FORTUNA
SILVER MINES INC.

DELIVERING GROWTH CREATING VALUE

2012 ANNUAL REPORT

Our Vision

To be valued by our workers, the community and our shareholders as a leading silver mining company in Latin America.

Our Mission

To create value through the growth of silver reserves, metal production and the efficient operation of our assets with a commitment to safety, social and environmental responsibility.

Our Values

We value the health and safety of our workers: We do not tolerate unsafe acts or conditions

We value the environment: We subscribe to the highest environmental standards

We value our neighbours and other stakeholders: We respect cultural diversity and work as a strategic partner towards the sustainable development of neighbouring communities

We value the commitment to excellence: We achieve high standards and best practices

We value integrity: We act according to our philosophy

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This annual report contains forward-looking statements. Please refer to the cautionary language under "Cautionary Statement on Forward-Looking Statements" on page 61 of the Management's Discussion & Analysis.

Fortuna Silver Mines Inc., one of Latin America's fastest growing silver producers, aims to become one of the leading silver miners in the Americas. Established in 2005, we are poised for sustainable growth with two, 100 % owned underground operating silver mines and extensive property holdings in Peru and Mexico.

Our annual production rate is forecast to reach approximately five million ounces of silver and 26,000 ounces of gold, plus base metals, by third quarter of 2013. Ongoing brownfields exploration programs on our 95,000 hectare land package offer attractive opportunities for driving organic growth.

The company employs over 2,000 people in Canada, Mexico and Peru. Our common shares trade on the New York Stock Exchange (FSM), Toronto Stock Exchange (FVI), Bolsa de Valores de Lima (FVI) and Frankfurt Stock Exchange (F4S.F).

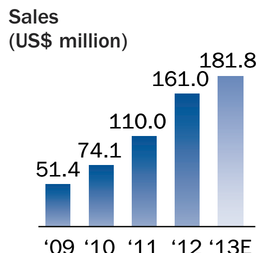
San Jose Mine, Mexico

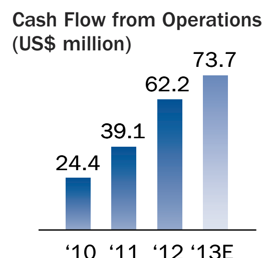
DELIVERING GROWTH CREATING VALUE

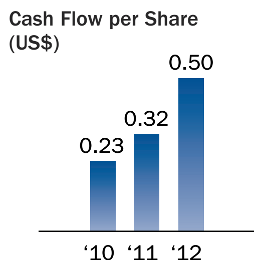
In 2012, Fortuna delivered its sixth consecutive year of record silver and gold production, exceeding its guidance by 8 % and 19 %, respectively. Revenue, net income and cash generated by operating activities also reached record levels. With efficient, low-cost operations and a strong balance sheet to support its disciplined growth strategy, the company is better positioned than at any other time in its history to create long-term value for our shareholders.

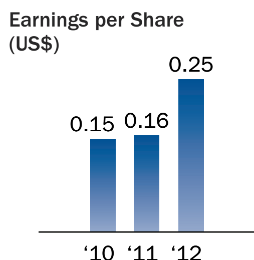
Sustainability is central to our operations. We are committed to ensuring the health and safety of our personnel, subscribing to the highest environmental standards and respecting our host communities.

We believe responsible corporate citizenship results in greater operational effectiveness – minimizing risks and contributing to the creation of sustainable value for all stakeholders.









Performance Growth

Production, cash flow and earnings increase for the sixth consecutive year

2012 Highlights

Annual financial and operational performance

- Sales increase US$51.0 million or 46 % to US$161.0 million
- Cash cost per silver ounce of US$5.96 per ounce, net of by-product credits for gold, lead and zinc
- Net income grows US$12.0 million or 62 % to US$31.5 million
- Cash generated by operating activities rises US$23.1 million or 59 % to US$62.2 million
- Basic earnings per share increases US$0.09 or 56 % to US$0.25
- Silver production increases 1.5 million ounces or 60 % to 4.0 million ounces
- Gold production increases 13,684 ounces or 195 % to 20,699 ounces
- Inferred resources increased by 38 % in contained silver and 26 % in contained gold

