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Transcript of
Fortuna Silver Mines
First Quarter 2013 Earnings Call
May 8, 2013

Participants

Carlos Baca – Manager, Investor Relations
Jorge Ganoza – President & CEO
Luis Ganoza – CFO

Analysts

Heiko Ihle – Euro Pacific Capital
Craig Johnston – Scotiabank
Benjamin Asuncion – Haywood Securities
Nicholas Campbell – Canaccord Genuity
Jeff Wright – Global Hunter Securities
Paul Heppner – Alameda Capital
Graeme Jennings – Cormark Securities
George Shea – Cicada Investments

Presentation

Operator
Greetings, and welcome to the Fortuna Silver Mines' First Quarter 2013 Earnings call. At this time, all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Carlos Baca, Investor Relations Manager for Fortuna Silver Mines.

Carlos Baca – Manager, Investor Relations
Good morning, ladies and gentlemen. I would like to welcome you all to Fortuna Silver Mines and to our first quarter and operations results call. We are hosting the call from Lima and Vancouver.

I would now like to turn the call over to the President, CEO and Co-Founder of Fortuna, Mr. Jorge Ganoza. Thank you once again to everyone for joining us this morning.

Jorge Ganoza – President & CEO
Thank you, Carlos. Good morning to all. I am joined on the call today by Luis Ganoza, our CFO. I will initiate the conference and with the assistance of Luis, we will be giving a summary and analysis of our operations and financial results for the first quarter of the year. Once concluded, we will address your questions.

During the quarter, the company recorded sales of $40.7 million, when compared against Q1 2012 sales were essentially flat. Cash generated by operations before changes in working capital increased by 11% to $16.3 million. We reported net income of $6.7 million, a drop of 40% and earnings per share were $0.05.

Our mines produced a million ounces of silver and 4,500 ounces of gold. Silver production was in line with our budget and 4% above Q1 2012, while gold was 6% below budget and 13% below Q1 2012. Gold variation is attributable to a 9% drop in head grades for the quarter of the San Jose mine. This variability in rates is within the range of our model and attributable to local variations in our production source. For 2013, average guidance is for silver production of 4.4 million ounces and gold of 23,300 gold ounce; we are on-track to meet our guidance.

Our precious metal production for the quarter accounted for 81% of revenue. Silver represented 67% of revenue while gold accounted for 14%. The balance was made by byproduct … sales. Realized silver price for the quarter was $30 and $1,550 for gold is 6% and 2% lower, respectively, when compared against Q1 2012.

Cash cost per tonne at both of our operations was in line with guidance for the quarter. Caylloma reported cash cost per tonne of $94.20, 2% below guidance and 15% above Q1 2012. San Jose reported cash cost per tonne of $77.96, 2% above guidance and 19% above Q1 2012 cash costs. Consolidated cash cost per ounce net of by-products was $6.48.

We have started to see high cost operations moving to standby and layers in the Peruvian mining industry and layers in Mexico. We anticipate see easing of cost pressures in labor and services throughout the year. Fortuna remains as one of the lower cost primary Silver producers in the sector.

Expansion of the San Jose mine is our main capital priority for 2013, I can advance that we continue on schedule and within budget to commission the expansion in the month of August. I want to highlight that the project and models we preferred to contemplate a best case scenario of 1,500 tonnes per day, but the new nominal plant capacity is for 1800 tonnes per day. We plan to be operational at this new rate of capacity by the start of Q4 2013. We will be updating our guidance for the year with this new triple capacity in the month of June.

On the exploration front, we continue to be most excited about the discovery of the North extension of the San Jose …, and to what it can represent for short and medium term production plans. On April 22, we reported initial drill results from this … with effect drill hole interval in Hole 283 of 7.3 meters through thickness with 1700 grams per tonne silver and 10 grams per tonne gold. We also reported additional successful drill holes with wide intersects that can be seen on drill hole 275, with a thickness of 13.7 meters with 510 grams per tonne silver and 3.3 grams per tonne gold. This extension remains open to the north and … and is a focus of our ongoing drilling. The proximity of these new areas and core mining infrastructure will allow for a swift integration into a mine plant.

