

***Transcript of
Fortuna Silver Mines, Inc.
First Quarter 2016 Earnings Call
May 10, 2016***

Participants

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

Analysts

Jessica Fung – BMO Capital Markets
Chris Thompson – Raymond James.
Raul Geuron – Private Investor

Presentation

Operator

Greetings, and welcome to the Fortuna Silver Mines 2016 First Quarter Earnings Call. At this time, all participants are in listen-only mode. A question-and-answer session will follow the formal presentation. (Operator instructions.) As a reminder, this conference is being recorded.

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

Carlos Baca – Investor Relations Manager

Thank you, Latonya. Good morning, ladies and gentlemen. I would like to welcome you all to Fortuna Silver Mines and to our first quarter 2016 financial and operations result call. Jorge Ganoza, President and CEO and Luis Ganoza, CFO will be hosting the call from Lima, Peru.

Before I turn over the call to Jorge, I would like to indicate that this earnings call contains forward-looking information that is based on the company's current expectations, estimates and beliefs. This forward-looking information is subject to a number of risks, uncertainties and other factors. Actual results could differ materially from a conclusion, forecast, or projection in the forward-looking information. Certain material factors or assumptions were applied in drawing a conclusion or making a forecast or projection, as reflected in the forward-looking information.

Additional information about the material factors that could cause actual results to differ materially from the conclusion, forecast or projection in the forward-looking information and the material factors or assumptions that were applied in drawing a conclusion or making a forecast or projection, as reflected in the forward-looking information is contained in the company's annual information form, which is publicly available on SEDAR.

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

Jorge Ganoza – President and Chief Executive Officer

Thank you, Carlos, and good morning to all. Both our Caylloma and San Jose mines operated consistently within plan during the quarter. In Q1, the company purchased 1.6 million ounces of silver and 9,200 ounces of gold.

Silver production was in line with Q1 2015 and gold production 5% below. We're well within schedule to meet our guidance for the year of 7 million ounces of silver and 43,000 ounces of gold. For the quarter, precious metals accounted for 76% of sales. Silver representing 54% and gold 22%. The balance is made of by product lead and zinc from the Caylloma mine in Peru.

We realized our silver price for the quarter was \$14.99 and \$203 dollars for gold. This was 10% lower for silver and basically in-line for gold compared with a year ago. In terms of production both our Caylloma and San Jose mine had an eventful quarter and performed largely in-line with our guidance. At San Jose, we had the benefit for higher silver and gold grades against budget, which lead to 14% and 13% higher production compared to budget again. Caylloma commissioning of the plant optimization at the end of the quarter generated a few more days of downtime, more than we planned but it is up and running now.

Something to highlight is our holding consolidated cash cost per silver ounce metal by products for the quarter and the consolidated figure came in at a low of \$9.39, well below the \$11.80 a year ago and also, below our 2016 guidance of \$11.10.

Another thing to note is the advance for capital projects, our infrastructure cap ex guidance figure for 2016 is \$46 million. The location is \$37 million to San Jose mine and roughly \$9.5 million to Caylloma. The bulk of the budget is allocated to San Jose where we continue advancing with the 3,000 tonnes per day expansion, according to schedule and budget. We are in pre-commissioning stage and plan to be operational by end of June.

I will now turn it over to Louis, who will give you more detail on the financial results.

Louis Ganoza – Chief Financial Officer

Thank you. Sales for the quarter were \$42.7 million, that's 7% above the comparative period in 2015. Silver sold was slightly above at 2% and gold slightly below at 4%. We had significant increments in lead and zinc sold, however, of 126% and 44%. Realized prices on operational sales were below the previous year for all metals. Although, we had a positive effect from the rise in silver prices towards the end of the quarter, which gets reflected in sales adjustments. All in all, we had a higher metal production compensating for lower metal prices.

Our mine operating earnings was \$15.5 million. That is 24% above Q1 2015, reflecting the sales growth and stronger margins at both operations, San Jose and Caylloma. The San Jose mine operating earnings increased 18% to \$12 million and the gross margins increased 4 percentage points to 43%, as higher head grades and improved recoveries more than compensated lower silver and gold prices. The Caylloma mine operating earnings increased 31% to \$3.5 million driven by lower unit costs and lower depletion.

