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Transcript of
Fortuna Silver Mines, Inc.
First Quarter 2015 Earnings Call
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Participants
Carlos Baca – Investor Relations Manager
Jorge Ganoza – President, CEO and Director
Luis Ganoza – Chief Financial Officer

Analysts
Chris Thompson – Raymond James
Benjamin Asuncion – Haywood Securities
Craig Johnston – Scotiabank

Presentation

Operator
Greetings, and welcome to Fortuna Silver Mines' First Quarter 2015 Earnings Call. At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. (Operator instructions.) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Mr. Carlos Baca, Investor Relations Manager. You may begin.

Carlos Baca – Investor Relations Manager
Thank you, Rob. Good morning, ladies and gentlemen. I would like to welcome you all to Fortuna Silver Mines and to our First Quarter 2015 Financial and Operations Results Call. Jorge Alberto Ganoza, President and CEO; and Luis Dario Ganoza, CFO, will be hosting the call from Lima, Peru.

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

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

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

Jorge Ganoza – President, CEO and Director
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 produced 1.6 million ounces of silver and 9,700 ounces of gold, up

6% and 19% respectively when compared to Q1 2014. We're well within schedule to meet our guidance for the year of 6.5 million ounces of silver and 35,000 ounces of gold.

The driver for the quarter-over-quarter production growth was the expansion of the San Jose Mine from 1,800 tons per day to 2,000 tons per day in April 2014. For the quarter, precious metals accounted for 84% of sales; silver representing 61%, and gold 23%. The balance is made of by-product lead and zinc from the Caylloma Mine.

At San Jose, we processed 178,000 tons at an average grade of 215 grams per ton silver and 1.83 grams per ton gold, resulting in 1.1 million ounces of silver and 9,300 ounces of gold. San Jose guidance is for 4.3 million ounces of silver for this year, and 33,300 ounces of gold. At Caylloma, we processed 114,000 tons at an average grade of 171 grams per ton silver, 3.3% zinc and 1.86% lead, resulting in 536,000 ounces of silver, 7.5 million pounds of zinc and 4 million pounds of lead. For 2015, we have guided 2.2 million ounces of silver at this mine and we remain on target to meet guidance.

We reported lower operating costs at both our mines. At San Jose we achieved $59.80, down from $66 in Q1 2014. At Caylloma, we achieved $84, down from $87.85 in the comparative quarter. Cost per ton at both operations were below guidance for the year at $62 at San Jose and $90 at Caylloma.

At San Jose lower costs against guidance are explained by an 8% evaluation of the peso, partially offset by higher mining costs, basically break up haulage and [indiscernible].

At Caylloma, the cost reductions are explained by lower headcount services and zinc concentrate transport tariffs and the impact of a 4% evaluation in the sol, the local currency.

For the quarter, our consolidated all-in sustaining cash cost net of by-products decreased to $11.80 per ounce of silver, down from $16.50 per ounce in Q1 2014. Our guidance for 2015 is for $16.60. We expect to be within this guidance for the year due to the scheduled capital investments in the coming quarters related to our filter tailings and dry stack product.

All-in sustaining cash cost at the San Jose Mine was $9.37 versus $14.41 in Q1 2014. The 2015 guidance is for $16; $6 out of this figure is attributed to our filter tailings and dry stack product.

At Caylloma, all-in sustaining cost was $11 versus $13 in the comparable quarter. The 2015 guidance is for $12.78. We expect to be within guidance as sustaining capital products, particularly mine development, pick up in the second and third quarters.

Our capex guidance for 2015 is for $70.6 million, the allocation is $56.5 million to the San Jose Mine and $14 million to the Caylloma Mine. In the first quarter, we have reported investments in mineral property, plant and equipment of $6.1 million. We expect the capital investment line to pick up in the course of the year, as our main projects are advancing according to schedule.

The San Jose tailings project, the largest budget this year with $28 million, has a physical advance of 60%, and for the 3,000 ton per day expansion with a 2015 budget of $12.5 million, orders for the bow mill and other large equipment have been placed already.

Touching briefly on exploration at the San Jose Mine, we are advancing, we are drilling at the north end of Trinidad, with eight drill holes and 4,800 meters concluded up-to-date. We're advancing with exploration of two new areas; La Noria to the west of the mine, which is a parallel vein system, and the continuation of the Trinidad system on some southern place some two kilometers from the core and mine facility along [indiscernible] to the south. We expect to report our results on these new areas as the work advances.

Now I'll let Luis take you through a summary of the financial results.

Luis Ganoza – Chief Financial Officer
Thank you, Jorge. For Q1 2015, we recorded sales of $39.8 million, down 13% from Q1 2014, and net income of $3.9 million, a decrease of 20% compared to the same period last year. The main driver for a lower income and sales was a lower realized silver price, which fell 18% to $16.60 per ounce. This negative price effect was partially compensated by higher gold and base metals sold of 11% and 10% respectively, where silver sold was 1.62 million ounces with no significant variation from Q1 2014.