I will now let Luis take you through financial statements.

Luis Ganoza – CFO
Thank you, Jorge. We reported $6.10 million of net income in the first quarter of 2013 compared to $11.1 million in the prior year period. When compared to the first quarter of 2012 net income was affected by a $2.8 million difference in final price and assay

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adjustments, a lower margin contribution from the San Jose mine and the higher share based payments of $1.3 million.

Sales were flat compared to 2012 and provision of sales actually increased 8% driven by higher silver sold of 13%. This, however, was offset by a lower realized silver price of 5% and the difference in final sales adjustments. This $2.8 million difference stems from negative adjustments of $1.4 million in Q1 of 2013 compared to positive adjustment of $1.4 million in Q1 of 2012.

Our lower margin contribution from San Jose has to do more with an exceptional quarter last year than with lack of performance in Q1 of 2013. … compared to our budget exceeded silver production by 4% and was in line on unit cash cost with a slightly lower gold production than planned of 5%. When compared to last year, however, gold production was 12% lower and unit cost 19% higher, therefore explaining lower volumes year-over-year. As a result of this, our mine operating earnings were 20% below the prior year period.

Down below the income statement, G&A increased $1.6 million, mainly as a result of higher share based payments of $1.3 million when compared to Q1 of 2012. This difference stems from the recording of the credit of $0.3 million in 2012 and, again, finally net income was $6.7 million or $0.05 per share.

Moving on to the cash flow statement, we had reported cash flow before changes in working capital and after taxes an interest rate of $16.3 million or $0.13 per share. This is an increase of 11% above the prior year period, which was driven by comparatively lower taxes paid in 2013 of $4.9 million.

Cash consumed in investment activities, mainly on mineral properties, plant and equipment was $18.4 million and the net increase in cash in the period was $3.2 million after adjusting for redemptions of short-term investments. Our planned capital project at both our mines this year should demand an additional $35 million to $40 million capital spending in 2013 as we conclude the expansion of San Jose and other non-recurring infrastructure projects.

At current metal prices, we expect to be able to fund … requirements with a modest reduction in our treasury. Our cash position as of the end of the quarter, including short-term investments, was $68.7 million and we recently closed an expansion through our revolving credit facility for up to $40 million; it puts the company in a strong position to execute on its investment plans and maintain necessary financial flexibility.

Thank you. Back to you, Carlos.

Carlos Baca – Manager, Investor Relations
Thank you very much for listening to us. We would now like to turn the call over to any questions that you may have. Please state your name clearly.

Operator
Our first question comes from the line of Heiko Ihle with Euro Pacific Capital.

<Q>: Guys, when we last spoke your course of action was to maintain the status quo when it comes to the overall labor force. I'm just trying to see if anything has changed, I mean obviously with the changes in the Peruvian labor markets you described earlier, there may be quite a few selected hires that you may want to have on board. Or, vice versa, are you thinking about instituting layoffs yourself? I mean,

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obviously, a lot of your peers in Mexico have already started to do so, but granted, you guys are a lower cost operation, but regardless I'm sure that thought's entered your mind.

Jorge Ganoza – President & CEO
We are reviewing our capital project to see opportunities to be fair, some of it, most of it. Fortuna is coming out of capital intensive phase this year, 2013. This year our largest capital budget is the $50 million basically requirement to expand the … line to these new triple capacities, 1,800 tonnes per day. We also have some one-time capital … at the Caylloma Mining in Peru. So when we look our measures, we talk to, we're not looking only in the context of 2013, but in the context of both cash flows and predicted cash flows in this price scenario over 2013, 2014 and 2015.