Our selling and G&A was \$9.7 million compared to \$5.5 million in Q1 2015. When we look at the breakdown of this line item we see the large increase coming from higher stock-based compensation charge, which went from \$0.8 million in the previous year to \$5.7 million in 2016.

These large swings are the result of certain instruments being mark-to-market in the context of the variability of our share price. Excluding the variability, the charge in 2016 would have been \$2.2 million and \$1.4 million in 2015. Our G&A cash expenses actually came down from \$4.5 million in 2015 to \$3.8 million in 2016, mostly as a result of lower corporate expenses. Our operating income was \$6.1 million and 23% below Q1 in 2015, in spite of our strong operating results due to the higher stock-based compensation charge, which I described.

Cash flow from operations before changes in working capital and after taxes paid was \$9.9 million, up 86% from Q1 2015. The largest portion of the increase is related to timing issues in the payment of income taxes. On working capital items, we have a large change in Accounts Receivable of \$60 million, which is due to having collected payment for December sales in the month of December, when it would typically take place in a separate

month. As a better comparison of cash generation capacity for this quarter, EBITDA for Q1 2016 increased 18% to \$18 million.

On expenditures in mineral property planning equipment, we reported \$16.1 million. We expect to see a similar figure in Q2, as we conclude the San Jose plant expansion, after which we should see lower amounts in the second half of the year. Finally, cash and short-term investments were \$95.9 million at the end of the quarter and total liquidity available to the company was \$115.9 million considering the \$20 million revolving facility we have in place.

Thank you, back to you, Carlos.

Carlos Baca – Investor Relations Manager

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

Operator

(Operator instructions.) Our first question comes from Jessica Fung with BMO Capital markets. Please proceed with your question.

Q: All right, thank you. Good day, everyone. Just a question on San Jose, good to hear that the expansion is going as planned. Wanted to get an idea from you guys what you think sustaining cap ex will be at San Jose, after this expansion is done?

Louis Ganoza – Chief Financial Officer

Yes. Thank you, Jessica. For sustaining capital figure for 2017 and onwards is around \$10 million, \$12 million in our life of mine [ph] models.

Q: Okay, perfect and then a second question, if I can, just to get an update on your M&A activity and how you guys are progressing and what you're looking at.

Louis Ganoza – Chief Financial Officer

Well, we continue very active seeking for investment acquisition opportunities. We have done through detailed reviews on capital, as you all can appreciate. I am not in a position to give detail but I can say that we are currently working on a couple of reviews.

Q: Okay, perfect. That's it for me. Thank you very much.

Louis Ganoza – Chief Financial Officer

Thank you.

Operator

(Operator instructions.) Our next question comes from Chris Thompson with Raymond James. Please proceed with your question.

Q: Hi. Good morning guys. Congratulations on a great quarter. Two quick questions really, Jorge. Can you just remind us again on the optimization plans at Caylloma and where you are right now?

Jorge Ganoza – President and Chief Executive Officer

Yes, great. The optimization work at the Caylloma plant basically consisted of having additional flotation capacity on the less liquid to improve retention time on the circuit; and second, adding high frequency screens in the

classification or in the milling circuit. Those two projects are concluded, the optimization has been commissioned and we should start seeing the benefit of that starting the second quarter of the year.

Q: That's great.

Jorge Ganoza – President and Chief Executive Officer

Another thing to add is, at last we managed to conclude the interconnection to the national grid. All of our power is now coming from the grid at Caylloma, before we were still sourcing seasonally about 20%, as much as 30% of our power was being self-generated. We should also start seeing the full benefit of that in the second quarter.

Q: Fantastic. I noticed your costs were good, were low. Do you see those being sustainable for the rest of the year at the Q1 level?

Jorge Ganoza – President and Chief Executive Officer

I'll let Louis elaborate a bit more but in general terms, we would expect to see cost come up. There's some mainly on the mine, some development that we'll start to pick up in the second quarter, third quarter. We would expect to see that cost trend towards the guidance. It came at a low \$5, I think. The voice of Caylloma management group are to be praised, not all of the savings are going to be permanent as again, a lot of that has to do with some lag in the start to development.

But, Louis, do you want to elaborate?

Louis Ganoza – Chief Financial Officer

I think that covers it all, Jorge. We basically should see, as Jorge mentioned, costs pretty much trending on our guidance level, as we progress throughout the year.

