Transcript of
Fortuna Silver Mines
Second Quarter 2013 Earnings Call
August 13, 2013

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Participants

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

Analysts

Benjamin Asuncion – Haywood Securities
Nicholas Campbell – Canaccord Genuity
Chris Lichtenheldt – Dundee Capital Markets
Chris Thompson – Raymond James

Presentation

Operator
Greetings, and welcome to the Fortuna Silver Mines' Second 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. (Instructions given.) As a reminder, this conference is being recorded.

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

Carlos Baca – Fortuna Silver Mines – Investor Relations Manager
Thank you, Operator. Good morning, ladies and gentlemen. I would like to welcome you all to Fortuna Silver Mines and to our second quarter financial and operations results call. Jorge Ganoza, President and CEO; and Luis Dario Ganoza, Chief Financial Officer will be hosting the call from Lima, Peru.

Before I turn over the call to Jorge, I would like to indicate that certain information contained or incorporated by reference in this earnings call, including any information as to our strategy, projects, plans, or future financial or operating performance, constitutes forward-looking statements. All statements other than statements of historical fact are forward-looking statements; the word "believe", "expect", "anticipate", "contemplate", "target", "plan", "intend", "continue", "budget", "estimate", "will", "schedule", and similar expressions identify forward-looking statements.

Forward-looking statements are entirely based on a number of estimates and assumptions that, while considered reasonable by the company, are inherently subject to significant business, economic and competitive uncertainties and contingencies. Known and unknown factors could cause actual results to differ materially from those projected in the forward-looking statements. We disclaim any

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intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events, or otherwise, except as required by applicable law.

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

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
Thank you, Carlos, and good morning to all. I'm joined on the call today by Luis Ganoza, 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 second quarter of the year, and the three-year outlook. Once concluded, we will address your questions.

Our mines in Peru and Mexico recorded strong production and cost figures in the quarter in line with annual guidance. Silver produced was 1,074,000 ounces and 5,183 gold ounces. Compared to Q2 2012, silver is up 8% and gold down 11%. The company is on schedule to achieve its production guidance for 2013 for 4.5 million ounces of silver and 23,600 ounces of gold or 5.9 million silver-equivalent ounces.

Silver accounted for 64% of sales; gold, 16%; lead and zinc accounted for 20%. Our realized silver price for the quarter was $22.97 per ounce and $1,397 per ounce for gold. This was 21% and 13% lower respectively when compared with Q2 2012.

We met and even improved on cost guidance for the quarter. Recorded cash cost per tonne at Caylloma was $93.34, or 4% below guidance. At San Jose, we recorded $77, or 2% below guidance.

Cash cost per ounce net of by-product credits at Caylloma and San Jose was $8.80 and $6.50 respectively. The consolidated figure for cash cost per ounce net of by-products is $7.58 for the quarter.

Management has moved to implement a series of measures to ensure the company enhances free cash flow and is well positioned in the current price environment. The main four initiatives include; one, streamlining of corporate overhead. We have obtained an annual reduction of 33% or $5.5 million in expenses. This includes a 33% reduction in corporate headcount.

Two, focus on critical path and sustainability projects at our mines. Here, we have obtained a 24% reduction of $12.6 million in our 2013 guided capital budget, taking it down to $40.1 million. Of the $12.6 million in reductions, Caylloma reductions represent $12.1 million, mainly coming from: 1) costs of $3.6 million in camp infrastructure; 2) $3.1 million in power infrastructure; 3) $2.4 million in mine development; and 4) $2.3 million in plant improvements. At San Jose, capital savings account for half a million coming mainly from savings in the plant expansion and some reductions in mine development.

Due to the investments in exploration, mine development and infrastructure of our mines over last years, we're in a comfortable position that allows us to tighten our capital budget at both mines for the period of 2014-2016. For the three years, we are projecting average sustaining capital budgets of $8 million and $13.5 million at Caylloma and San Jose, respectively.

Three, focus on high-reward targets within Brownfield's explorations. The restructuring of our 2013's budget, under this guideline, has allowed us to cut $3.7

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million or 26% of the 2013 exploration. We have ceased drilling at Caylloma for the second half of the year; and at San Jose, we're only focusing on drilling the extension of the Trinidad North high-grade discovery with 5,300 meters in the revised budget.

Four, drive cost reductions at our operations. At Caylloma, we're planning for a reduction of operating costs of 8% or $1.7 million for the second half of the year. This brings cash cost per tonne down to approximately $88 per tonne for Q3 and Q4, compared to the original 2013 guidance of $95 per tonne.