When we look at the all inclusive cash cost of our mines, Caylloma is in the mid-teens and Jose is in the low-teens. So when we—and this lower price, in this new price environment, we're starting to see flex limitation on the cost side, mainly by the way of services and labor. We're starting to see layoffs taking place on the higher cost operations, and that undoubtedly will start leading through the year to easing of cost pressures in the sector, mainly labor and specialized services, contractors, engineering services or whatnot.

So that will be to our benefit. So again, we are not moving quickly to make cuts. We're looking at this in the context of three years, predictions of two to three years in a low price environment and opportunities that we can capture there taking advantage of the fact that our mines are low cost operations including all inclusive cash costs. What we could expect, again, through the easing of the market is opportunities to just seek cost reductions moving forward. So we are not moving at this moment to make aggressive layoffs and we are trying to see opportunities, as we do every year, to make our G&A more efficient and effective, better focus our exploration with the information we have on hand this year. Our budgets are prepared in October, November of the previous year.

So in light of the information we have today we can refocus our programs, refocus our capital project. So we are looking at opportunities like that. We are being very hawkish, we are looking at our models closely, and looking at the … as well, and we will be acting accordingly to … being paid to the company. We believe that in this environment we can continue to aggressively pursue our strategic objectives and even pride in our environment like this.

<Q>: Also given the gold production … just a touch lower than what I had modeled and obviously lower than your budget as well. Give me your mine plan, is it time to update longer term models for the analysts, or is it just sort of one-item and a blip on the radar?

Jorge Ganoza – President & CEO
I have the benefit of seeing our production out of our metallurgical balances every day, and I can tell you that up to now, up to yesterday our gold production at the San Jose Mine is very much in line with budget. So we will not see the deviation in gold production at San Jose Mine, that's a trend. It's just part of normal variation and within the range of our models. We are not forecasting any deviations from our guidance and, in fact, we are seeing opportunities to exceed guidance once again this year.

<Q>: And then last question, given the current share price of 2.86 and your $68 million worth of cash short term investment, I think it's like 64 and 4. At what point in

time are you going to guide the board for a share repurchase program? I mean, it would certainly make sense at the current price level, just given the NAV of the stock and the current trading price?

Jorge Ganoza – President & CEO
We are working, we are looking at both initiatives we have now, policies regarding buybacks or initiatives in long term at this time, none that I can speak of, but it's something that we are going to be discussing with the board, certainly this year. In the current price environment we all start to see ourselves cheap and that will prompt some initiatives likely, but I cannot report anything additional.

Operator
Our next question comes from the line Craig Johnston with Scotiabank.

<Q>: Just wondering if you could provide some color on the Union at Caylloma, just wondering if you anticipate labor cost to rise as a result and if you could give us a sense of kind of what the percentage of labor force is under the Union?

Jorge Ganoza – President & CEO
Yes. First, let me give you some background. We were up now, for the seven years we have been operating in Caylloma, the only mine that was not unionized in entire area. We think 60 kilometers of Caylloma there five, six other mine operations and what has brought it, the formation of the Union, is the fact that last year the profit sharing, which is by law here in Peru, 8% profit share for 2011, which was paid at the end of Q1 2012, averaged about 11 to 14 additional monthly salaries per worker; between 11 and 12 monthly salaries per worker. This year that number has been reduced, and it's only four to five monthly salaries per worker.

So that reduction that they have seen in the profit sharing is what has prompted this movement to come together as a union and bring in the demands forward to the company. The number of unionized workers right now is around 70 out of a population of close to 500. We can expect that figure to grow perhaps, and they have presented a list of demands, many of which we already comply with them, but there is going to be a negotiation. We had in our budget a 5% increase for this year on wages; that is in our budget.

Right now I would not be in a position to say that there will be an increase or a … for a potential increase as we are just starting with the negotiations. And again, even though there are some pressures to pay additional bonuses to contemplate the law they have on the profit sharing, or their perceived loss on the profit sharing, it's part of the reality of now and there are many other things we already fund for the workers and that we are trying to stress and put forward to the union. So we are not in a position right now to say what would be the magnitude, or if there will be an impact here from the negotiations that are just starting.

