

**Transcript of
Fortuna Silver Mines Inc. (FVI.TO)
Third Quarter 2012 Earnings Call
November 9, 2012**

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Participants

Jorge A. Ganoza, President, Chief Executive Officer, and Director
Luis Dario Ganoza, Chief Financial Officer
Carlos Baca, Investor Relations Manager

Presentation

Operator

Greetings and welcome to the Fortuna Silver Mines Third Quarter 2012 Earnings Conference Call. At this time, all participants are on a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please dial *0 on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Mr. Carlos Baca. Thank you. You may begin.

Carlos Baca – Fortuna Silver Mines Inc. – Investor Relations Manager

Good morning, ladies and gentlemen. I would like to welcome you all to for Fortuna Silver Mines' third quarter financial and operation results call. Hosting the call are Jorge Ganoza, President and CEO of the company; and Luis Dario Ganoza, Chief Financial Officer. I would now like to turn the call over to Jorge Ganoza.

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Thank you, Carlos. Good morning. I'm joined on the call today by Luis, our CFO. I will initiate the conference and, with the assistance of Luis, will be giving a summary and analysis of our operations and financial results for the third quarter of the year. Once concluded, we will address your questions.

During the third quarter our company reported record sales of \$43.8 million, net income of \$8 million or \$0.06 per share, and cash generated by operations before changes in working capital of \$20 million or \$0.16 per share. Historic records for both sales and cash from operations. Our earnings for the quarter are slightly below analysts' consensus at \$0.07 per share and our cash flow per share exceeded analysts' consensus of \$0.12 per share for the quarter.

Production for the quarter was 1 million ounces of silver and 5300 ounces of gold. Production for the first nine months of the year was 2.98 million ounces of silver and



16,300 ounces of gold. We are in a trajectory to exceed our 2012 annual guidance of 3.7 million ounces of silver and 70,000 ounces of gold.

Our precious metals production for the quarter accounted for 85% of revenue. Silver comprised 69% and gold accounted for 16% of revenue developed by probably enhanced (ph) sales. Silver price for the period was \$29.91 per ounce compared to \$38.79 per ounce for Q3 2011.

Moving on to cost, at our Caylloma and San Jose mines, cash cost for the quarter and nine months are in line with budget and at this moment, we are not anticipating material variations for the remainder of the year. At Caylloma, cost per ton of processed ore for the quarter was \$85 and \$84 for the nine months; this is consistent with our budget. At San Jose, cash cost per ton for the quarter was \$80.59 and for the nine months \$70.94. We do not see the increment in the quarter with respect to the nine months as a trend at this moment. We estimate cash cost at San Jose will remain in line with budget and in the low 70s per ton for the year.

As we are currently working on our 2013 budget, we continue to see cost pressures in Peru and Mexico but particularly in Peru. At this moment, we start to anticipate cost increments in the range of 5% to 7% for 2013 in certain areas of our operations, including mine, contractor tariffs, transport cost, diesel generated power to cover temporary constraints in power line at Caylloma, and others.

Quarter consolidated cash cost per ounce of payable silver, net of by-product gold and base metal, was \$4.81 and for nine months, the cash cost fee here is \$3.93, compared to an estimate industry average of approximately \$8 per ounce for primary silver producers net of by-product.

With regard to our main capital project, at San Jose, we continue with execution of our expansion plan to take production from the current annual estimate of approximately 2 million ounces of silver and some 18,000 ounces of gold to the new rate of 3 million to 3.5 million ounces of silver and 25,000 ounces of gold by mid 2013. With this expansion, our consolidated annual production will be ramped to 5 million to 5.5 million ounces of silver and some 27,000 to 30,000 ounces of gold.

Purchase orders for key equipment have been placed including a new ball mill and flotation cells and detailed engineering had been awarded to a Mexican firm. Work is well advanced and within schedule.

A site has been secured 300 kilometers from the mine for the construction of the concentrate leaching facility and Dore producing facility. We plan to present the environmental impact statement in early January. Approval time is expected to take approximately 12 months. Basic engineering is to culminate in early December, immediately followed by purchase orders for key equipment and detailed engineering. This new plant is planned to be operational in Q4 2013. Payback time on the project is three years for a \$16 million capital budget estimate. Estimated impact of this project on our cost per ounce on a consolidated basis is a reduction of \$2 per ounce.

