciation. For the first quarter of 2010, cash cost per ounce of payable silver net of by-product credits at Caylloma was negative \$11.41 (Q1 2009: positive \$0.10) and the change is attributable to a 143% increase in by-product credits and a 32% increase in payable silver ounces, as compared to the same period in the prior year. (See page 8 for reconciliation of cash production cost to the cost of sales in the consolidated statement of operations).

*Discovery of high-grade silver-gold at Caylloma Mine, Peru*

On February 2, 2010, the Company announced the discovery of high-grade silver-gold mineralization in the upper portion of the Animas Vein at the Caylloma Mine in southern Peru. The Animas vein, traditionally a polymetallic vein, is the source of 85% per cent of production at the Company's Caylloma mine. The Company has recently concluded a 1,930 m drilling program and is working to produce a resource estimate to be included in the Company's mine plan.

*Price protection program - Derivatives*

As at December 31, 2009, the Company had entered into commodity forward and option contracts to secure a minimum price level on part of its Caylloma's zinc and lead metal production throughout the period covering January 2010 to December 31, 2010. The option contracts are min/max zero cost collars and both the option and forwards are settled against the arithmetic average of metal spot prices over the month in which the contract matures.

*A summary of the derivative contracts is shown below:*

Period	Metal	Instrument	t/month	% of production	strike price
January 2010 to June 2010	Zn	Min/Max	350	39%	\$2,000/t - \$3,010/t
	Zn	Forward	175	20%	
	Total Zn			525	59%
	Pb	Min/Max	200	24%	\$2,000/t - \$2,975/t
	Pb	Forward	300	36%	
				500	60%
July 2010 to June 2010	Zn	Min/Max	525	59%	\$2,000/t - \$3,010/t
	Pb	Min/Max	475	57%	\$2,000/t - \$2,974/t

t/month = tonne/month

Mexico - San Jose Silver-Gold Project

Fortuna has already been granted all of the necessary permits to commence construction at San Jose. Project staffing for the construction phase is currently being finalized and the Engineering Procurement Construction

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Management (EPCM) contract for the construction of the plant and ancillary facilities has been awarded to M3. M3 is an international engineering and construction company out of Tucson, Arizona with ample experience in Mexico. The Company has also initiated pre-construction activities for the water project, tailings facilities and power connection.

The Company anticipates to commission San Jose in the second semester of 2011.

For financing of this project, refer to Liquidity and Capital Resources (page 8).

*Project Summary for the pre-feasibility study results released on April 26, 2010*

Based on the total estimated mineable Reserves of 3.5 million tonnes, a project life of 9 years is projected. Average head grades for the life of the Reserves are estimated at 205 g/t of silver and 1.6 g/t of gold. The economic evaluation is treated on a project basis using a silver price of \$15.12 per troy ounce and a gold price of \$897.51 per troy ounce.

Pre-tax and after-tax NPVs are estimated at \$46 million and \$36.4 million, respectively, both at a discount rate of 8%. The IRR is estimated at 20% and 18% pre-tax and after-tax, respectively. Pay back on an undiscounted basis is estimated at 5.5 years. Cumulative undiscounted free cash flow is projected at \$95.1 million.

Capital costs for the pre-production stage are projected at \$55.7 million. Capital costs during the operational stage for the life of Reserves are estimated to be \$60 million for purposes of sustaining CAPEX as well as project expansion to the 1,500 tpd production level.

At the San Jose Project there will be two payable metals - silver and gold, with silver being the predominant metal. The San Jose Mine will be an underground operation with the metallurgical process consisting of conventional flotation to recover silver and gold from sulphide ores in the form of a concentrate.

Operations are modeled to start at 750 tpd scaling to 1,000 tpd after the initial two and a half years of operation with a subsequent ramp-up to 1,500 tpd. Metal produced in concentrates over the life of current existing Reserves will be 20.4 million ounces of silver and 163,000 ounces of gold. These projections do not take into consideration the silver and gold that will be produced from the Inferred Resources following their upgrading to mineable reserves.

Average unit cash costs throughout the life of the Reserves are estimated to be \$38.80 per tonne of treated ore and \$6.90 per Ag Eq ounce.

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**Cash cost per silver ounce and cash cost per tonne (non-GAAP measures)**

Cash cost per ounce and cash cost per tonne are key performance measures that management uses to monitor performance. In addition, cash costs are presented as they represent an industry standard method of comparing certain costs on a per unit basis and management believes that certain investors use these non-GAAP measures to evaluate the Company's performance. These performance measures have no meaning within Canadian Generally Accepted Accounting Principles ("Canadian GAAP"), and, therefore, amounts presented may not be comparable to similar data presented by other mining companies.