Operator
Our next question comes from the line Benjamin Asuncion with Haywood Securities.

<Q>: I just had some questions, just wanted to touch back on some of your comments, Jorge, on San Jose and the expansion. Can you give us a sense of what the progression would look like? I believe you mentioned that it was going to be commissioned in August. Would it be running at the 1,500 tonne per day run rate at that point in time?

Jorge Ganoza – President & CEO

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Yes, the mine is well ahead of schedule to meet not only the 1,500 tonnes per day, but also take use of full nominal capacity of the plant at 1,800 tonnes per day starting in the 'start of Q4, in the last quarter. So the mine is well ahead of schedule, and on top of that we have large stockpiles on surface that we could always serve as a cushion for the mine. So we see no problem on the mine end to meet the 1,500 tonnes per day and quickly accelerate before the end of the year to a full nominal capacity of 1,800 tonnes per day.

<Q>: Perfect. And just touching on some of the more recent exploration results here on, I guess it's the … expansion, can you give a sense of how much drilling you would need in order to be able to start or when you would be in a position to start talking about how some of those results could be incorporated into a mine plan and wrap development around it.

Jorge Ganoza – President & CEO
Well, we were having a discussion here because the way things are moving, and this new area being so close to existing mine infrastructure, we might start mining some of that before reserve is …. We currently have close to $7 million budgeted for exploration at San Jose and most of that is being funneled to the drilling of this new area. We currently have two rigs working there, we are looking to add a third and we are going to be drilling from surface, we are going to be drilling from underground. This area is only 200 meters north of an existing mine infrastructure, so it will be quickly—200 meters is basically too months of drifting.

So we are already moving in that direction, and I believe the integration of business owned or production plants will be taking place even before we have time to publish our annual updated reserves, which is scheduled for publication in early 2014. We do our publications every year in the first quarter. So we will have a cut date of June for the resources and from that we start working on the resource model, reserve model budget and then we probably should not wait on resources and reserves by Q1 of next year. Again, what I see is that we are going to start developing and consider even start scratching and mining there before we have reserves published.

<Q>: Can you give us a sense of how far down the road that would be in terms of when you would be in, or I guess drifted in that area that you could develop it?

Jorge Ganoza – President & CEO
Well, due to the consideration of our mine, we have our supporting infrastructure is developed through a decline on the footwork of mineralization. So most of the development that we will be doing in this new area will be in ore once we branch out from the main …. So I would anticipate that a lot of that is just drifting on structure because of the width of mineralization will start forcing or melting. The widths of mineralization are quite significant to a width of 7 meters, 12 meters as you can see in the drilling. It is not strange; I mean it's common for this area. So we are very excited about that and the potential means. So I expect we will start feeding the new ore from … before the end of the year before results are published.

<Q>: My last question here, just given your balance sheet strength and the increased credit facility that you have available to you, can you comment on some of the opportunities that you are looking at?

Jorge Ganoza – President & CEO
Yes, we continue to focus on predevelopment, post discovery, … opportunities throughout America; our team impacting the—we conducted two site visits this past month. We have to take advantage of our strength and the strength that our low cost

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production gives us, the strength of our clean balance sheet, no debt, strong cash position, the availability of additional flexibility to … facility. To use this environment, to go there and capture the good opportunities there are, there are not a lot of those. There are lots of companies, there are lots of employees, but we are focusing on things that meet our threshold, and when we look at that we ask first ourselves, what we are bringing, enhancing or detracting from our asset portfolio. The best mine we have in our portfolio today is San Jose, and anything we bring has … to compete financial metrics of ….

<Q>: Just lastly, can you give us a sense of the size in terms of what your bite size, or what you would be comfortable with in terms of valuation range.

Jorge Ganoza – President & CEO
Could you repeat that please?