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We're also pleased to announce the completion of the pipeline installation which connects the Ocotlán sewage plant with our San Jose mine. This project is fully operational now. Since September 2010, we have been operating the sewage treatment plant located 13 kilometers away from our mine site. This is a project with the community and we're working jointly. By upgrading and operating the plant, we're contributing to improve the environment for the community in exchange for residual water from the process that we use in the industrial process of our mine.

At Caylloma, the main project is a new phasing site, the Ministry of Energy and Mines started the site inspection; its final site inspection was on Monday, the 5th of November, this past Monday. We expect the authorization within days and with this, we can be operational before the end of the month.

On the exploration front, we're working with eight drill rigs, five in Peru in our brown fields concessions around the Caylloma mine and three in Mexico around our San Jose mine. This is part of our \$15 million exploration budget for the year. We will be releasing an exploration update before the end of the year and producing an update for resources and reserves with a cut date of December 31st, which will be made public by February of next year.

Moving forward, I'd like to say that I have never seen our company in a better position to continue delivering growth as a low cost silver producer. Our talented teams of professionals with a proven track record of performance and our solid financial position support our growth strategy to become a leading silver mining company.

I will now let Luis take you through the financial statement.

Luis Dario Ganoza – Fortuna Silver Mines Inc. – Chief Financial Officer

Thank you.

As Jorge mentioned, this has been another solid quarter on the back of strong silver and gold production at both of our mines. We have reported record revenue of \$43.8 million and record cash from operations of \$20 million. Our reported net income was \$8 million, down 22% over the prior period as our gross margins were impacted mainly by the lower metal price environment and the combination of higher cost at Caylloma and lower base metals sold.

The increase in our sales for the quarter of 35% compared to the prior year period was driven by the contribution from our San Jose mine which, in Q3 2011, had only one month of commercial production. Revenue at Caylloma decreased 26% due to lower silver, lead, and zinc prices of 23%, 20% and 15%, respectively; and lower lead and zinc sold of 16%. Our total final price adjustments for the quarter were positive \$1.7 million compared to positive \$2 million in Q3 of last year.

Our mine operating income for the quarter decreased slightly compared to the prior year period by 3% as a contribution from San Jose was offset by lower margins at Caylloma, which were affected by the lower sales, as I've already mentioned, and higher unit cash cost of 22%. Our consolidated gross margins came down from 61% to 44% driven again mainly by the lower price environment.

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As Jorge has mentioned, cash cost performance at Caylloma for the quarter and year-to-date is in line with our budget.

Down below on the financial, the selling and G&A line item for the quarter shows an increase of 36% or \$1.8 million over the prior year period. Out of this increment, \$0.8 million is explained by the mark-to-market of share based payment instrument; \$0.6 million responses to added G&A coming from our operations in Mexico; and \$0.4 million of higher corporate G&A.

Our operating income for the quarter was down 18% over the prior year period at \$8 million.

Our effective tax rate for the quarter was 35%, slightly below the 38% to 39% we expected on average and significantly below the 54% recorded in Q2 of this year as of the time we experienced significant fluctuation related to the exchange rate volatility.

Moving on the cash flow statement, cash generated by operating activities before changes in working capital and after taxes paid totaled \$20 million for the quarter, an increase of 30% over the same period in 2011. The strong performance on a cash basis was driven by the strong cash margins from San Jose and the then overall lower cash tax rate.

Cash used in investing activities was \$12.5 million for the quarter and \$29 million year-to-date. Our investments over the course next few quarters are expected to increase as we advance with the expansion of San Jose and plan the infrastructure projects at Caylloma.

Our cash position, including short term investments, at the end of the period was \$62.7 million with an additional available revolving line of \$20 million which we are in the process of expanding and working capital worth \$91 million, an increase of \$27 million with respect to year end 2011, reflecting the increase in cash and accounts receivable related to higher sales.

Thank you. Back to you, Carlos.