The main drivers for the plan: reductions in cost are at $1.60 per tonne in mine preparations; $0.70 per tonne at the mill; and $3.90 per tonne in indirect costs, mainly training, consulting, and some services; and $2.20 per tonne in distribution costs, mainly transport of concentrates and we're changing service provider as well.

For the period 2014-2016, we're projecting annual cash costs at approximately $85 per tonne. At the San Jose mine, we're not revising cost guidance at this moment as we're not concluded with our internal review, but we can advance that an 11% reduction in headcount has been approved. As a result of headcount reductions at corporate and subsidiary, roughly a 12% reduction in overall company headcount, the company is expecting the main impact of severance costs to be recorded in Q3 with a projection of half a million dollars.

We are reporting for the first time in this quarter an all-inclusive sustaining cash cost per silver ounce figure net of by-product credits for each of our mines and the consolidated figure as well, under the guidelines of the World Gold Council. We believe the all-inclusive sustaining cost numbers will be helpful in assessing the ability of our mines and business to generate free cash, particularly important in the current price environment.

For 2013, we're guiding for a consolidated all-inclusive sustaining cash cost per silver ounce metal by-products of $20.50. This reflects a capital-intensive 2013 in both our mines. For the three-year period of 2014-2016, we project the same average annual figure of approximately $13 per ounce. This encompasses the capital and cost reducing measures previously discussed. Management will be reviewing the price environment closely and making adjustments to its projects as required.

At San Jose, we're planning to commission the mill expansion to 1,800 tonnes per day this month of August. We're currently in the process of testing the mill with its full load and concluding piping and electric installations. All major equipment has been installed already. The mine is scheduled to feed fresh mine ore at 1,500 tonnes per day in August, and expand to 1,800 tonnes per day by November. We're looking to find opportunities to accelerate the ramp-up to 1,800 tonnes per day.

On the exploration front, we will be releasing additional grid results for Trinidad North in the coming days. Drilling has stopped and is looking to resume in September from underground stations being developed.

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

<u>**Luis D. Ganoza – Fortuna Silver Mines – Chief Financial Officer**</u>
Thank you. We recorded a net loss for the quarter of $10.6 million driven by an impairment charge at the Caylloma mine in Peru. The minor impairment was $15 million before tax or $10.2 million after-tax out of our current book value for Caylloma of $87 million.

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The impairment is a consequence of a sharp decline in the silver price in the past few months, which in the context of the rising operating costs we have seen accumulated at Caylloma over the past three years or so has impacted the economics of our Peruvian operation.

We will reassess this figure at yearend, as is expected. In particular given by then, we will have an updated research estimate, and we should be in a better position to incorporate into our assessment the proposed reductions in operating costs.

We have also reported adjusted net income of $0.1 million. Let me rectify that—an adjusted net loss of $0.1 million after adjusting for the impairment charge and the write-off of mineral exploration projects we made to our San Luisito property in Mexico.

Silver sold in the period in terms of ounces was 10% above 2012 on the back of strong production; although, gold was down 15%. Realized prices for silver and gold in our provisional sales in the period, however, were down year-over-year by 22% and 14%. In addition, we recorded $5.2 million of sales adjustments related mainly to a deep decline in the silver price throughout the quarter. The result of this was a drop in sales year-over-year of 22%.

Our mine operating earnings fell by 62% to $6.5 million, mainly driven by the sharp drop in sales. Unit cash cost per tonne of processed ore in our operations, as Jorge mentioned, was in line with guidance; however, above the prior period by 9% at the Caylloma mine and 16% at the San Jose mine.

Our cash flow statement for the first six months of the year, we generated net cash from operations of $22.4 million and consumed cash in investments of mineral properties, plants, and equipment of $39.8 million, which includes a $10 million payment for the acquisition of the Taviche Oeste concession in Mexico. The total reduction in cash from the balance at yearend 2012, excluding net movements of short-term investments, was of $16.3 million for a total balance at the end of Q2 2013 of $48.4 million, including short-term investments.

Carlos Baca – Fortuna Silver Mines – Investor Relations Manager
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 Benjamin Asuncion with Haywood Securities. Please proceed with your questions.

<Q>: Good morning, guys. Thank you for taking my questions. I just want to clarify a few points here. First, I guess with San Jose and the ramp-up, any comments? Is the ramp-up going as expected, because I thought we were looking for the mine to be producing 1,800 tonnes per day by November, and I believe I read in the MD&A that now we're looking at the first quarter of next year?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
No. The MD&A indicates November. We are expecting to commission then the expansion. The mill should be ready to accommodate 1,800 tonnes per day through the course of this month of August. The mine should be in that position to source fresh ore at 1,500 tonnes per day starting late August, and we should be in a position to feed fresh ore at 1,800 tonnes per day in November.