<Q>: Could you give us a sense of the size, how big of an opportunity or what the evaluation range that you'd be looking at is?

Jorge Ganoza – President & CEO
Well, you know we are looking more at incremental growth opportunities rather than transformation of projects that require large capital … that will stretch our balance sheet and put us in a risky position. You know, we are gearing our efforts in the search for assets that are coherent with the current financial position of the company and are more incremental growth for us rather than just trying to go out there and look for transactions that will require Fortuna to be valued on the basis of this new development project rather than the current … base. So just to give you a sense of how we are thinking; that's how we think.

Operator
Our next question comes from the line of Nicolas Campbell with Canaccord Genuity.

<Q>: A lot of my questions already have been answered, but just on the expansion or extension of the Trinidad issue. There is an additional $6 million option payments payable on the production decision to Pan American. Is that given that you are talking about getting or really getting in there before the end of the year; are you going to, when do you think you will be making that payment for the rest of the remaining interest on that asset?

Jorge Ganoza – President & CEO
Before the end of the year.

<Q>: Can you give us a little more color in terms of the expected total capital that we should see quarter-over-quarter, and obviously it should be frontloaded given that you are still expanding San Jose. Can you give us an idea as to how much capital you guys should be putting in in Q2?

Jorge Ganoza – President & CEO
Well, our capital budget for the year, eating our guidance; we're not seeing any material deviations from our capital project. Sometime rates accelerate in the second half of the year or what not, but I think … for your model, if that is what you're looking for, is to consider a steady execution of a capital budget, which is in our guidance.

Now we are going to be looking in the coming, actually this week here in Lima we have a meeting with our Vice Presidents … we're going to be reviewing capital projects and see if there are any opportunities to defer some of our capital projects.

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We're going through that exercise, opportunities to defer product that would not impair in any way our ability to continue finding our growth, nor challenge our sustainability in any way.

It's something that we've been very diligent at and has paid off is we have always kept our mines and infrastructure well ahead of production and that gives our mines tremendous flexibility. That's why I think we are recognized out there in the market as a company with the ability to meet guidance in a sustained way for production. So we don't want to lose that flexibility, but, nevertheless, we will be reviewing our capital projects and seeing an exploration how we can refocus, if there is opportunity for that, and the first time, some of this budget. But on the safe side for your models, I will keep with the guidance we gave in the year and just apply through the year in your model.

<Q>: So I assume when you are going to your … process, there is likely to be a little bit of a—you may find some savings in some areas, but that's probably going to be offset by some increased spending to develop and drift over into the new zone. And you can potentially see some increase in exploration spending at San Jose given the success you've had?

Jorge Ganoza – President & CEO
I do not expect an increased spending in exploration because probably something that we will likely be doing is our budget has already some breathing room for drilling and things that we can find, so we will be likely, again, focusing our drilling effort where we're being most successful today and where we can have a better impact in short to medium term. I do not expect increases in our drilling budget, especially at San Jose nor Caylloma at this moment, but in the case of additional development to bring this news on is not material, it's not a material amount. Yes, it cover percent perhaps an increasing cost towards the second half of the year as we start developing these new zones. But again, we already will have enough plant capacity to standard to nil so we should see benefit of higher production as well. So on a cost per ounce basis cost, cost per tonne basis, that should be netted off. The problem is when you start developing and you cannot run it through your mill, or you are developing way ahead production; which have been to us in preparation for the 1500 tonnes per day, but we included that already.

<Q>: And at San Jose, are you still expecting to start paying some cash taxes in 2014?

Jorge Ganoza – President & CEO
Could you repeat that please?

<Q>: When do you expect to start paying cash taxes at San Jose?

Luis Ganoza – CFO
I am sorry, Nick, you question was when do start, we plan to start returning cash to the shareholders, is that what are you telling?

<Q>: When are you expecting to have to pay cash taxes in Mexico for San Jose?