The following table presents a reconciliation of cash costs per tonne of processed ore and cash cost per ounce of payable silver to the cost of sales in the consolidated statement of operations for the quarter ended March 31, 2010 and 2009.

	<u>Quarter ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
<b>Cost of sales</b>	<b>6,778</b>	5,494
<b>Add / (Subtract)</b>		
Change in inventory (ore and concentrate stock piles)	<b>(263)</b>	(37)
Depletion, depreciation, and accretion	<b>(1,609)</b>	(1,399)
<b>Cash cost</b>	<b>4,906</b>	4,058
<b>Total processed ore (tonnes)</b>	<b>101,503</b>	91,449
<b>Cash cost per tonne of processed ore (\$/t)</b>	<b>48.33</b>	44.37
<b>Cash cost</b>	<b>4,906</b>	4,058
<b>Add / (Subtract)</b>		
By-product credits <sup>1</sup>	<b>(10,519)</b>	(4,334)
Refining charges	<b>395</b>	311
<b>Cash cost applicable per payable ounce</b>	<b>(5,218)</b>	35
<b>Payable silver ounces</b>	<b>457,216</b>	345,316
<b>Cash cost per ounce of payable silver (\$/oz)</b>	<b>(11.41)</b>	0.10

<sup>1</sup> By-product credits as included in the provisional liquidation

**Liquidity and Capital Resources**

The Company's cash as at March 31, 2010 was \$68.22 million, short term investments was \$1.04 million, and working capital amounted to \$72.73 million.

During the first quarter of 2010, cash generated by operating activities before changes in working capital was \$4.88 million. Further liquidity consumed by changes in working capital amounted to \$1.00 million, for total cash generated by operating activities of \$3.88 million.

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During the first quarter of 2010, the Company invested a total amount of \$2.66 million in mineral properties, \$1.57 million in plant and equipment, and net redemptions in short term investments of \$5.02 million. Additionally, the Company incurred a net amount of value added tax refundable credit due from the Mexican Government of \$0.06 million. This is net of value added tax disbursements on local expenses during the period.

Management believes the Company's cash position as well as its ongoing operation in Caylloma is sufficient to support the Company's operating and capital requirements on an ongoing basis. Actual funding requirements may vary from those planned due to further acquisition opportunities. Management believes it will be able to raise equity capital or access debt facilities as required in both the short and long term, but recognizes the uncertainty attached thereto.

### **Guarantees and Indemnifications**

The Company may provide guarantees and indemnifications in conjunction with transactions in the normal course of operations. These are recorded as liabilities when reasonable estimates of the obligations can be made. Indemnifications that the Company has provided include obligation to indemnify:

- directors and officers of the Company and its subsidiaries for potential liability while acting as a director or officer of the Company, together with various expenses associated with defending and settling such suits or actions due to association with the Company;
- certain vendors of acquired company for obligations that may or may not have been known at the date of the transaction.

The Caylloma mine closure plan was approved in November 2009 with the total closure costs of \$3,346 of which \$1,756 is subject to annual collateral in the form of a letter of guarantee, to be awarded each year in increments of \$146 over 12 years, and is based on the life of the mine.

Banco Bilbao Vizcaya Argentaria, S.A., a third party, has established a bank letter of guarantee on behalf of Bateas in favor of the Peruvian mining regulatory agency in compliance with local regulation associated with the approved Bateas' mine closure plan, for the sum of \$146. This bank letter of guarantee expires 360 days from December 2009.

Interbank, a third party, has established a \$2 bank letter of guarantee on behalf of Bateas in favor to the Peruvian Ministry of Energy and Mines to guarantee a temporary concession for performing studies on electric power generation. The letter of guarantee expires on May 3, 2010.

The Company acts as guarantor to capital lease obligations held by two of its mining contractors. These capital lease contracts are related to the acquisition of mining equipment deployed at the Caylloma mine. As at March 31, 2010, these obligations amounted to \$1,201 and mature in 2010.

### **Off-Balance Sheet Arrangements**

The Company does not have any off-balance sheet arrangements or commitments that are expected to have a current or future effect on our financial condition, results of operations, liquidity, capital expenditures, or capital resources that is material to investors, other than those disclosed in this MD&A and the consolidated financial statements and the related notes.

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**Related Party Transactions (expressed in \$'000's)**

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

<b>Transactions with related parties</b>	<b>Expressed in \$'000's</b>	
	<b>Three months ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Consulting fees <sup>1</sup>	\$ 43	\$ 31
Salaries and wages <sup>2,3</sup>	29	23
Other general and administrative expenses <sup>3</sup>	80	-
	<b>\$ 152</b>	<b>\$ 54</b>

<sup>1</sup> Consulting fees includes fees paid to two directors, Simon Ridgway and Mario Sztolender.