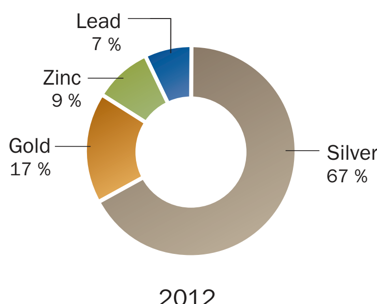
Community and environment

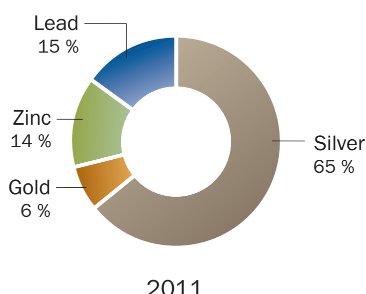
- Implemented various economic development programs in San Jose del Progreso, Mexico, to support local artisans, mine contractors and suppliers
- Started construction of sport and community arena in Caylloma, Peru, that will benefit over 5,000 residents when completed in July 2013

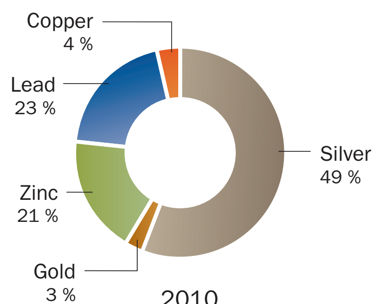
Capital Share Structure

As of April 16, 2013	
Issued and Outstanding	125,305,166
Options	6,067,474
Fully Diluted	131,372,640

Sales by Metal







2012 Performance Chart

	2012			2011			2010
Processed Ore	**Caylloma Mine**	**San Jose Mine**	**Consolidated**	**Caylloma Mine**	**San Jose Mine**	**Consolidated**	**Caylloma Mine**
Tonnes milled	462,222	369,022		448,866	125,301		434,656
Average tpd milled	1,266	1,055		1,272	949		1,231
Cash cost (US$/oz Ag) [1]	8.07	3.76	5.96	(0.78)	4.69	0.25	(5.99)
Silver							
Grade (g/t)	177	188		171	144		159
Recovery (%)	77	88		81	85		86
Production (oz)	2,038,579	1,949,178	3,987,757	2,008,488	490,555	2,499,043	1,906,423
Realized price (US$/oz) [2]			30.91			34.83	20.09
Net realized price (US$/oz) [3]			27.40			31.09	18.18
Gold							
Grade (g/t)	0.40	1.74		0.36	1.36		0.40
Recovery (%)	47	87		46	85		46
Production (oz)	2,781	17,918	20,699	2,393	4,622	7,015	2,556
Realized price (US$/oz) [2]			1,648.83			1,631.39	1,227.52
Net realized price (US$/oz) [3]			1,295.32			1,179.90	921.00
Lead							
Grade (%)	1.99	–		2.15	–		2.44
Recovery (%)	88	–		93	–		91.28
Production (000 lbs)	17,886	–	17,886	19,677	–	19,677	21,373
Realized price (US$/lb) [2]			0.94			1.10	0.98
Net realized price (US$/lb) [3]			0.63			0.86	0.79
Zinc							
Grade (%)	2.56	–		2.68	–		3.10
Recovery (%)	85.77	–		88	–		88
Production (000 lbs)	22,396	–	22,396	23,424	–	23,424	26,137
Realized price (US$/lb) [2]			0.88			1.00	0.98
Net realized price (US$/lb) [3]			0.66			0.66	0.60
Copper							
Production (000 lbs)	–	–		–	–		1,026

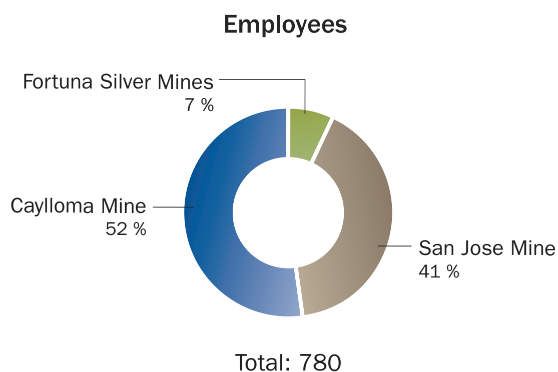
[1] *Net of by-product credits*

[2] *Based on provisional sales before final price adjustments*

[3] *Net after payable metal deductions, treatment, and refining charges. Treatment charges are allocated to the base metals in Caylloma and to gold in San Jose*