Luis Ganoza – CFO
Okay, I am sorry; probably your line is not the best. The second half of this year we should start incurring taxes at San Jose.

Operator

Our next question comes from the line of Jeff Wright with Global Hunter Securities.

<Q>: I think most have been covered, but just to ask a couple questions on the flexibility you have with capital deployment; if you were to either scale back or postpone some capital initiatives, what's kind of outlined, out of the $22 million, what do you think would be the low hanging opportunities? Would it be with the … or the power grid or camp infrastructure; you know, where do you think that postponement would be?

Jorge Ganoza – President & CEO
One opportunity that we can have is the second phase of the camp facility at Caylloma, for example. Now we are basically concluded the first phase and the second phase is a $3.5 million budget. It has not started yet. We are starting with the preparation of the business process for that and that's certainly some low-hanging fruit. We could defer that …, not at $3.5 million. We have some budget allocations for the reengineering of the … facility for the concentrate at San Jose, which is an area that we postponed already early in the year, but we can have some opportunities to defer a small cost, … small budget there, $300,000 or $400,000. So opportunities like that, and release it always for G&A. I mean that's an exercise we do regularly, but we can abandon—we usually do that mid-year. We are going to be doing it now.

<Q>: Along those lines, from the other questions it sounds like the $7.5 million in exploration in San Jose is very solid. Do you have flexibility around the $6.7 million at Caylloma?

Jorge Ganoza – President & CEO
In Caylloma, we are currently enjoying success with our drilling in the north silver vein system. We should be releasing results, drill results for that program in the coming days. Something that we will be looking with the exploration team … is again opportunities to focus on drilling, but our view on exploration is that some people will look at exploration and the first thing you can cut, and I do not necessarily sign up with that thinking. We are looking at opportunities to increase the average grade of our resources and research right now. And that is the result of two, three years of hard work by our exploration teams to identify these …, discover them, and we are there right now.

I mean if we want to battle off and fend off from a low price environment, well, what you have to do it bring higher grade ore to your resources and research, and that is what we are doing right now and this is not spontaneous generation. This is the work of two, three years of continued work. So we have refocused our work, but I'm very reluctant to just go out there and slash exploration costs. We can still fund exploration and I think that is the best medium long term and the best return we can give to shareholders. We had the cheapest growth, the kind of profitability will come from improved … at our mines; the best returns for our shareholders are there.

Operator
Our next question comes from the line of Paul Heppner with Alameda Capital.

<Q>: My question is, as silver prices continued kind of lag or even drop, in the next two to three years, where do you see growth coming from at Fortuna?

Jorge Ganoza – President & CEO
Currently our Caylloma mine is at a steady state of production. It delivers to us two million ounces of silver, and unless we make a discovery there that can help us to change that production profile, that mine will continue steady state. The bigger

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opportunities are at San Jose Mine today. Again, we have a nominal capacity for 1,800 tonnes per day. That would keep our production profile growing in to 2015, while we see the opportunity to take our production from our … 4.4 million ounces of silver. Our guidance is to take—what I would expect from this nominal expansion taking the plant and operations to 1,800 tonnes per day is that we are able to take our silver production to the 6 million ounce threshold and our gold production to 35,000, 40,000 ounces of gold annually from the current 23 for gold and 4.4 for silver. That will take break over the next two years; 2014, 2015.

Beyond that I believe that there are more opportunities for growth at San Jose, our limited factor into water. We have the rights already and initial solution for the water problem, which is what is allowing us to talk now about nominal capacity, reaching nominal capacity of our plant at 1800 tonnes per day, which is through … operation at a large reservoir that holds the water at our mine. We are moving ahead with an implementation of this solution to control our operation and that will make more water available to us, and that we talk about considerably 2,000 tonnes per day.