<sup>2</sup> Salaries and wages includes employees' salaries and benefits charged to the Company based on an estimated percentage of the actual hours worked for the Company.

<sup>2,3</sup> Radius Gold Inc. ("Radius") has directors in common with the Company and shares office space, and is reimbursed for various general and administrative costs incurred on behalf of the Company.

In September 2009, the Company was granted an option to acquire a 60% interest in the Tlacolula silver project located in the State of Oaxaca, Mexico from Radius.

<b>Amounts due to/(from) related parties</b>	<b>Expressed in \$'000's</b>	
	<b>March 31, 2010</b>	<b>December 31, 2009</b>
Owing (from)/to a director and officer <sup>4</sup>	\$ -	\$ (1)
Owing to a company with common directors <sup>3</sup>	\$ 53	\$ 50
	<b>\$ 53</b>	<b>\$ 49</b>

<sup>4</sup> Owing from a director includes a non-interest bearing loan to Jorge A. Ganoza Durant with no specific terms of repayments.

The transactions with related parties are measured at the agreed upon exchange amount, which is the amount of consideration established and agreed upon by the parties. The balances with related parties are unsecured, non-interest bearing, and payable in the normal course of business.

**Critical Accounting Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. These estimates and assumptions are based on established industry standards, historical experience, and are reviewed on an ongoing basis to confirm their continued applicability.

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*Depletion and Mineral Properties Cost*

Mineral property costs are comprised of acquisition costs and capitalized exploration, construction and development costs. Upon initiating production, the asset is depleted over its estimated useful life on a units-of-production basis. The Company estimates reserves and resources and the economic life of its mines and utilizes this information to calculate depletion expense. Depletion charges are adjusted prospectively based on periodic re-assessments of the Company's mineral reserves.

The estimate of mineral reserves is prepared by Qualified Persons in accordance with industry standards defined under NI 43-101 of the Canadian Securities regulatory authorities. Mineral reserve estimates can change over time as a result of numerous factors, including changes in metal prices, production costs, or the re-evaluation of geological, engineering and economic data of a deposit. A significant reduction in mineral reserves would have a negative impact on the calculation of the depletion of this asset.

*Asset Retirement Obligations*

Fortuna's determination for asset retirement obligations involves estimation of timing and amounts of future costs relating to ongoing environmental and mine closure activities required under applicable law or the Company's own remediation plans. These estimates are subject to significant uncertainties because many of these costs will not be incurred for a number of years, the nature of the reclamation activities might change and the assumptions regarding the rate of inflation and credit risk-adjusted interest rate used in the calculation may vary over time. Therefore, actual costs and their timing might differ from current estimates.

*Impairment of Long-lived Assets*

Management reviews and evaluates its long-lived assets for impairment when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Examples of such events or circumstances are changes in metal prices, sudden physical deterioration of the asset, legal circumstances or political risks in the countries Fortuna operates, or other external factors which could have a significant impact on the operations of the Company. Impairment is considered to exist if total estimated future cash flows or probability-weighted cash flows on an undiscounted basis are less than the carrying amount of the assets, including mineral property, plant and equipment and non-producing property. An impairment loss is measured and recorded based on discounted estimated future cash flows or the application of an expected present value technique to estimate fair value in the absence of a market price. Future cash flows include recoverable proven and probable reserves and a portion of recoverable resources, silver, zinc, copper, lead and gold prices (considering current and historical prices, price trends and related factors), production levels, capital and reclamation costs, all based on detailed engineering life-of-mine plans. Assumptions underlying future cash flow estimates are subject to risks and uncertainties. Any differences between significant assumptions and market conditions and/or the Company's performance could have a material effect on any impairment provision, and on the Company's financial position and results of operations.

*Income Taxes*

The estimation of the Company's future tax liabilities and assets involves significant judgment around a number of assumptions. Judgement must be used to determine the Company's future earning potential, and the expected timing of the reversal of future tax assets and liabilities. Further uncertainties are the result of interpretation of



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tax legislation in a number of jurisdictions which might differ from the ultimate assessment of the tax authorities. These differences may affect the final amount or the timing of the payment of taxes.

*Stock-based Compensation*

The determination of the value of stock-based compensation is estimated using the Black-Scholes option pricing model. Option pricing models require the input of highly subjective assumptions, particularly as to the expected price volatility of the stock. Other assumptions include the expected life of the options and the risk-free interest rate at the time of the grant. Changes in these assumptions can materially affect the fair value estimated.