Carlos Baca – Fortuna Silver Mines Inc. – Investor Relations Manager

Thank you very much to all for joining today's conference call. Jorge and Luis will now like to address any questions that you might have.

Operator

We will now be conducting a question-and-answer session. If you would like to ask a question, please press *1 on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press *2 if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the * keys. One moment while we pole for questions.

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Our first question comes from line of Heiko Ihle with Euro Pacific Capital. Please proceed with your questions.

Heiko Ihle – Euro Pacific Capital

Hello, Jorge. Thanks for taking my questions.

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Good morning. Go ahead.

Heiko Ihle – Euro Pacific Capital

I was trying to get a grasp on the cost pressures on through for next year and 2014. Can you just maybe elaborate a little more past what's given in the press release would you expect to see next year and then also in 2014 given the current political climate with Humula and the overall strong demand that everybody there is seeing for skilled manual labor?

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Yes. Thank you for the question. We expect to cost pressures in – for both our operations. In Mexico, we do not see any major pressures apart from the expected rate of inflation – for general inflation. In Peru, we are in the budgeting process right now and doing forward looking at our costs into 2013 and we are using pressures mainly on labor. The labor really accounts roughly for 40% of total consolidated cost, including the impact of labor on our contractors and it is significant and there is certainly pressure driven by higher demand on production expansions in Peru. In Peru, be reminded that there is a portfolio of \$50 billion in mining projects over the next 10 years and some of those projects are advancing. And they become as they advance – they do require people and services and even though we do not compete for the same talent as most of these projects are large scale mining and infrastructure project, we do not compete necessarily for the same pool of talent. There is definitely a domino effect and an overlap in some areas, which generates the press of the labor market. So we do expect and we are seeing already pressures coming mainly on the part of contractors – mining contractors and certain services driven by labor and technical stuff.

At Caylloma, we also have a temporary constrain on power availability. That means due to the power line. We are working with our neighbors to achieve a new inter-connection to a secondary line which has spare capacity. By doing this, we will free power availability in the line we're connected to. But until that happen, we are having to burn diesel to cover the power deficiencies that we have in the system. So we expect that will be the case at least into the first half of next year as well. So that will bring added cost pressures at the Caylloma mine. But we believe that all of these – at the same time, we have cost reduction initiatives that are taking place. They are discussing the MD&A. We are changing mining method in the narrow veins. We're consolidating our pool of contractors on site and initiatives of that sort. So we believe the net effect of inflation into the next year as we see at this moment could be in the range of 5% to 7% with respect to our cost structure for 2012.

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Heiko Ihle – Euro Pacific Capital

That's very fair. And thanks for the very good answer there. Have you made any progress in doing any sort of meaningful M&A activity? I mean, not only you have another producing asset, you have the balance sheet to do it, but it would also sort of help you smooth out temporary production shortfall or temporary cost pressures?

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Well, first, we are currently engaged in an expansion project at the Mexican operation that secures our growth – continued growth over the next 12 to 18. As we take San Jose from the current 1000 ton per day throughput to 1500 tons per day. Apart from that, we are targeting the avenue of organic growth. We are exploring aggressively in our properties. We have high expectations regarding adding new resources in the surrounding ground around both our mines and we're deploying the resources to that end. Again, we have eight drill rigs turning, between Peru and Mexico as we speak, a \$15 million budget for this year, and I can anticipate a similar budget going into next year.

For M&A, we are aggressively pursuing initiatives on that end. The first step we took was to strengthen our internal capabilities to identify and pursue these initiatives. We created a new position in the company – that of Vice President of Corporate Development. Mr. Robert Brown joined the company a couple of months ago and he is working closely with me and the board in identifying and pursuing some of these initiatives. As you can imagine, I cannot discuss at this moment any particular one but I can tell you that we are actively looking in Mexico, in Peru, and mainly focusing on post-discovery, predevelopment stage opportunities but also looking at some opportunities with other producers.

Heiko Ihle – Euro Pacific Capital

Should I be shocked to see something done this year or are we looking at Q1 or Q2?

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

No, we are – this is a process. We need to –

Heiko Ihle – Euro Pacific Capital

Right.