Our flat economy has a budget of 1800, so we are going to be scoping expansions to 2000 tonnes per day based on the water we believe we have available from the moment we are running at this moment. So 2013, 2014, 2015 I see the driver for growth being San Jose through expansions that are already taking place and new expansions that are coming and also from the exciting new tonnes that we are discovering and we can swiftly integrate into a production plan. Based on new zones … more ore but ore that has a mineralization that has high year average grade than the existing resources that we search, so we have an impact on the great profile of the mine as well.

<Q>: Do you have any long term kind of projections or expectation for production; either annually or quarterly? And I'm talking about long time like the next four to five years?

Jorge Ganoza – President & CEO
We do not get to your question, I am sorry. Could you repeat, please?

<Q>: Does Fortuna have any kind of expectations or estimates regarding their annual or quarterly production in the next four or five years; like long term production goals?

Jorge Ganoza – President & CEO
Yes, and they are currently in our presentation. We have a production profile page on our presentation. It's public information.

Operator
Our next question comes from the line of Graeme Jennings with Cormark Securities.

<Q>: Hey, guys just want to touch on this expansion up to 1800 tonnes per day. I know you were just touching on this point, about controlling evaporation from the tailings to allow you to go from 1500 to 1800, potentially 2000. I was wondering if you can just expand on that a little bit? I know you had to install that water line to get up to 1500 tonnes per day, and then now are we just controlling evaporation to get to this next lift?

Jorge Ganoza – President & CEO
Yes, basically. The project was originally designed for 1500 tonnes per day, and in the implementation of the project we decided—the mine has never been a limitation at San Jose. The mine, due to its configuration and core and size of reserves and

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resources we believe can do well beyond 2,000 tonnes per day. So the infrastructure of the mine has been designed and built, and I am talking specifically of the underground mine, to allow for this. When we decided to build the 1,500 tonne per day …, we acknowledged that there were opportunities to go beyond that.

So in the implementation phase, we overbuilt to a nominal capacity of 1,800 tonnes per day. Our problem was when we hit the water for this and one was the interconnection of the water pipeline, which we were able to successfully complete, and right now we have a closed water system, where the biggest loss is through our operation as we store water in a large reservoir, which is our tailing facility. So we're implementing a solution which is some standard technology to cover the pond and controlling operation, and that will allow us to have enough water available to grow even beyond 1,800 tonnes per day just looking at water availability.

Right now our models indicate that we could be doing as much as 2,000 tonnes per day with the water we would have available. So in 2013, we're going to be pushing the mine hard to reach nominal capacity this year so we can be at 1,800 tonnes per day by the end of Q3, early Q4, and into 2014 we're going to be working to see how we can accommodate those additional 200 tonnes per day that could allow us to go to 2,000 tonnes per day and optimize the water availability with the size of our operation.

<Q>: And then what about as you go up the next levels, how do you foresee when you're going into higher through put with your grade reconciliation? Can you expect to be able to continue buying in line with you mine plan?

Jorge Ganoza – President & CEO
Basically, what we would be seeing is the acceleration as we go to 1800 tonnes per day and 2000 tonnes per day of work. That's already planned because of the configuration of the mine. The ocean is very compact for San Jose, the entire mineralization, the 5 million tonnes we have in reserves and resources occupy a space that has a longitudinal extent of 450, 400 meters and a vertical extent of 450 meters. So this all acts as the entire body of resources and reserves to one decline and we ventilate the entire area with four ventilation … that we have been already built. We just have to continue deepening, and the integration of these new … that's why we believe can be swift because we can easily branch off from the main decline into these new zone, that will only be some 200 meters away.

In fact, we are already there with drifting to build the drift chambers to accelerate the drilling through underground drilling. So the money would not be an issue. A lot of the capital to be spent is just acceleration of budgets in some instances, and we should be in a position that we can see a short lag between development and production.

Operator
Our next question comes from the line of George Shea with Cicada Investments.

<Q>: You mentioned in the MD&A that the lower house of Mexico voted in favor of a Mexico mining law reform for 5% increase in the tax and it may pass the Senate. What would be the effect of that? Is that a large amount or is it?