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<Q>: Alright. Perhaps, you can just clarify the 29,000 tonnes of stockpiled ore; could you give us a sense of the grades?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
I'm sorry.

<Q>: The 29,000 tonnes of stockpiled ore you had mentioned, can you give us a sense of what the grades of that ore are?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
The grade of the ore we have stockpiled in Mexico comes mainly from development and lower-grade production zones that we have stockpiled mainly from the upper zones of the mine. I do not have the grade on top of my head here, Ben, but it's lower than the average grade of reserves. We should be in a position to source that ore to the mill. Worst case scenario, we have a large stockpile, but we are confident that the mine will be in a position to source 1,800 tonnes per day starting—maybe the second to fourth quarter.

<Q>: Okay. Just lastly, the timing of the maiden resource at Trinidad North?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
Of the new resource estimation of Trinidad North?

<Q>: Yes.

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
October.

<Q>: October. Okay. Just one thing to clarify, I guess maybe from Luis here. With respect to the negative $5.2 million adjustment in revenues or provisional sales, can you give a breakdown of how much of that was revisions on Q1 sales that were closed during the quarter versus how much over mark-to-market adjustments at the end of the quarter?

Luis D. Ganoza – Fortuna Silver Mines – Chief Financial Officer
Yes. First of all, we disclose that out of $5.2 million, there's a $1.6 million amount that is non-related to price adjustments, but rather add to adjustments, and mostly related to sales from 2012. Out of that remaining amount, the adjustment corresponding to sales that actually took place in previous quarters is around $1.2 million, and the actual mark-to-market of June at the price—at the end of June was lower and the average price of June is around $800,000.

<Q>: Perfect, so we should see that come back though in the third quarter, so there's a positive revision should metal prices sustain above that $18 level at the end of June, right?

Luis D. Ganoza – Fortuna Silver Mines – Chief Financial Officer
Yes. With respect to a mark-to-market, yes, and I also believe that the current prices are above the average price of June as well, so we should see a version of that to a degree of those final adjustments.

<Q>: Okay. The last question, just maybe, Jorge, there were some comments in the notes there with respect to Caylloma guidance going forward, sort of over that three years and lower cash cost guidance due to the higher proportion of base metals. Does this have any impact on your silver production guidance then from Caylloma?

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Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
No. Ben, we continue to add roughly 2 million ounces of silver annually at the Caylloma mine up until, you know, midrange plan to 2016.

<Q>: Okay and what would be the cost per tonne guidance that's baked into those 2014 to 2017 numbers? Would you be able to provide them by mine?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
Yes. We're guiding roughly $84 or $85 at the Caylloma mine for the period 2014-2016; and at San Jose, for the same three-year period, roughly $65 per ounce, or per tonne. I'm sorry, $65 per tonne. Those are the cost figures that go into our all-inclusive cash cost estimate that we provided in the MD&A and news release.

<Q>: Perfect. Thank you. I'll hop back in the queue and let other people ask some questions. Thank you a lot, guys.

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
Thank you.

Operator
Thank you. Our next question comes from the line of Chris Lichtenheldt with Dundee Capital Markets. Please proceed with your question.

<Q>: Good morning, everyone. I just wanted to ask, going back to your all-in sustaining cost of around $13 over the next few years, you indicated there's some savings on cost per tonne that are helping to bring that number down and lower capital spending. Is there also some element of high grading in that or are there changes to the mine plans that you're making in order to help reduce that cost per ounce?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
The short answer is no. We continue moving ahead with our mine; the Caylloma mine is centered on an area, on the central portion of the Animas vein, where we have a concentration of production areas. We have been working there for a number of years now. We have good services in terms of [indiscernible] field infrastructure, power infrastructure, so we will continue mining there and let the natural sequence of the mining and mining plan for Animas and Caylloma, so there are no material changes to the plan.

San Jose is a new mine. It's a well-defined mine on a very small area. The entire San Jose resource and reserves occupy an area that extends 500 meters longitudinally and roughly 450 meters vertically. Now, with the Trinidad North discovery, we're looking to extend that, but the mine is well concentrated and it's just following its natural sequencing as we laid it out in the original plan.