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

We understand it as such and we have been very disciplined, and I like to stress this, and selective in our approach to growing this company. And we believe we have two assets that give us a great foundation to take Fortuna to the next level. We not only have production and sustained growing production over the last six, seven years that is low cost silver production. So we will continue focusing on high margin, low cost silver and gold producing opportunities in the Americas mainly from our bases of operations in Peru and Mexico, but it is a process. Even if we get involved – even if it's an early stage project, we ask ourselves, is it in the right place, can we socialize this project correctly, do we believe we can gain the kind of socializing, what is the

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cost structure? Even though if it's certainly early on because what we want to see is the translation of those ounces in the ground to the balance sheet in a profitable way. So we are not rushing out there to just do a transaction, to show the market we can do a transaction, but we're being thoughtful, methodical, and we really want to be able to move faster than our competitors, think smarter, look deeper, and find value just like we had done in the past.

Heiko Ihle – Euro Pacific Capital

That's very fair. Thank you very much.

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Thank you.

Operator

Our next question comes from the line of Andy Scopick, a private investor. Please proceed with your questions.

Andy Scopick – Private Investor

Good morning. I have several questions for you. First, can you give us any additional color on the expectation for improvement in silver recoveries at Caylloma in the year ahead?

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Yes, I'll address that question. The historic recovery at Caylloma is in the range of 85% to 88%. That is what we've been mining on the sulfide portion of the deposit. The mine is today transiting through a portion of the reserves that is close to surface on level 6. We've been mining there for two years now and that area is sourcing today roughly 30% of a mill feed. The ore in that upper portion of the reserves close to surface is not completely oxidized but there is mixed sulfide oxide ore and the mineral species that we find in that portion of the reserves interfere with flotation so that is the reason for the lower recoveries we have been experiencing. We've been driving initiatives to try to improve our process to accommodate this challenging ore. It is a fact that oxides don't float – they do not float or float fully. And so we do two things. One, we try to balance the mixture of level 6 ore that we send to mill, not have it exceed 30% of total contribution. And second, again, we are driving several initiatives. We are seeing improvements in the recoveries over the last couple of months among closer to the range of 77% and we have had days of up to 80% recoveries for silver at Caylloma. But this is a process, it's slow, it's painful. Eventually, the mine will transition outside of level 6. We expect that will take place towards the end of 2013 into early 2014. We do not have more oxide ore in our reserves apart from what is found on level 6 today. So it is a temporary issue but we expect we will be out of there in late next year.

I would like to add that what we expect out of Caylloma is a contribution of 2 million ounces of silver a year. And even though at – we've been experiencing lower methodological recoveries at the Caylloma mine from the historic 88% down to as low as 74%, 75%. The ore from level 6 is higher grade than the average of the reserve.

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So we balance the contribution of level 6 in a way that even though we achieve lower recoveries, we can meet the contribution of 2 million ounces of silver out of the mine.

Andy Scopick – Private Investor

Thank you for explaining that. Furthermore, could you give any additional color on the expectation for completing the construction of the Dore plant at San Jose?

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Yes. I will have to start. I will give you a little background. One of our commitments with the community of San Jose was that we would not use cyanide in our process. So our plant at San Jose is a conventional flotation plant and we do not use cyanide. So for commercial product at this mine is a high grade silver gold concentrate, which we sell through metal traders. Our concentrates today are going to Korea to be smelted.

Of course, there is an added and significant cost in treatment and refining charges – smelting charges related to handling and selling of concentrates. And we believe we can save as much as \$2 per ounce in cost by producing at the river. So that requires that we do a cyanide leaching plant for the concentrate. We know for concentrate, an ore is very amenable to cyanide leaching. We achieve recoveries in concentrate of as high as 98% for both metals, silver and gold, by cyanide leaching the concentrate. So we began searching for an offsite location away from our mine where we could locate this plant. That process has taken longer than we expected and has been the main source of delay up to now for us to get really going with this project. We have scouted various places in the state of Oaxaca, in the neighboring State of Puebla, in central Mexico, and in northern Mexico. And we have now secured a site in an industrial park in the State of Puebla where we had a good reception by the local authorities and the other members of the industrial park. So now that we have secured the site, we are working on advancing basic engineering to go into detailed engineering and adjusting our budget to the new physical requirements for the new site. And it's a \$16 million budget. It has got a really fast payback time of three years. So it's a very profitable project. It makes all the sense in the world and we expect we can have it up and running in the fourth quarter of next year.