Our mine operating earnings was $12.6 million, 27% below Q1 2014 as a result of the lower sales. Gross margin, that is mine operating earnings over sales, came down from 38% to 32%, reflecting the impact of lower metal prices. This negative effect, however, was partially offset by lower unit costs year-over-year at both of our operating units.

We recorded selling, general and administrative expenses of $4.6 million, a decrease of $3.4 million compared to the prior year period. The decrease is explained by lower stock-based compensation charges, a reduction in corporate expenses of $0.8 million and a foreign exchange gain in the period.

Operating income was $8 million, 14% below Q1 of 2014. And finally, net income was $3.8 million or $.03 per share compared to $0.04 per share in Q1 of 2014. When comparing our financial results to the previous quarter, that is to Q4 of 2014, our sales were 5% higher, mine operating earnings was 25% higher, and operating income was 180% higher as a result of lower costs and expenses and higher metals sold.

Moving down to the cash flow statement, cash flow from operations before changes in working capital and after taxes paid was $5.6 million, compared to $16.9 million in Q1 of 2014. The majority of the increase is related to timing issues in the payment of income taxes. And as a better comparison, EBITDA for Q1 2015 was $15.2 million, 16% below the $18 million generated in Q1 of 2014. Expenditures in mineral properties, plant and equipment was $6.1 million. As Jorge mentioned, we expect to see this figure rise over Q2 and Q3 as our two main projects for the year gain momentum.

Moving onto the balance sheet, our total cash position, including short-term investments as of the end of the quarter was $77 million, which remains at similar levels compared to year-end 2014. On our payables, we closed 2014 with $9.7 million of income tax payable related mostly to our Mexican operation. For this year moving forward, we anticipate we will see the opposite effect as we start paying taxes. So we should expect to see a tax credit building up in the balance sheet over the next couple of quarters.

On April 1st, we drew down $40 million in the term loan trench of our expanded bank credit facility. The $40 million is structured as a bullet loan with a four-year term. We have also proceeded to fix the interest rate on the loan to an interest rate swap. All this will allow us to add additional financial flexibility to our balance sheet during the expansion phase of the San Jose Mine, as well as secure what we regard as a very competitive interest rate.

Thank you. Back to you, Carlos.

Carlos Baca – Investor Relations Manager
We would now like to turn the call over to any questions that you may have.

Operator

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

<Q>: Good morning, gentlemen. Thanks for taking my question. A couple of quick, quick questions here. The first one relates to the gold grades at San Jose. I noticed they're slightly higher than guidance. Do you see this as continuing and is this sustainable?

Jorge Ganoza – President, CEO and Director
Hello, Chris. Grades we expect to be weak for the year, we expect to be within guidance. Yes, we don't see many of [indiscernible] any changes are just natural swings in the sequencing of the mine.

<Q>: Okay, great. Good costs for the quarter are really on the back, I guess, of weakness in the peso and sol. If you walk forward and assume that same sort of weakness or the status quo as it is today, do you see your costs on an operating basis indicative of what was delivered in Q1 for the remainder of the year?

Luis Ganoza – Chief Financial Officer
Hello, Chris. As you say we assume the exchange rate we've seen in Q1 the answer would be yes. We would expect to be somewhat below our guidance, otherwise we would expect to be very much close to what we guided, within a 3% to 4% range.

<Q>: Okay. Thanks. As far as the capex on occasion for the billed items at San Jose for the remainder of this year, would it be fair to say for what you're looking to spend this year should we apportion it in equal portions through the remainder of the year on a quarterly basis? Is that how you see things happening?

Jorge Ganoza – President, CEO and Director
We expect over the next two quarters to see the bulk of the scheduled capex being expensed. Let's call it $45 million to $40 million over the next two quarters.

<Q>: Perfect. Great. Thank you very much. Congratulations again, guys.

Jorge Ganoza – President, CEO and Director
Thank you.

Operator
Our next question is from Craig Johnston with Scotiabank. Please proceed with your question.

<Q>: Hi, guys. Thanks for taking my call, good quarter. Just two questions just relating to costs in both operations. I noticed you mentioned, and looking at the detailed schedules, that mining costs at San Jose seem to of trended higher Q4 as well as into Q1. Just wondering what's driving that and where you see mining costs going forward at San Jose?

Jorge Ganoza – President, CEO and Director
Yes. Well, we have been accelerating some unscheduled development in the mine that will have an impact. Also, there is some changes in support so we don't see any material deviations nor anything that would lead us to alter our guidance at this moment.

<Q>: Okay. Thanks. Then just going to Caylloma, it looked like a great quarter from a cost per ton perspective, well exceeding or beating last year. Just thinking is that primarily related to the depreciation in the currency or is there more to it and we can expect to see a cost per ton beat going forward?