**Financial Instruments and Related Risks**

The Company's financial instruments are exposed to certain financial risks, including currency risk, credit risk, liquidity risk, interest risk, and price risk. The Company's Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework and reviews the Company's policies on an ongoing basis.

*(a) Fair value of financial instruments*

The carrying value of cash, short term investments, accounts receivable, accounts payable and accrued liabilities, due to related parties, net, approximate their fair value due to the relatively short periods to maturity and the terms of these financial instruments.

Fair value estimates are made a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and, therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The analysis of financial instruments that are measured subsequent to initial recognition at fair value can be categorized into Levels 1 to 3 based upon the degree to which the fair value is observable.

- Level 1 - inputs to the valuation methodology are quoted (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - inputs to valuation methodology include quoted market prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value of measurement.

The Company has classified the determination of fair value of accounts receivable and derivatives as level 2, as the valuation method used by the Company includes an assessment of assets in quoted markets with significant observable inputs.

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Expressed in '000's				
Financial assets (liabilities) at fair value as at March 31, 2010				
	Level 1	Level 2	Level 3	Total
Short term investments	\$ 1,041	\$ -	\$ -	\$ 1,041
Accounts receivable	-	8,580	-	8,580
Derivatives	-	(42)	-	(42)
	<b>\$ 1,041</b>	<b>\$ 8,538</b>	<b>\$ -</b>	<b>\$ 9,579</b>

Expressed in '000's				
Financial assets (liabilities) at fair value as at December 31, 2009				
	Level 1	Level 2	Level 3	Total
Short term investments	\$ 6,034	\$ -	\$ -	\$ 6,034
Accounts receivable	-	8,322	-	8,322
Derivatives	-	(3,055)	-	(3,055)
	<b>\$ 6,034</b>	<b>\$ 5,267</b>	<b>\$ -</b>	<b>\$ 11,301</b>

Accounts receivable includes accounts receivable from provisional sales. The fair value of accounts receivable resulting from provisional pricing reflect observable market commodity prices. Resulting fair value changes accounts receivable are through sales. Transactions involving accounts receivable are with counterparties the Company believes are creditworthy.

Derivatives are carried at their fair value, which is determined based on internal valuation models that reflect observable forward market commodity prices. Resulting fair value changes to derivatives are through net gain (loss) on commodity contracts. Transactions involving derivatives are with counterparties the Company believes to be creditworthy.

During the three months ended March 31, 2010, there has been no changes in the classification of financial assets and liabilities in level 3 of the hierarchy.

*(b) 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 Canadian dollars, Nuevo Soles, and Mexican Pesos. A significant change in the currency exchange rates between the United States dollar relative to the other currencies could have a material effect on the Company's results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

At March 31, 2010, the Company is exposed to currency risk through the following assets and liabilities denominated in Canadian dollars, Nuevo Soles and Mexican Pesos (all amounts are expressed in thousands of Canadian dollars, thousands of Nuevo Soles or thousands of Mexican Pesos):

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	Expressed in '000's					
	March 31, 2010			December 31, 2009		
	Canadian Dollars	Nuevo Soles	Mexican Pesos	Canadian Dollars	Nuevo Soles	Mexican Pesos
Cash	\$ 43,007	S/. 946	\$ 4,575	\$ 21,283	S/. 302	\$ 1,283
Short term investments	1,061	-	-	560	-	-
Accounts receivable	-	1,237	8,722	5	880	6,565
Accounts payable and accrued liabilities	(54)	(14,016)	(1,182)	(194)	(17,150)	(623)

Based on the above net exposure as at March 31, 2010, and assuming that all other variables remain constant, a 10% depreciation or appreciation of the US dollar against the above currencies would result in an increase or decrease, expressed in US dollars, as follows:

Impact to other comprehensive income (loss)	\$ 4,798		
Impact to net income (loss)		\$ (463)	\$ 108

*(c) 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 and short term investments are held through large Canadian, international and foreign national financial institutions. These investments mature at various dates within one year. All of the Company's trade accounts receivables are held with large international metals trading companies.

The Company holds derivative contracts with financial institutions and in this regard is exposed to counterparty risk. The Company mitigates this risk by transacting only with reputable financial institutions to minimize credit risk.

As at March 31, 2010, the Company has a Mexican value added tax of \$0.48 million and Peruvian value added tax of \$0.22 million. The Company expects to recover the full amounts from the Mexican and Peruvian Governments.

*(d) 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 by continuing to monitor forecasted and actual cash flows. The Company has in place a planning and budgeting process to help determine the funds required to support the Company's normal operating requirements on an ongoing basis and its development plans. The Company strives to maintain sufficient liquidity to meet its short term business requirements, taking into account its anticipated cash flows from operations, its holdings of cash, short term investments, and its committed liabilities.