So the project, as it stands today, has been delayed by almost three months or a quarter with respect to our original estimation at the beginning of the year and, as I explained, maybe due to the difficulties in finding an adequate site to locate the facility.

Andy Scopick – Private Investor

So your expectation is that you will have construction completed by the end of 2013.

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Yes.

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Andy Scopick – Private Investor

Okay. My last question for you is on the current estimated life of mine at Caylloma, what is that and do you anticipate that that will be improved when you give us an update on resources early next year?

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Okay. If you look at our published reserves at Caylloma, we report about 4.5 million tons of reserves. Now, we have experienced from 2011 into 2012 significant cost escalation that was accounted for in the second half of last year. So, the impact – that cost escalation will have an impact on our reserves. We can anticipate some of our reserves will be migrating back to resources due to the cost escalation using the current price environment. Remember, prices last year hovered around \$35, \$38. Today, we're talking about \$30, \$32. So with that combined effect, we are estimating a reduction of reserves. We do not believe it will be at this point a reduction of reserves that can compromise our mine in any way in the long term because we do have – this mine has a traditional five to seven years of reserves, as much of eight years depending on what prices and costs are doing and then we have a significant base of resources from which we convert annually. This mine has been operating – it's a vein deposit and as such, it is replacing reserves and resources year on year keeping a cushion of five to eight years. We've been very successfully and replacing what we consume and increasing reserves beyond what we consume annually. But in the short term, I think our guidance would be to expect a reduction in reserves and likely the resources to stay at the same level or increase.

Andy Scopick – Private Investor

Okay. Thank you.

Operator

Our next question comes from line of Chris Thompson with Raymond James. Please proceed with your questions.

Chris Thompson – Raymond James

Guys, thanks for taking my – listening to my questions. I just got one question relating to the production expansion at Caylloma. Is that still on the cards or is that pretty much dependent on the power and what sort of scale of expansion are we looking at?

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Thanks for your questions, Chris. The temporary – the power constraint, we believe at this moment, is only temporary. There is a long-term solution for the power requirement which is mainly related to the saturation of the current transmission line. But we believe that problem should be resolved early next year at the latest because it is not only ours but other offshore mines mainly in the district are going through the same issues. So we are all working for our solutions here.

With regard to the – going pass now the energy limitations which are temporary, our current nameplate capacity is for 1300 tons per day and we have been working on a project to optimize and increase that with a view that we could achieve 1600 tons per

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day. Have to say that in light of challenges we have been battling with this year to increase metallurgical recoveries and improve flotation of oxide at this mine, we have deprioritized the expansion project trying to focus more on ground work, metallurgical work, and process optimization. That has been and continues to be the big focus of our work at Caylloma.

And so into next year, we're locating budgets to achieve more than growth beyond 1300. We are locating budget to optimize the process at this plant and make it more efficient. There are a lot of opportunities for optimization that should result in improvements in recovery and on cost efficiencies as well. So, parts of our cost cutting initiatives go through a process optimization of the plant. So we're – I have to say that there has been a shift in focus from expansion to optimization of this plant at this moment.

Chris Thompson – Raymond James

Great. Thanks, guys. Thanks.

Operator

Our next question comes from the line of Trevor Turnbull with Scotiabank. Please proceed with your questions.

Trevor Turnbull – Scotiabank

Yeah, just maybe continuing on quickly with Caylloma. I was wondering if you could give us a sense of how much getting back or getting to the grid power and off of having to use diesel at Caylloma, it would save you on a, say, per ton or per ounce basis?

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

We believe the cost increments, Trevor, related to energy are in the range of \$4 – \$4 per ton of ore. That is what we're seeing right now. For example, the new tailings facility requires pumping. So we need power for those pumps and that power will not come from the grid right now, it will be generated by diesel - so the thermal generators. And we are also taking some initiatives, for example, regarding compressed air in remote locations; for example, production in the narrow range on the backend of the property on the Silvia and Soledad vein has been stopped. So that brings also reduced energy needs and compressed air needs that were met with diesel generation. So we're taking a series of initiatives but into next year, what we're seeing is as much as \$4 per ton.