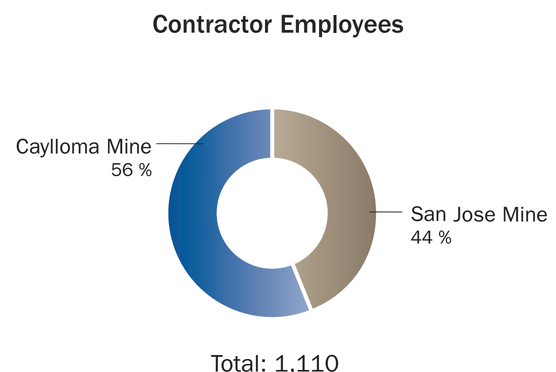
2012 Head Count

Employees



Total: 780

Contractor Employees



Total: 1,110

Jorge A. Ganoza
President, CEO and Co-founder

Chief Executive Officer’s Letter

Dear shareholders,

I am pleased to report that Fortuna’s production, cash flow and earnings increased for the sixth consecutive year in 2012—keeping us well on track to achieving our vision of building a leading silver mining company in the Americas. To this end, we continue to focus our energy and resources on operational excellence, brownfields exploration and implementing a disciplined long-term growth strategy.

Our current financial resources and talented management team ensure that we can face the challenges of growing our business and creating sustainable value for our stakeholders. For that reason, I remain confident in our ability to achieve our strategic objective of producing at an annual rate of 14 million silver equivalent ounces by 2016, while maintaining cash operating costs below the industry average.

We are better positioned than at any time in the company’s history to face the challenges of growing our business and creating sustainable value for our stakeholders.

Operational excellence

Consistent operational excellence at our mines over the past five years has positioned Fortuna among the industry’s lowest-cost silver producers.

In 2012, our consolidated cash cost per ounce of silver was US$5.96, net of by-product credits, or 41 % below the industry average of approximately US$10.04. Throughout the year, we continued to capitalize on opportunities to increase production at the San Jose Mine, resulting in silver and gold production exceeding annual guidance by 8 % and 19 % respectively.

For 2013, we expect silver and gold production to continue to grow, as throughput capacity at San Jose increases 50 % to 1,500 tpd upon completion of our mill expansion project. We expect this project, which is scheduled for commissioning in the third quarter of 2013, to also lower operating costs.

Recognizing that our stakeholders have a keen interest in our operational performance for the coming year, we are, for the first time, providing cost and capital expenditure guidance for 2013.

Many of the cost pressures we face are the result of external forces. In Peru and Mexico, shortages of experienced technical staff and contract services have persisted for the past four years, creating operating challenges throughout the entire industry. Recently however, we have witnessed an easing of cost pressures associated with these shortages, and expect this trend to continue in 2013. Within Fortuna, we have implemented our own initiatives to

mitigate industry cost pressures. We are offering competitive retention plans for key positions, we've reduced the number of mine contractors we employ and we've begun using lower-cost ammonium nitrate explosives.

For 2013, we forecast that cash costs per tonne at San Jose will decrease by about 5 % following the mill expansion. At Caylloma, we expect cash costs per tonne to increase by approximately 10 %. Capital expenditures, meanwhile, are expected to begin to decline, as Fortuna emerges from a period of intense capital expenditure activity that began with the construction of the San Jose Mine in 2010. Capital expenditures in 2012 at both mines were US$31.1 million. For 2013, our capital budget is US$52 million, which includes the San Jose expansion and three one-time infrastructure projects at Caylloma.

Starting in 2014, we expect annual capital requirements at Caylloma and San Jose to drop closer to sustainable levels of approximately US$20 million to US$25 million. Fortuna is positioned to self-fund all foreseeable capital expenditures.

Brownfields exploration

In addition to the ever-increasing production at both of our mines, since 2005, we have been steadily building Fortuna's reserve and resource base. Today, we project a mine life beyond eight years at both operations, based on reserves of approximately 50 million silver equivalent ounces.

In 2012, we continued to capitalize on brownfields exploration opportunities, completing more than 40,000 meters of diamond drilling in an exploration program totaling US$13 million. The highlight of this program was the discovery at San Jose of a wide, high-grade extension of the Trinidad-Bonanza ore shoot, Trinidad North. This mineralization is open to the north and at depth, offering the opportunity to add high-grade resources in the immediate area of the mine.

For 2013, our US$14 million budget for brownfields exploration includes over 50,000 meters of diamond drilling. At San Jose and Caylloma our exploration teams will pursue new zones with aggressive drill programs throughout the year.