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The Company expects the following maturities of its financial liabilities (including interest), operating leases, and other contractual commitments:

	<b>Expressed in '000's</b>					<b>Total</b>
	<b>Expected payments due by period as at March 31, 2010</b>					
	Less than 1 year	1 - 3 years	4 - 5 years	After 5 years		
Accounts payable and accrued liabilities	\$ 7,740	\$ -	\$ -	\$ -	\$ -	7,740
Due to related parties, net	53	-	-	-	-	53
Derivatives	42	-	-	-	-	42
Long term liability	928	1,306	-	-	-	2,234
<b>Total<sup>1</sup></b>	<b>\$ 8,763</b>	<b>\$ 1,306</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>10,069</b>

<sup>1</sup> Amounts above do not include payments related to the following: (i) the Company's anticipated asset retirement obligation of \$2,575 associated with mine closure, land reclamation, and other environmental matters.

*(e) 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 is limited because the balances are generally held with major financial institutions in demand deposit accounts.

*(f) Metal price risk*

The Company is exposed to metals price risk with respect to silver, gold, zinc, lead, and copper 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.

In order to mitigate this risk in the medium term, the Company put in place price protection strategies for approximately 59% and 60% of its zinc and lead metal production, respectively, for the six month period between January 2010 and June 2010. For the six month period between July 2010 and December 31, 2010, the Company put in place price protection strategies for 59% and 57% of its zinc and lead metal production, respectively.

**Other Data**

Additional information related to the Company is available for viewing at [www.sedar.com](http://www.sedar.com) and the Company's website at [www.fortunasilver.com](http://www.fortunasilver.com).

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**Share Position and Outstanding Warrants and Options**

The Company's outstanding share position as at April 27, 2010 is 110,162,465 common shares. In addition, a total of 8,050,500 incentive stock options, with 2,665,000 subject to shareholder approval, are currently outstanding as follows:

<u>Type of Security</u>	<u>No. of Shares</u>	<u>Exercise Price (CAD\$)</u>	<u>Expiry Date</u>
Incentive Stock Option	30,000	\$0.80	July 24, 2010
	270,000	\$1.35	February 5, 2016
	250,000	\$2.29	March 30, 2016
	60,000	\$1.75	May 8, 2016
	200,000	\$1.75	May 22, 2016
	7,500	\$0.85	July 5, 2016
	225,000	\$1.55	July 5, 2016
	860,000	\$1.66	July 10, 2016
	225,000	\$1.61	September 13, 2016
	90,000	\$0.85	January 11, 2017
	700,000	\$2.22	January 11, 2017
	50,000	\$2.75	February 6, 2017
	15,000	\$0.85	April 22, 2017
	38,000	\$0.85	June 27, 2017
	30,000	\$0.85	July 2, 2017
	25,000	\$0.85	October 24, 2017
	250,000	\$2.52	February 5, 2018
	100,000	\$1.25	August 25, 2018
	1,070,000	\$0.85	October 5, 2018
	640,000	\$0.85	November 5, 2018
	250,000	\$0.83	July 6, 2019
	2,150,000	\$1.60	October 27, 2019
	490,000	\$1.70	November 8, 2019
	25,000	\$2.23	November 23, 2019
<b>TOTAL OUTSTANDING OPTIONS</b>	<b><u>8,050,500</u></b>		

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**Change in Accounting Policy**

*Adoption of New Accounting Standards*

The Company has not adopted any new accounting standards during the current period.

**Recently released Canadian Accounting Standards**

The Company has assessed new and revised accounting pronouncements that have been issued and determined that the following may have an impact on the Company:

*Convergence with International Financial Reporting Standards ("IFRS")*

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with International Financial Reporting Standards ("IFRS") over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canadian GAAP. This date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company will begin reporting its financial statements in accordance with IFRS on January 1, 2011, with comparative figures for 2010.

The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Company for its year ended December 31, 2010, and of the opening balance sheet as at January 1, 2010.

The Company is continuing to assess the financial reporting impact of the adoption of IFRS and, at this time, the quantitative impact on future financial position and results of operations is not reasonably determinable. The Company anticipates an increase in disclosure resulting from adoption of IFRS.

The Company continues to advance through the IFRS transition project plan.

During 2009, the Company began planning its transition to IFRS. The process will consist of three phases: Scoping and Diagnostics, Analysis and Development, and Implementation and Review.