Trevor Turnbull – Scotiabank

Okay. And the other – I guess you mentioned the tailings, you also said that the ministry came and did an onsite inspection earlier this week. Do you know what the kind of next steps are? Is it just kind of these guys making a decision back in their office or is there anything else that has to happen before they can issue an operating permit?

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Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

No. Just to describe the process, we were granted over a year ago the environmental impact statement that was approved. After that you have to get a construction permit. That construction permit is what is delayed. It was that we were caught in the middle of a change of government last year. So we got that – we advanced with the construction of the facility. The construction of the facility was virtually built and then we were granted the permit, the construction permit we made that part of our disclosures in the MD&A. The site visit that took place now is just an inspection by the Ministry of Mines where they go to the field and compare what you applied for with what has actually been built. And once they do that review, they just give you an authorization to discharge. That inspection took place this past Monday and the timing for them to grant the authorization to discharge into the facility is expected within days.

There is a small process in the Ministry of Mines where the technical review team produces a document that goes to a legal area in the Ministry of Mines, so we have to work closely with them to ensure that the documents move at the pace that we need. And the expectation is that we are operational and discharging into a new facility by the end of this month.

Having said that, I would like to stress what we already mentioned repeatedly before that we de-risked this project by expanding the existing facility and the existing facility, where we are discharging today, has enough holding capacity until June of next year.

Trevor Turnbull – Scotiabank

Okay. And then just one other question with respect to Caylloma. You talked about the Animas vein having a bit the near surface, a bit more oxide and you thought that would probably contribute to the ore feed probably through the end of next year and then you'd be getting away from some of that oxide material. Can you give us a sense that when that change over happens, will there be a change in base metal grades as well? Should we be looking for a trend towards higher or lower lead and zinc content?

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

That is a good question. What we should see is base metals moving higher.

Trevor Turnbull – Scotiabank

And that's – right. That would make sense and that is something probably to look for towards the end of 2013 or 2014?

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Yes. So we are already working on our five-year models and think that is what we are seeing. Once the contribution of level 6 starts reducing, we see an uptick in base metal grade.

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Trevor Turnbull – Scotiabank

Yes.

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

And there will be a slight reduction – potential reduction in silver grades but that is offset in terms of net silver production by increased recoveries as well.

Trevor Turnbull – Scotiabank

Right. Okay. And a final question I guess with respect to San Jose. I know that as the mine gets developed a bit deeper as you get into the mine life, you are expecting higher grades. Should we started to look for those in 2013 or does that take a bit longer for the grades to move up?

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Well, we are already benefiting from some of the higher grades in the deeper parts. We have been outperforming our guidance on the back of higher grades at San Jose up until the third quarter and that is because the main decline at San Jose has – the team at the mine has been able to accelerate beyond our initial plan the deepening of the decline which has given access to deeper levels with better grades. And as we start developing and advancing on those levels, we've been having enjoying more flexibility. We do more work in phases with better grades. So that has translated into our quarterly production. That's why we are beating our guidance for the year.

What we have – a big portion of the better grade in the deeper portions is still an inferred resource category. The reserve that we have reported has an increasing grade profile, but the big upside is with the conversion of inferred resources and we are going to be drilling starting early next year for resource conversion from the underground and it's a big program that we have to start early next and with expectation that by mid next year we can have an updated resource reserve estimation. By mid 2013, we can have an updated reserve which is incorporating the migration of these inferred resources into measure indicated on reserves.

Trevor Turnbull – Scotiabank

Okay. It sounds good. I think that's all the questions I had.

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Thank you.

Operator

Again, if you would like to ask a question, it's *1 on your telephone keypad, *1 if you would like to ask a question.

Our next question comes from the line of Ben Asuncion with Haywood Securities. Please proceed with your questions.