Project pipeline

In August 2012, Robert Brown joined Fortuna, assuming the newly created position of Vice President of Corporate Development. With more than 20 years of industry experience, he will play a key role in implementing our growth strategy. Our goal is to acquire attractive pre-development stage silver-gold projects in the Americas that will add low-cost production, enabling us to reach our objective of producing at an annual rate of 14 million silver equivalent ounces in 2016. We will, as always, follow a disciplined approach, favoring Peru and Mexico, countries where we have well-established presence and infrastructure.

With annual production forecast to grow 9 % to 5.7 million silver equivalent ounces in 2013, a commanding land position of more than 95,000 hectares and re-energized merger and acquisition efforts, we are well equipped to reach our goal through organic growth and acquisitions.

We continue to work collaboratively with communities in Mexico and Peru to establish programs that will benefit the local population and protect and preserve the environment.

"Fortuna supported us in the building of water reservoirs, which has improved the quality and quantity of our harvest. Both of our sons are employed by the mine."

Epifanio Gonzalez Ramirez and Carlos Gonzalez Ramirez
San Jose del Progreso farmers, Oaxaca, Mexico

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Sustainability

Since Fortuna's establishment, our Board and management have maintained that our bottom line results are second to our core values of ensuring the health and safety of our workers, complying with the highest environmental standards and conducting ourselves responsibly in our host communities.

It was, therefore, with great regret that we reported the death of a contract driller at San Jose in January 2013. Our entire organization mourned this tragic loss. As part of our standard procedures, a thorough independent accident investigation was conducted. We have further strengthened safety procedures companywide, as recommended by the investigation. I am confident that these improvements, together with our long-standing efforts to encourage a safety-first culture, will ensure this accident is an isolated event.

I pay tribute to our most valuable asset – our employees – the more than 2,000 women and men who work together every day in Peru, Mexico and Canada to fulfill our vision and mission.

With respect to our community development activities, we continue to collaborate with communities in Mexico and Peru to establish programs that will benefit the local population and protect and preserve the environment. Working with local stakeholders, our community relations and environmental departments completed two important projects in 2012:

- In Ocotlan de Morelos, Mexico, we completed a water pipeline project connecting the town's grey water treatment plant with the San Jose Mine. The project, which included renovating a sewage treatment facility, now provides 20 % of the mine's industrial water. Most importantly, the upgraded treatment plant has eliminated the discharge of raw sewage into a nearby creek and improved living standards in the community.
- In Caylloma, Peru, we are working with the community to build a town hall. The meeting facility will allow community gatherings, sport and cultural events to take place indoors in a town exposed regularly to extreme weather at over 4,500 meters above sea level.

In closing, I pay tribute to our most valuable asset – our employees – the more than 2,000 women and men who work together every day in Peru, Mexico and Canada to fulfill our vision and mission. I thank everyone for their great work and commitment. It is gratifying to note that the investment community continues to recognize the strength and performance of our operating teams as among the best in the industry.

I also thank you, our shareholders, for the confidence you place in our company. I look forward to reporting on our continued growth.

Jorge A. Ganoza
President and Chief Executive Officer

"Being from Caylloma, the mine gives me the opportunity to work. Like my fellow townspeople, we work hard to bring progress to our town, especially our families."

Marleny Infa Mercado
Caylloma community member, Arequipa, Peru

I believe Fortuna has put in place the right ingredients necessary to build a great mining company: an experienced and talented leadership team, an effective growth strategy and attractive mineral properties.

Simon Ridgway
Chairman of the Board and Co-founder

Chairman's Letter

To our valued shareholders,

We continue to make gratifying progress toward our goal of building Fortuna into one of the leading silver mining companies in the Americas. Since placing our first mine, Caylloma, back into production in 2006, we have grown silver production every year and have been profitable since 2009. Last year, in 2012, Fortuna recorded the best operating performance in its eight-year history, achieving record annual production, revenue and cash flow.

I believe Fortuna has put in place the right ingredients necessary to build a great mining company: an experienced and talented leadership team, an effective growth strategy and attractive mineral properties with the potential to support low-cost, long-life mines. Importantly, we also have the financial resources to execute our strategy and build on our successful track record of growth and profitability. At year-end, Fortuna had cash and short-term investments of US$65 million, no long-term debt and an un-tapped US$40 million credit facility.

Unpredictability and uncertainty are everyday factors in our business. As mine operators, we have no control over metal prices. We can, however, manage our operations to maintain high levels of efficiency and productivity, as we did during 2012 in the face of weaker precious and base metal prices.