**Phase One:** Scoping and Diagnostics, which involves project planning and identification of differences between current Canadian GAAP and IFRS, was completed in the third quarter of 2009 with the assistance of external advisors. This process identified the areas of accounting difference of highest potential impact to the Company, based on existing IFRS, as: IFRS 1 "First Time Adoption of IFRS"; International Accounting Standard ("IAS") 21 "The Effects of Changes in Foreign Exchange Rates"; and, IAS 16 "Property, Plant & Equipment". As part of this phase, preliminary recommendations were made in respect of transitional elections available under IFRS 1, "First-Time Adoption of International Reporting Standards". At the present time the company is planning to apply two of the 17 exemptions which include:

- IFRS 3 "Business Combinations" which allows an entity that has conducted prior business combinations to apply IFRS 3 on a prospective basis only from the date of transition. This avoids the requirement to restate prior business combinations, although some adjustments may still be necessary. Currently, the

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Company has three prior business transactions that meet the criteria of a business combination under IFRS.

- IFRS 2 "Share-Based Payment Transactions" which allows full retrospective application to be avoided for certain share-based instruments depending on the grant date, vesting terms and settlement of any related liabilities. The Company has not disclosed the value of the share options historically and therefore cannot apply IFRS 2 retrospectively.

**Phase Two:** Analysis and Development involves detailed diagnostics and evaluation of the financial impacts of various options and alternative methodologies provided for under IFRS: identification and design of operational and financial processes; initial staff training; analysis of IFRS 1 optional exemptions and mandatory exceptions to the general requirement for full retrospective application upon transition to IFRS; summarization of 2011 IFRS disclosure requirements; and development of required solutions to address identified issues. The Company expects to complete this phase in Q2 2010.

The progress made in this phase to date is detailed below.

Following the completion of the scoping and diagnostic assessment, the Company engaged external advisors to assist with detailed technical reviews of the identified potential high impact areas. These reviews include the identification of IFRS - Canadian GAAP differences, accounting policy considerations, and preliminary implementation plans. The high impact areas relating to conversion include foreign currency; property, plant and equipment; income taxes; and provisions (including asset retirement obligations). The technical review aspects of these assessments have been completed for foreign currency; property, plant and equipment; and income taxes. A summary of the potential impacts in these areas are as follows:

*a) Foreign Currency*

Under IAS 21, it is necessary to assess the functional currency of all the Company's entities based on the primary economic environment in which the entity operates. In addition, secondary factors may also provide evidence of an entity's functional currency. Once the functional currency is determined, it does not change unless there is a change in the underlying nature of the transactions and relevant conditions and events.

All entities that have a Canadian GAAP measurement currency that is different than the functional currency under IFRS will need to translate their balance sheets to the functional currency at the transition date. The Company will need to update its consolidation model for foreign currency translation.

The Company's preliminary analysis is the functional currency of all the group's entities is U.S. dollars, the same as the presentation currency. As a result, the Company is planning to take the IFRS 1 exemption that resets the cumulative translation adjustment balance to zero, to reduce the conversion effort.

*b) Property, Plant and Equipment*

Under IAS 16, each part of an item of property, plant and equipment with a cost that is significant in relation to the total costs of an item is depreciated separately. This is commonly referred to as component depreciation. Each separate part is depreciated over its useful economic life to the residual value. Under IFRS, the assessment of the useful economic life and the residual value of each part of the asset are determined on an annual basis. The Company is currently completing a detailed review of fixed assets to determine if additional component depreciation will be necessary.

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Canadian GAAP does not specifically state how to treat borrowing costs related to the construction of an asset, whereas IFRS states that borrowing costs that are directly attributable to the acquisition or construction of a qualifying asset shall be capitalized as part of the cost of that asset on a net basis.

Under IFRS, there is an option to use either the cost method or the revaluation model for subsequent measurement of classes of assets. The Company plans to continue to use the cost method.

For impairment, Canadian GAAP generally uses a two-step approach to testing: first comparing asset carrying values with undiscounted future cash flows to determine whether impairment exists, and then measuring any impairment by comparing asset carrying values with fair values. IAS 36, "Impairment of Assets", uses a one-step approach for both testing for and measurement of impairment, with carrying values compared directly with the higher of fair value less costs to sell and value in use (which uses discounted future cash flows). This may potentially result in more write downs when carrying values of assets are supported under Canadian GAAP on an undiscounted cash flow basis, but could not be supported on a discounted cash flow basis.

However, the extent of any new writedowns may be partially offset by the requirement under IAS 36 to reverse any previous impairment losses where circumstances have changed such that the impairments have been reduced. Canadian GAAP prohibits reversal of impairment losses.

*c) Income Taxes*

The analysis completed to date has identified two significant relevant differences in the area of accounting for income taxes.