Jorge Ganoza – President & CEO
So initially, as we understand today that 5% mining tax on taxable income, we understand as well that this would be deductible for income tax purposes. So the net effect at the subsidiary level would be an additional 3.5 percentage points on the

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effected tax rate. So if you think of the impact on a consolidated basis, we're probably talking within 1.5 to 2 additional percentage points on our effective tax rate.

Operator
Our next question comes from the line of Andy Shelby, a private investor.

<Q>: Two questions for you. Jorge, first, I want to ask you to give some additional color or commentary concerning your expectations for cash cost per ounce of payable silver, net of byproducts, for the rest of the year. Last year they were just under $6 per ounce, we had a discussion about the couple of extraneous factors that caused those costs to rise over 880 in the fourth quarter and where they're here at about 660 for this quarter. Do you have any guidance for us as to how those costs will track in the balance of the year?

Jorge Ganoza – President & CEO
Again, when we analyse cost per ounce, first we need to look at the bigger component of the equation, which is actual cost measured on a cost per tonne basis, and as you can see, cost per tonne has been a very marching line with our guidance at both operations. Now when we look at cost per ounce, we will be subject to … coming from the by-products. 67% of our revenue comes from silver and 14% of revenue is contributed by gold and the balance is made up by lead and zinc. So fluctuations in the price of gold and in this quarter, for example, the fluctuation in the configuration of gold in the equation had a main impact. We purposely refrained from dealing quarterly cost per ounce guidance, because of that reason our guidance has been on cost per tonne basis on a quarterly basis, and with it gives a guidance on cost per ounce for the year because we believe that quarter-on-quarter we are exposed to … variation that is difficult to manage.

Now we can manage our costs, and we can manage our grades, but we cannot manage the price of … byproducts, which go into the equation. So our guidance for the year for silver, for cash cost per ounce, is $6 and change, and again, we do not, I would expect that in a lower price environment for gold—sorry, $5.50 is our cash cost guidance for the year. Cash cost per ounce net of byproducts for the year. I would expect that, if we see a reduction in gold, in the price of gold, we will see an impact on our, that will have an impact on our guidance for cost per ounce.

<Q>: One other question I would like to direct to the Luis, I've noticed over the past couple of years that the share base compensation costs have been jumping around in a very erratic manner, including some quarters in last year, when you had recoveries. I see about 900,000 of share based compensation expense for the first quarter here, you had $1.7 million last year and $3.6 million in such costs in 2011. I would like to understand what the factors are that contribute to that and if you can give us any general guidance on the 2013 share based compensation cost?

Luis Ganoza – CFO
Yes. The guidance based on our existing stock option plans and divesting schedule is in the range of $3 million for 2013. The reason for the volatility has to do with certain outstanding share based instruments, and particularly these are used as our mark-to-market. So, in particular with respect to Q1 of 2012, we saw a sharp drop in the share price and that explains the credit I mentioned, $0.3 million recorded for the quarter, right. So there is unfortunately a bit of volatility coming from mark-to-market of, as I mentioned, particular certain instruments outstanding.

<Q>: Is that's likely to continue in the current year as well?

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Luis Ganoza – CFO
Yes, those instruments are still outstanding, and as long as there is volatility in the share price, that will get reflected on the share based statement line item of our income statement, but again, outside of that effect the guidance is $3 million for the year.

<Q>: Once again, I would like to request or remind you of the interesting meeting with either of you on a future trip into New York. I know I haven't heard anything last couple of months, so if …?

Jorge Ganoza – President & CEO
We will follow-up on that.

Operator
Mr. Baca, there are no further questions at this time. I would like to turn the floor back over to you for closing comments.

Carlos Baca – Manager, Investor Relations
Yes, to our last caller, do you mind sending us an email at info@fortunasilver.com please with your details so we can follow-up on New York? I'll contact you personally. Thank you very much.

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 quarter. Thank you very much and have a very productive day. Stay well.

Operator
This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.