As I pointed out in the 2011 annual report, our success will not be determined solely by the volume and value of the metals that we mine. Rather, it will also be measured by the economic, social and environmental sustainability of our operations. We continue to demonstrate our commitment to stakeholders in our host communities. Completion of the Ocotlan grey water treatment plant project near our San Jose Mine is but one of many examples that you can read about in this report.

The San Jose and Caylloma mines are the rock solid foundation of our future. By continuing to execute our three-pronged growth strategy – maximize production, profitability and cash flow, capitalize on brownfields exploration opportunities and selectively pursue M&A opportunities – our silver and gold production should again reach record levels in 2013 and 2014.

I thank all employees for their contributions in 2012. I couldn't be more proud of their efforts. I also thank my fellow shareholders for their trust and support. I am confident that together we can continue to deliver growth and create value as a responsible mining company.

Simon Ridgway
Chairman of the Board

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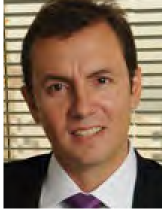
Senior Management

Jorge A. Ganoza, Geological Engineer
President, CEO and Director
Jorge A. Ganoza is a geological engineer with over 18 years of experience in mineral exploration, mining and business development throughout Latin America. He is a graduate from the New Mexico Institute of Mining and Technology. Jorge is a fourth generation miner from a Peruvian family that has owned and operated underground gold, silver and polymetallic mines in Peru and Panama. Before co-founding Fortuna in 2004 he was involved in business development at senior levels for several private and public Canadian junior mining companies working in Central and South America. Jorge also serves as Chairman of the Board of Atico Mining Corporation.



Luis D. Ganoza, B. Sc. Engineering, MBA, M. Sc.
Chief Financial Officer
Luis D. Ganoza has 12 years of experience in the operation and financial management of mining companies. He has held the position of CFO at Fortuna since 2006 and previously held the positions of Controller and Treasurer for one of Peru's largest public mining companies. Luis has a B.Sc. in mining engineering from the Universidad Nacional de Ingenieria in Peru, and an M.Sc. in accounting and finance from The London School of Economics. Luis also serves as a Director of Atico Mining Corporation.

Dr. Thomas I. Vehrs, Ph.D.
Vice President of Exploration
Over the past 38 years, Dr. Thomas I. Vehrs has built a successful career in mineral exploration and mine development. During this time, he has consulted for and/or held senior positions with Gold Fields, Cyprus-Amax, Western States Minerals and Anaconda Minerals, as well as being a founder, President and COO of Aquest Minerals Corp. Since 1980, Tom has worked extensively in Latin America, developing and managing exploration programs in Chile, Peru, Bolivia, Colombia, Argentina, Mexico and Central America with emphasis on epithermal and porphyry-related mineralized systems. Dr. Vehrs is a Founding Registered Member of The Society for Mining, Metallurgy, and Exploration, Inc. (SME Member Number 3323430RM), a Fellow of the Society of Economic Geologists and a Member of The Geological Society of America. Tom has been Vice President of Exploration since 2006. He also serves as an independent director for AQM Copper Inc.

Manuel Ruiz-Conejo, B. Sc. Engineering
Vice President of Operations
Manuel Ruiz-Conejo is a mining engineer graduated from the Universidad Nacional de Ingenieria in Lima, Peru. He has more than 25 years in the mining industry and has worked for the most prolific polymetallic mines and mine contractors in Peru. As an engineer, he participated in the implementation and execution of critical projects. As an executive, he devised and supervised the execution of several multimillion dollar mining projects. In 2005, he became Chief Operating Manager of Minera Atacocha S.A.A. Manuel also holds an Executive Management Program from the Universidad de Piura in Peru. Amongst his different areas of expertise, he has vast experience in community relations.

Cesar Pera, Bachelor in Psychology, Masters in Organizational Psychology
Vice President of Human and Organizational Development
Cesar Pera is an organizational psychologist with a master's degree in Organizational Psychology from the University of Madrid. Cesar has over 25 years of experience in organizational development and change in Latin American companies. He has served as president of the Peruvian Association of Human Resources (APERHU) and also as Vice President of the Interamerican Federation of Human Management (FIDAGH) for the Andean region. Cesar is currently director of the master's degree program in Organizational Development and People Management at the Universidad del Pacifico in Peru.