Q: Great. Thanks, guys. Just a final question then. I guess as far as the expiration activity at San Jose, can you elaborate on where we stand right now with a sense of timing of new flow?

Jorge Ganoza – President and Chief Executive Officer

Yes, we have currently drilled roughly about 7,000 meters in the first quarter, about 3,000 meters of drilling on the [indiscernible] deep, which is a central portion of the main deposit. We started drilling from the underground, as well. This new blind discovery, which we call the awkward land vein, which is a parallel vein running parallel in the north, parallel to the main Trinidad [indiscernible] area. It's in the area of Trinidad North and it's a blind new vein. We have about 350 meters of drilling there to date.

Then on La Noria, which is this mirror system to the main deposit located some 1800 meters due west from the vein system we're currently mining, we have another 3,000 meters, for a total of roughly 7,000 meters of drilling done to date. Results should be coming this month before the end of the month. I would expect we can give an update on the published results.

Q: Perfect, Jorge. Thanks a lot. Congratulations, guys.

Jorge Ganoza – President and Chief Executive Officer

Thank you.

Operator

Thank you. Our next question comes from Raul Geuron [ph], a private investor. Please proceed with your question.

Q: Again, congratulations on a great quarter. My question has actually been answered already but I do want to touch base on a couple of minor items. I am thinking Fortuna is the lowest cash cost producer among all the silver companies. Can management comment on that based on the annual guidance given and then based on Q1 results? Is it correct to say that Fortuna is the cost of leader in the silver space? Thank you.

Jorge Ganoza – President and Chief Executive Officer

Thank you for your question. We certainly praised ourselves of being one of the lowest cost silver producers in this space of primary silver miners. We expect that as we materialize expansion of the San Jose mine this year are the consolidated all-in sustaining cost will trend from our current guidance of about \$11 to below \$10, in the neighborhood of \$10, slightly below \$10. At that point, our San Jose mine will likely be producing at an all-in sustaining cost of roughly, in the neighborhood of \$6 to \$7 per ounce of silver. Certainly, it's a key asset for us, the San Jose mine.

As we can see Caylloma can contribute to the low cost structure. It is not a high cost compared to San Jose. Yes, it is but on an absolute basis San Jose is not a high cost operation. It is certainly something we look at carefully and when we look at business developmental opportunities, as well, or margins, is something that we look at carefully.

That is to help answer your question and give you management's view with respect to or intent to continue preserving the attribute of being one of the lowest cost producers in the space. As we look for new business development opportunities, we certainly pay a lot of attention to margin accretion.

Q: Thank you, one more quick question and I appreciate you allowing me to ask questions. Regarding next year, because the expansion is completed at both San Jose and Caylloma this year, I understand you already achieved 10% expansion at the Peru mine, Caylloma. Now, looking at next year, I suspect it is hard to find an acquisition matching your current operations, the kind of lowest cost operations.

Obviously, management has proved over time or many number of years that you have always planned ahead and come up with an alternate scenarios. What does next year mean in store for you without giving too much detail? Obviously, we don't want to reveal. Do you have plan B to maintain, however, cost leadership, as well as growth leadership? Because, I view Fortuna in both of these venues right now has proved itself over time, not just in one year or so. Thank you, that's all my questions.

Jorge Ganoza – President and Chief Executive Officer

Thank you for that last question. What I can say is that we are actively looking for our next project, our next mine and here I am talking outside of Brownfields, because we are everyday working hard in our own grounds. We are starting to look for the past year or over a year now we've been very actively driving a process to identify projects and those not only don't need to be necessarily a producing mine.

We look at opportunities all through the development spectrum from early stage exploration to more advanced project, but a key attribute that we will look at is exploration potential, certainly a jurisdiction and margin accretion, therefore low cost. That's something that we keep in mind.

If we start generating, as we expect with the expansion, significant cash and we cannot identify a place where we can get the kind of returns I think our shareholders deserve, we will certainly consider a way to return capital to our shareholders via dividend or share buybacks or that still needs to be discussed at the board level. But if we cannot give you the kind of returns that you expect from us through the development of another project, we will institute a way to give back to the shareholders.

Operator

Thank you. At this time, I would like to turn the call back over to management for closing comments.

Jorge Ganoza – President and Chief Executive Officer

Carlos. Thank you, everybody.

Carlos Baca – Investor Relations Manager

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