Canadian GAAP has a specific exemption for future income taxes related to non-monetary assets or liabilities of integrated foreign operations. Future income taxes cannot be recognized for a temporary difference arising from the difference between the historical exchange rate and the current exchange rate translation of the cost of non-monetary assets or liabilities of integrated foreign operations. Under IFRS, deferred tax is recognized on the difference between: the accounting basis of all items, which is accounted for as specified under IFRS. For foreign currency non-monetary assets or liabilities, this is the local or tax basis currency translated into the functional currency at the historical rate; and the tax basis, which is the local or tax basis currency amount translated to the functional currency at the spot exchange rate at the balance sheet date. The result of this calculation difference will be added volatility in the tax expense as foreign exchange swings will have an impact on the tax expense.

IFRS 12 does not permit recognition of a temporary difference on initial recognition, except if the transaction is a business combination or if the transaction affects accounting or taxable profit or loss. Under Canadian GAAP, assets acquired in other than in a business combination, may have a tax basis different than the carrying amount on acquisition. The associated FIT assets (subject to the more likely than not test) or liability is recognized at the time of acquisition and added to the cost of the asset. The amount of the FIT is calculated using a simultaneous equation; this method of tax calculation is referred to as the 'gross up' method. Under IAS 12, any temporary differences arising on subsequent asset acquisitions, other than in a business combination, would be ignored. On adoption of IFRS, the temporary differences arising from the 'gross up' method under Canadian GAAP will be reversed.



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*d) Other*

The Company also considered both IFRS 2 - "Share-based Payments" and IFRS 6 - "Exploration for and Evaluation of Mineral Resources" as part of its initial diagnostic assessment and has concluded that there will be no significant or material transitional adjustments or changes in report results arising from the application of these standards upon transition to IFRS.

During the first quarter of 2010, the Company commenced the technical review in respect to provisions (including asset retirement obligations). As well, the Company commenced the quantification of the identified technical differences in respect to foreign currency; property, plant and equipment; and income taxes.

Concurrent with the technical analysis, we have prepared draft pro forma consolidated annual IFRS financial statements to help understand the disclosure impact of the change to IFRS. These will be presented to the Audit Committee at the end of the first quarter of 2010.

Internal Controls over Financial Reporting

In conjunction with the initial quantification of differences, which is currently in progress, the Company is considering what effects the IFRS transition will have on internal controls over financial reporting.

Disclosure Controls and Procedures

The Company is currently considering what effects the IFRS transition will have on our disclosure controls and procedures.

Business Activities and Key Performance Measures

The Company is considering what effects the IFRS transition will have on our business policies and activities. The following key areas are likely to be affected:

- Internal controls over financing reporting with respect to the IFRS transition project;
- Dual reporting obligation for the year 2010 because statements are required under both Canadian GAAP and IFRS for that year;
- Budgeting and Forecasting activities during the IFRS transition year, 2010; and,
- Key performance measures.

Financial Reporting Expertise in IFRS

The Company is maintaining its financial reporting expertise and competencies by addressing training requirements through IFRS sessions provided by external advisors. The training is targeted to key finance staff and will continue to be delivered in 2010 and 2011.

IT Systems

The extent of the impact of the Company's information systems for transitioning to IFRS has been determined. The adoption of IFRS will have an impact on the Company's information systems, particularly in the consolidation process. The Company is in the process of obtaining proposals from third parties to assist with the implementation of required modifications to ensure an efficient conversion to IFRS.

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**Phase Three:** Implementation and Review, will involve the execution of changes to information systems and business processes; completion of formal authorization processes to approve recommended accounting policy changes; integration of appropriate changes to maintain the integrity of internal controls over financial reporting and disclosure controls and procedures; and further training programs across the Company's finance and other affected areas, as necessary. It will culminate in the collection of financial information necessary to compile IFRS-compliant financial statements and reconciliations; embedding of IFRS in business processes; and, audit committee approval of IFRS-compliant financial statements. This phase is anticipated to commence in the third quarter of 2010.

The Company has established the following timeline for reporting its IFRS convergence progress to the Audit Committee.

<i>Deadlines</i>	<i>Task to be completed</i>	<i>Status</i>
<i>Q3 2009 Audit Committee Meeting</i>	<i>Management to present the IFRS phase 1 report including IFRS decisions</i>	<i>Completed</i>
<i>Q1 2010 Audit Committee Meeting</i>	<i>Management to prepare and present shell interim and annual financial statements and key accounting policy choices.</i>	<i>In progress</i>
<i>Prior to Q2 2010 Audit Committee Meeting</i>	<i>Management to prepare opening balance sheet (January 1, 2010) for external auditor review and complete IFRS 1 reconciliations</i>	<i>In progress</i>
<i>Q2 2010 Audit Committee Meeting</i>	<i>Management to present opening balance sheet and IFRS 1 reconciliations</i>	
<i>Q3 2010 Audit Committee Meeting</i>	<i>Management to present shell interim financial statements and IFRS 1 reconciliations</i>	
<i>Year end 2010 Audit Committee Meeting</i>	<i>Management to present full IFRS shell annual financial statements including all 2010 comparatives and disclosures</i>	
<i>Q1 2011</i>	<i>First interim IFRS financial statements to be publicly released</i>	