Robert Brown, B. Sc. (Honors Geology), MBA
Vice President of Corporate Development
Robert Brown has 20 years of international experience in exploration, project development, finance and corporate development. Throughout his career he has identified exploration and development opportunities through the detailed analysis of economic, geologic and corporate criteria. Prior to joining Fortuna, Robert was President and CEO of Calibre Mining Corp. where he was responsible for the acquisition, exploration and development of the company's projects in Australia, North America and Central America. He also spent nine years with Barrick Gold in various senior management roles in exploration and business development and was involved with numerous exploration, valuation, and merger and acquisition transactions. Robert is a graduate of the University of Alberta with a Bachelor of Science degree in Geology (Honors), and an MBA from the Rotman School of Management at the University of Toronto.

Board of Directors

Simon Ridgway
Chairman of the Board

Simon Ridgway is a co-founder of Fortuna Silver Mines Inc., a prospector, a mining financier and a Casey Research Explorer's League inductee. Grass roots exploration is his first love and he has had a successful career as an explorationist since starting out as a prospector in the Yukon Territory in the late 70s. Simon and the exploration teams under his guidance have discovered gold deposits in Honduras, Guatemala and Nicaragua. On the financial side, companies operating under the Gold Group banner have raised over CAD$350 million for exploration and development projects since 2003. Simon is the Chairman of Fortuna Silver Mines Inc., CEO of Focus Ventures Ltd., President and CEO of Radius Gold Inc.

Jorge A. Ganoza

Jorge A. Ganoza is a geological engineer with over 18 years of experience in mineral exploration, mining and business development throughout Latin America. He is a graduate from the New Mexico Institute of Mining and Technology. Jorge is a fourth generation miner from a Peruvian family that has owned and operated underground gold, silver and polymetallic mines in Peru and Panama. Before co-founding Fortuna back in 2004 he was involved in business development at senior levels for several private and public Canadian junior mining companies working in Central and South America. Jorge also serves as Chairman of the Board of Atico Mining Corporation.

Robert R. Gilmore

Robert Gilmore is a graduate of the University of Denver with a bachelor of science degree in Business Administration, Accounting. Robert is a Certified Public Accountant and a Member of the Colorado Society of Certified Public Accountants and the American Institute of CPAs. Robert has more than 30 years of experience working with resource companies and currently serves as Chairman of the Board for Eldorado Gold Corp., a TSX and NYSE listed Canadian gold mining company, and as a Director of Layne Christensen Company, a NASDAQ listed US company with nearly US$1 billion in revenues.

Tomas Guerrero

Tomas Guerrero is a geological engineer with over 30 years of mine geology and mineral exploration experience in Peru, Mexico, Bolivia, Venezuela, Chile, Argentina and Ecuador. Until 2001, Tomas held a ten year tenure as Director of Explorations for the Hochschild Group, a leading private Peruvian mining company with multiple mine operations. Under his leadership Hochschild discovered and put in production three mid-size gold-silver mines. He is currently the principle of BO Consulting, an engineering consulting firm specializing in servicing the mining sector. Tomas is a Member of the SME (Society Mining Engineers – USA) and Fellow Member of the SEG (Society Economic Geologist – USA).

Michael Iverson

An entrepreneur for the past 30 years, Michael is the President and CEO of several publicly-listed TSX companies, including Niogold Mining Corporation, Volcanic Metals, and past President and CEO of Fortuna Silver Mines Inc. Michael brings a wealth of experience in public and private equity markets and important management disciplines in strategic planning, sales and marketing. He has also been responsible for other private interests for many years, including 30 years as head of Triple K Ventures, a private merchant capital investment company.

Mario Szotlender

Mario Szotlender holds a degree in international relations and is fluent in several languages. He has successfully directed Latin American affairs for numerous private and public companies over the past 20 years, specializing in developing new business opportunities and establishing relations within the investment community. He has been involved in various mineral exploration and development joint ventures (precious metals and diamonds) in Central and South America, including heading several mineral operations in Venezuela, such as Las Cristinas in the 1980s. He was President of Mena Resources Inc. until it was purchased by Rusoro Mining Ltd., of which he was also President. In addition to being a Director and co-founder of Fortuna Silver Mines, Mario is also a Director of Radius Gold Inc. and Endeavour Silver Corp.

Thomas Kelly

Thomas Kelly has bachelor and masters degrees in mining engineering from the Colorado School of Mines, is a Fellow of the Australasian Institute of Mining and Metallurgy and a registered member of the Society for Mining, Metallurgy & Exploration. Tom has over 35 years of worldwide experience with mineral industry leaders such as Freeport-McMoRan Copper & Gold, AMEC Americas and Inca Pacific Resources. He is a recognized expert in project management and development and is fluent in Spanish. Tom is currently COO of Atico Mining Corporation.