<Q>: Okay. That's helpful. I don't have all the numbers in front of me, but I seem to remember thinking that Caylloma was currently mining above reserve grade and that we would expect a natural decline in grade. Is that true to your recollection?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
Well, certainly what we will see in the second half of the year is a new resource reserve estimate, where we would expect a change in the types of our reserves and the resources due to the new price assumptions that we'll likely be using, so we would expect shorter reserve life with higher grades just as a natural consequence of pricing,

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but based on the current research, we review our mine plan constantly and when we see that concentration of reserves in the current area of mining, you know? So, that's why I am saying that we're not seeing a change or main deviation from the original life of mine or five-year plan that we use at these mines.

<Q>: I see. Okay, so we're coming across higher grades anyway and your reserve update may take out some of the lower grade ounces that were going to be coming later in the mine life anyway. Is that fair?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
Yes. Probably we'll see some significant shrinkage in deferred resource or the inability of some of the inferred to be brought into reserves so taking part in the incurred or measure indicated. We do expect and I think the impairment that we're taking right now is an indication of what we expect to see with the reserves at Caylloma.

<Q>: Okay. Is there any guidance you can give in terms of what the grade uplift might be like next year? I mean, are we talking 10%/20%?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
You know, our current mine plan, again, it stays very closely to what we're currently mining in terms of head grades, because Caylloma does not show significant variation in terms of silver. We are going deeper in Animas, so we are expecting to see some higher base metals and that is contributing also to bring cost per ounce lower in our forecast, but mainly in terms of silvers, grade remains basically close to what the levels we're seeing to [indiscernible] you know?

Luis D. Ganoza – Fortuna Silver Mines – Chief Financial Officer
Yes. I believe, this is Luis, it would also be relevant to add or complement to what Jorge has said that the higher base metal grades are incorporated into that forecast or cash flow per ounce for a three-year period takes place mostly in the later part of that three-year period, yes?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
That is just mining in the Animas vein and it concentrates on the deeper levels of the current production so no-tier levels 12 mainly, no, 11 to 12.

<Q>: Okay. That's very helpful. Then, just lastly on Trinidad, you said we'll get an initial resource in October. When would we expect drill results from your new underground drill station?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
We plan to restart drilling from the underground in the month of September, so I would expect before yearend we start seeing results. If we start drilling in September, we'll likely see results in November, December. We have a budget of a little over 5,000 meters of which close to 3,000 are for underground drilling. Again, the aim of the underground program is to push the exploration further to the north where we currently show the highest grades in the discovery zone.

<Q>: Great. Okay, that's it for me. Thank you a lot.

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
Thank you.

Operator

Our next question comes from the line of Nicholas Campbell with Canaccord Genuity. Please proceed with your questions.

<Q>: Hello, guys. I'm just wondering on the reserve financing, I think you're using 1,500 or $50 per ounce gold and about $28 per ounce silver. Where do you think you're going to be going with your own silver price assumptions in your reserve calculations going forward?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
That's a tricky question. I would say we're still in that process, Nick, and we will certainly be looking to be more conservative than last year, but any further [indiscernible] in terms of prices from the time of a drop in silver we saw this year will also help get a better sense of direction moving forward, so we still have, I guess, at least a month until we have to make that decision, but we're still in the middle of that process.

Luis D. Ganoza – Fortuna Silver Mines – Chief Financial Officer
We look for what you guys put out that is long-term prices.

<Q>: Okay. Alright. Fair enough. I think actually most of my other questions have been answered, so I'll let somebody else ask a question. Thank you, guys.

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
Thank you for the question.

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

<Q>: Good morning, guys. Thank you for the opportunity of asking questions. Two quick questions, one on San Jose, just looking at some of the grades I guess released in the Q2, are we—just remind me again, are those sustainable into the near-term at San Jose?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
Yes. The short answer is yes. We are projecting similar grades and in fact slightly higher as the grade profile of the mining improves with that, but in the same range; no material change.

<Q>: Okay. Great. Then, as far as Trinidad North, so we're anticipating some results, I guess, the next couple of days, you mentioned earlier. When is the cutoff as far as drill results required for the up and coming resource estimate?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
You know, we're trying to manage—we're managing the Trinidad North discovery in a way that separates from the current inferred resources and the currently reported inferred resources and reserves. What we expect is that the bulk of the resources that were in Trinidad North will be likely in the inferred category.

You know, the area that we have been able to drill or put holes into is not a large area right now, but we have anyhow decided to go ahead and produce a resource estimation that even though will likely provide most of the resources in the inferred category will allow us as we are currently mining there—you know, we have a good operator feeling, if you will, will allow our mine planners to start working on their

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projected infrastructure and plans, and we can start playing with those figures in our mine models, so that is the reason why we're moving ahead.