Ben Asuncion – Haywood Securities

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Hey. Thanks, guys. I guess most of my stuff was answered. I just wanted to touch base with respect to San Jose. I guess on the last press release you acquired an 1800 ton per day ball mill. Can you give us any color on what your thoughts are in terms of how soon we could potentially see an additional increase, I guess, from 1500 to 1800?

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

That is a good question. The reading of the sign of the mine – the mine has an integral design when we first conceived it back in 2009 and we did the basic engineering for a 1500 ton per day mine. And at the time, the bottleneck, if you will, to think beyond that was in the water availability. The valley of Ocotlán where our operation is located is a dry basin. So our team devised a very imaginative source of water for the project. One, we capture in a dam that it is a dual tailing reservoir, water reservoir. We capture rainfall water that we store. We recycle all the water in the mine. We have sealed discharge of water or industrial affluent from the plant. We recycle everything.

And with enabling community, we developed a very smart project we're proud of, where we upgraded the sewage facility of a neighboring town at our own cost. We revamped it at our own cost and we are operating it. We have an agreement with the municipality of the town where we operate the plant at our own cost and we invested our \$1 million in upgrading the facility. And we do that in exchange for the residual water from the treatment of sewage. So that water we pump it to the mine site, which is located 13 kilometers away and that adds to our water balance. So we are growing to 1500 tons per day and we will be revisiting our water balance after a year of operations at San Jose. With that hard data, not just estimate, we will be fine tuning our water balance to see if we have enough water availability in the balance to think beyond 1500 at this moment. We do not see bottlenecks at the mine today. And at the plants, we do not see bottlenecks either to think beyond 1500. In fact, as you already noted, we bought - we purchased a ball mill or a second ball mill for expansion. It's not sized precisely for 500 tons per day but rather 500 tons – 800 tons per day. With that, we can be producing in the range of 1800 tons per day. We have enough milling capacity for 1800 tons per day and if we push the existing mill a bit harder, perhaps we can go to 1200 so we can be between 1500 and 2000 tons per day with the milling capacity that we will have in place.

Of course, there will minor changes required to go beyond 1500, but the main core the plant is in the milling and we would have enough milling capacity to think beyond 1500. But the bottleneck is in the water balance and that is something we're going to be answering in the coming months now that we have the input of the water from the sewage plant and we have a year of hard date collected from the operation.

Ben Asuncion – Haywood Securities

Okay. Thank you. And then I guess just touching on that water plant. Can you give us an update on where you stand with that final sort of missing key to the pipeline? And if you have any better estimate in terms of when you think we can see a solution for that?

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Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

I just – during the call I mentioned it, I will repeat it. We – this past month of October, we connected the last two kilometers of the pipeline, so the waters – the sewage plant is operational. The plant – the pipeline is connected and we are currently receiving about 700 cubic meters of water per day from the plant on site.

Ben Asuncion – Haywood Securities

Perfect. Thanks. Sorry, I must have missed that. And then the last question here is just with respect to the grades you've been delivering at San Jose have been above plan. I guess this is the result of the development that was sort of ahead of schedule and accessing those higher grade blocks. Will we see this, I guess, continue if we will look at the last study? Would we still anticipate sort of grades higher than what were originally forecasted?

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Well, what I can tell you is that we are going to continue to push the ramp to deepen and deepen fast because we like flexibility in our mines and we are going to give guidance for 2013 in January.

Ben Asuncion – Haywood Securities

Okay.

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

So, right now, we are working on our planning, revisiting our – or as we do every year at this time, we are revisiting our annual planning, our five-year planning and we will be giving guidance in January and there you'll be able to see how we're going to manage it.

Ben Asuncion – Haywood Securities

Perfect. All right. Well, thank you very much, guys.

Jorge A. Ganoza – Fortuna Silver Mines Inc. – President, Chief Executive Officer, and Director

Thank you.

Operator

There are no further questions at this time. I would like to hand the floor back over to management for closing comments.

Carlos Baca – Fortuna Silver Mines Inc. – Investor Relations Manager

We want to thank you for your interest in the company and continued support. Have a good day.

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Fortuna Silver Mines Inc (FVI.TO)
Third Quarter 2012 Earnings Call
November 9, 2012**

Operator

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

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