San Jose Mine, Mexico

Strategy and Outlook

Fortuna has consistently delivered strong year-over-year growth in production and earnings by following a disciplined corporate strategy. Since commercial operations began in 2006, the company has emerged as one of the lowest-cost silver producers in the industry. Today, with a growing resource base and active brownfields exploration programs underway, the company is poised to continue delivering value to its stakeholders.

San Jose Mine

10

Investment Highlights

Proven mine developers and operators

- Caylloma Mine returned to full operation in 2006 after extended shutdown by previous owner
- San Jose Mine placed into commercial production on time and on budget in 2011, just six years after its acquisition as an exploration-stage project
- Annual silver production increased from 486,000 ounces in 2007 to 4.0 million ounces in 2012
- Annual gold production increased from 3,300 ounces in 2007 to 20,700 ounces in 2012
- Annual silver and gold production have exceeded forecasts for the past three years

Strong cash flow

- US$62.2 million in cash generated by operations in 2012, before changes in working capital
- US$64.7 million in cash and short-term investments at year-end, with no long-term debt or hedging
- US$40 million untapped credit facility provides financial flexibility

Demonstrated brownfields exploration upside

- Exploration increases inferred resources of silver by 38 % and gold by 26 %, as of December 2012
- US$14.2 million exploration budget for 2013

Disciplined growth strategy

- Acquisition strategy focused on opportunities that will add low-cost production in the short term
- Focus on projects with potential for high-margin operations, with silver/gold comprising 50 % of mine revenue
- Evaluating post-discovery, pre-development opportunities in the Americas

Caylloma Mine, Peru

"I thank God for initiating my work career at the Caylloma Mine where I was given the opportunity to expand and reinforce my knowledge. This has enabled me to contribute with ideas and work in the implementation of projects to achieve the Environment Department's goals. Every day we work and put effort into conducting environmentally responsible mining."

Lourdes Esperanza Yanque Huamani
Environmental Engineer, Caylloma Mine, Peru

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Growth Strategy

Our strategy is to grow organically and sustainably by capitalizing on the exploration potential of our 95,000 hectare land package in Peru and Mexico. We plan to supplement this growth by acquiring silver-rich projects in the Americas. We are evaluating post-discovery, pre-development stage projects in Peru, Mexico, northern Chile, Colombia and select countries in Central America.

Fortuna's objective is to reach an annual production rate of 14 million silver equivalent ounces by 2016; 7 million ounces from current reserves and mine plans and 7 million ounces from new reserves, plus lead and zinc by-products.

Maximize production, profitability and cash flow of operating mines

- Increase San Jose Mine capacity to 1,500 tpd, with commissioning planned for third quarter of 2013
- Focus on operational efficiencies to reduce cash costs at San Jose and Caylloma

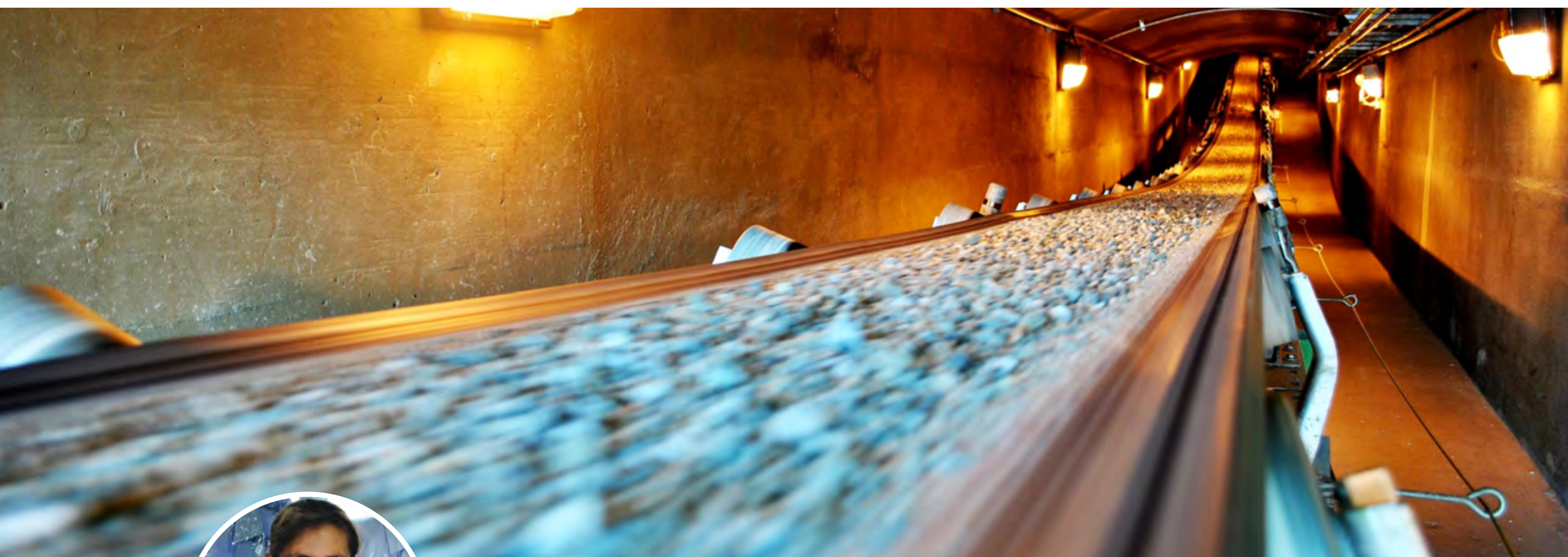
Capitalize on brownfields exploration opportunities