You know, if we need to—what we do at Fortuna if we have a cut date for resources of roughly June, July 20—midyear, as a cut date for resources and then we have a date for completion by yearend. You know, if we need to update the resource estimation for Trinidad North at any given time due to results, we will independently from the entire inventory of the main [indiscernible]. I don't know if that is what you were asking, Chris?

<Q>: Yes. No, that's fair enough. Just a—sorry—final quick question; how is the water situation at San Jose at the moment?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
You know, the water situation is good and sustainable. We have a large capital project at San Jose next year. If you look at the three-year all-inclusive cash cost guidance we are providing, you will pick up that San Jose does carry a figure that is particularly high, for example, compared to Caylloma. The reason for that is that next year we have a $12.5 million budget allocated at San Jose for the expansion of the tailings and the main reason for that is not just holding tailings, but also holding water.

You know, we continue with our plan. We do not have any water issues right now. We are also moving with implementation of operation control technology, a solution to control the operations to help us enhance water availability, but basically everything is within our plan. We do not have any issues with water availability at this point. We're connected now to a water treatment plant. We're sourcing water from there or have enough holding capacity to capture rainfall as the plan calls for. We're controlling our operations, so all of that is good and according to plan, Chris.

<Q>: Good. Thank you. Thank you a lot, guys.

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

<Q>: Thank you. Two questions; the first for Luis, how have your cash flow expectations for this year changed from where you were at the beginning of the year?

Luis D. Ganoza – Fortuna Silver Mines – Chief Financial Officer
Well, certainly the prices from the early part of the year, we were expecting to maintain a similar total cash balance as geared towards yearend compared to the beginning of the year in spite of our strong CAPEX commitments in 2013. What we've done in our outlook station, if you've noticed, is we provided an estimate of our cash balance at yearend, which takes into account our reductions in capital budgets, our reductions, projected reductions in operating costs and considers an $18 silver price for the second half of the year and a $1,200 gold price. What we are projecting is around $43 million of total cash position towards the end of 2013.

Now, moving forward, it becomes evident from our all-in cash cost forecast for period 2014-2016, we would expect even at current price levels to be at a capacity to generate cash surplus moving forward.

<Q>: Okay. One other question here for whoever wants to answer it; given the current mine plan—and I realize we can't talk about absolute numbers—but I'm looking more for direction and a general sense of how the percentage of sales going

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forward is likely to shift given the increased output from the expansion of the mill and in San Jose. Right now, we're doing 64% of the revenue from silver, 16% gold, lead/zinc about 20%. I assume that those relationships will be fairly similar for the balance of the year, but I'm really trying to get a sense for what the impact of San Jose is likely to be in 2014 in terms of increased gold. I know it depends on prices and other factors, but again, if you can give me some sense of what the company expects its percentage of metals contributions to be to revenue moving forward?

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
Yes. We can give you a precise figure probably in a moment, but in general terms, the percentage of silver contribution for San Jose has pretty much remained the same. For Caylloma, at current silver prices, we would expect the revenue composition to change, where silver was up the first quarter of this year contributing around 60% to 65% of revenue, at Caylloma, again. At $18 silver, we should see that contribution come down to around 50%, so that will have an impact on our consolidated revenue composition as well.

<Q>: Yes, again, I'm trying to get a sense of whether or not you're in a position today to talk about how 2014, based on current mine plan production, might look in terms of consolidated silver, gold, lead/zinc revenue contributions.

Luis D. Ganoza – Fortuna Silver Mines – Chief Financial Officer
Yes, yes. I don't have a figure at this very moment, but before the end of the call, we can certainly provide an answer. In general terms, again, on a consolidated basis it has been around 65%. As San Jose contributes a larger portion of our total revenue, it should offset the lower contribution of silver coming from Caylloma. Again, let us provide a figure in the next half a minute or so, but we should expect to see it come down somewhat.

<Q>: Silver?

Luis D. Ganoza – Fortuna Silver Mines – Chief Financial Officer
Yes. The position from silver, from 65% we would expect to see it come down somewhat in 2014. As we continue over the call, I should be able to give you an answer.

<Q>: Good. Thank you. Those are my questions.

Luis D. Ganoza – Fortuna Silver Mines – Chief Financial Officer
Okay.

Operator
Thank you. We have no further questions at this time. I would like to turn the call back over to management for closing remarks.

Jorge A. Ganoza – Fortuna Silver Mines – President & CEO
Well, I'd like to thank everybody for joining us this morning and we had a pending answer that I think we can get back to the caller and provide the figures.

Carlos Baca – Fortuna Silver Mines – Investor Relations Manager
Thank you, Jorge. 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

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

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