The disclosure reflects expectations based on information available at the time of reporting. The Company will continue to monitor changes in IFRS leading up to the changeover date, and will update the conversion plan as required. Changes in circumstances may cause the Company to revise its IFRS opening balance sheet and policy choices before the changeover date.

*Business Combinations*

In January 2009, the CICA issued the following Handbook Sections: Section 1582, "Business Combinations", Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests". These new

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standards are harmonized with International Financial Reporting Standards (IFRS). Section 1582 specifies a number of changes, including: an expanded definition of a business, a requirement to measure all business acquisitions at fair value, a requirement to measure non-controlling interests at fair value, and a requirement to recognize acquisition-related costs as expenses. Section 1601 establishes the standards for preparing consolidated financial statements. Section 1602 specifies that non-controlling interests be treated as a separate component of equity, not as a liability or other item outside of equity. The new standards will become effective in 2011 but early adoption is permitted. The Company is evaluating the impact of adopting these standards.

*Comprehensive Revaluation of Assets and Liabilities and Equity*

In August 2009, the CICA amended Section 1625, "Comprehensive revaluation of assets and liabilities" as a result of issuing "Business Combinations, Section 1582, "Consolidated Financial Statements", Section 1601, and Non-Controlling Interests", Section 1602, in January 2009.

In August 2009, the CICA amended Section 3251, "Equity" as a result of issuing Section 1602, "Non-controlling Interests". These amendments only apply to entities that have adopted Section 1602.

These amendments apply prospectively to comprehensive revaluations of assets and liabilities occurring in fiscal years beginning on or after January 1, 2011, but early adoption is permitted. The Company is evaluating the impact of adopting these standards.

**Other Risks and Uncertainties**

*Environmental risk*

The Company has recorded an asset retirement obligation of \$2.58 million as of March 31, 2010 in relation to the cost of reclamation associated with the Caylloma property. This amount has been estimated by a third party in compliance of local regulations and has been approved by the relevant authorities in November 2009.

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.

*Exploration and development*

The business of mineral exploration and extraction involves a high degree of risk. Few properties that are in the exploration stage ultimately become producing mines. Major expenses may be required to establish reserves by drilling and to construct mining and processing facilities at a site. It is impossible to ensure that exploration and development programs carried out by the Company will result in profitable commercial mining operations.

*Resources and reserves*

There is a degree of uncertainty attributable to the estimation of resources and reserves and to expected mineral grades. Mineral Resources and Mineral Reserves may require revision based on actual production experience. Market fluctuations in the price of metals, as well as increased production costs and reduced recovery rates, may render certain mineral reserves uneconomic and may ultimately result in a restatement of resources and/or

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reserves. Short term operating factors relating to the mineral resources and reserves, such as the need for sequential development of ore bodies may adversely affect the Company's profitability in any accounting period.

*Political and country risk*

The Company's mineral properties are located in emerging nations and consequently may be subject to a higher level of risk compared to developed countries. Operations, the status of mineral property rights, title to the properties and the recoverability of amounts shown for mineral properties in emerging nations can be affected by changing economic, regulatory, and political situations.

The State of Oaxaca has a history of social conflicts and political agitation which can lead to public demonstrations and blockades that can from time to time affect the Company's operations.

**Controls and Procedures**

*Disclosure Controls and Procedures*

The Company evaluated the effectiveness of the design and operation of the disclosure controls and procedures, as of March 31, 2010, under the supervision of the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based on the results of this evaluation the CEO and the CFO have concluded that such disclosure controls are sufficiently effective to provide reasonable assurance that material information relating to the Company is made known to management and disclosed in accordance with the applicable securities laws.

*Internal Control Over Financial Reporting*

The Company's management, with the participation of its CEO and CFO, are responsible for establishing a system of internal control over financial reporting to provide reasonable assurance regarding the reliability and integrity of the Company's financial information and the preparation of its financial statements in accordance with Canadian generally accepted accounting principles. Management of the Company, with the participation of the CEO and CFO, has evaluated the effectiveness of internal control over financial reporting as of March 31, 2010 and has concluded there are no material weaknesses. Management continues to review and refine its internal controls and procedures.

**Management Changes**

There were no management changes during the first quarter ended March 31, 2010.