Jorge Ganoza – President, CEO and Director
I think what we are seeing in Caylloma is the result in parts of the optimization of the mine that has been taking place. We have taken away through that some flexibility in the mine. But basically, we're benefiting from some lower targets. We're shipping zinc concentrate out of the Matarani sea port. That is a positive change.

With respect to what we have been doing historically at this mine where we've been trucking 1,000 kilometers all the way to Cayel [ph] in Lima. So that is a reduction that we hope will remain and lower headcount as part of the restructuring. At the same time we have taken some flexibility out of the mine reducing development head of production and what not. But all in all we expect savings to sustain.

<Q>: Great. That's very helpful and that's it for me. Thanks, guys.

Luis Ganoza – Chief Financial Officer
Thank you.

Operator
Our next question is from Benjamin Asuncion with Haywood Securities. Please proceed with your question.

<Q>: Good morning, guys. Just a quick question here for Luis. Just looking at the taxes, how should we look at taxes being paid going forward? There was an accrual of just over $4 million for Q1. What's the timing on tax payments?

Luis Ganoza – Chief Financial Officer
Yes, as I mentioned during the call, Ben, this year we start paying tax installments, we've also paid around $8.7 million—I'm sorry, actually more than that—$9.6 million in the first quarter, most of it related to fiscal 2014 in Mexico.

So where we should see—we should expect to see is payments above and beyond our incurred taxes in particular for our next two quarters. But all in all towards year-end, we should accumulate a tax credit in the balance sheet of in the range of $2 million to $3 million. Right? I hope that gives you a good sense with respect to payments based on the assumptions you might have on incurred taxes.

<Q>: Okay. Okay, so then on—just so I understand correctly, on a quarterly basis we'll see some cash outflow on taxes being made relatively consistently as opposed to a big bullet payment, correct?

Luis Ganoza – Chief Financial Officer
Yes.

<Q>: Okay. Perfect. That's it for me. Thanks, guys.

Luis Ganoza – Chief Financial Officer
Thank you.

Operator:
Our next question is from Ragul Goran, a private investor. Please proceed with your question.

<Q>: Hello. Thank you. Just calling to request you to comment on exploration activity on the San Jose and Trinidad; not specifically in all the southern areas. We were expecting a press release in the last couple of

months and there was nothing came and I was wondering when you would be commenting officially, releasing a press statement, something like that. Can you elaborate a little bit on that? Thank you.

Jorge Ganoza – President, CEO and Director
Yes. Thank you. We have a drilling budget of 12,000 meters basically allocated to San Jose this year. We have executed these first couple of year, 4,800 meters—sorry, these first months of the year 4,800 meters. That's in eight drill holes. We are waiting to conclude the program in the area of Trinidad North where we're currently working before releasing. We're just a few holes short of concluding this first phase of the program and with that we will be publishing a release. This is drilling taking place on the northern most end of the Trinidad northeast quarter.

We are also preparing to drill the north, the western vein system located some two kilometers away from the mine. Structurally, looks like a mirror system to the Trinidad system where we're currently mining. We have conducted all the necessary work to develop drill targets. We're working on getting land surface rights access to setup for drilling, and we expect to be drilling towards middle of the year. That's our expectation.

We are also advancing with work south of the mine area on some place called Maria, another miner's place from the main trend. We're also doing carrying surface work with expectation of developing new drill targets. What you will see us is concluding this year's drilling in Trinidad North in the coming weeks, publishing results for eight to twelve drill holes, and then working to move our drill rigs to these other areas; La Noria and hopefully Maria.

<Q>: Thank you. That's excellent. One other quick question if you may. Recently, zinc and lead prices have strengthened and they [indiscernible] the board well for Fortuna going forward being a by-product, Can you comment on your views on that and it's relating to [indiscernible] times ahead for the company either way you look. Thank you.

Jorge Ganoza – President, CEO and Director
Thank you for that. Yes, lead and zinc combined currently account for 15% of sales roughly. At the Caylloma mine they account for roughly 35% of sales. So they're definitely important at the mine level and a nice by-product credit that helps from an all-in perspective or cash cost-per-ounce perspective lower costs.

We are unhedged on these commodities, on these by-products, so we are benefiting from the increase in prices. We know that there's been for a long time an expectation of higher zinc prices that we share. If you see our zinc grades and lead grades at the Caylloma Mine, we've been moving or transitioning the mine towards areas of higher polymetallic grade.

Our zinc grades this quarter have been 3.3% versus 2.8% a year ago, and our lead grade is also slightly higher. That is a result of us transitioning the mine towards these higher grade base metal zones. We like to think that that mine is naturally hedged with its base metal component. We're reaping that benefit at the mine.

Operator
There are no further questions at this time. At this point, I'd like to turn the call back over to management for any closing remarks.

Carlos Baca – Investor Relations Manager
Thank you, Rob. If there are no further questions, I would like to thank everyone for listening to today's earnings call. We look forward to you joining us next week—next quarter, sorry.