- Conduct a 51,000 meter exploration program in 2013
- Generate and evaluate multiple silver-gold targets at San Jose and Caylloma

Pursue M&A opportunities

- Evaluate projects with silver/gold contribution of at least 50 % of revenue
- Focus on projects with cash costs below the industry average

San Jose Mine, Mexico



"When we started the association back in 2009 we had no training, capital or resources. We are very happy with what we have been able to accomplish working collaboratively with Fortuna. The company even assisted us in sourcing better suppliers to help bring costs down."

Irene Zoila Vasquez
San Jose del Progreso artisanal women's association, Oaxaca, Mexico

2013 Guidance

We forecast a 10 % increase in silver production to 4.4 million ounces and a 13 % increase in gold production to 23,300 ounces.

Production Guidance

Mine	Silver (Moz)	Gold (koz)	Zinc (Mlb)	Lead (Mlb)
San Jose Mine, Mexico	2.4	20.6	–	–
Caylloma Mine, Peru	2.0	2.7	25.1	19.4
Total	**4.4**	**23.3**	**25.1**	**19.4**

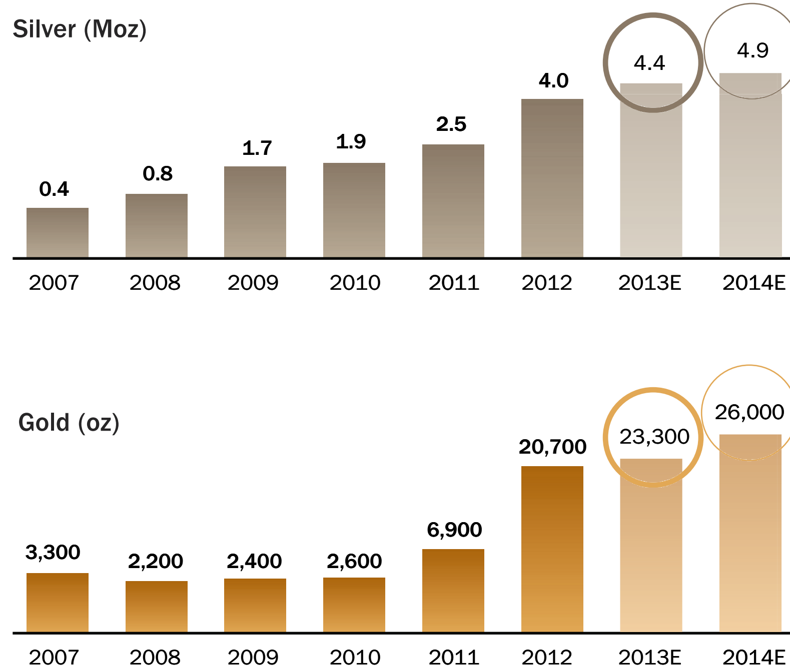
Cash Cost Guidance

Mine	Q1 (US$/t*)	Q2 (US$/t*)	Q3 (US$/t*)	Q4 (US$/t*)	2013 Cash Cost (US$/t*)	2013 Cash Cost (US$/oz**)
San Jose Mine, Mexico	76	78	67	65	70.4	2.9
Caylloma Mine, Peru	96	97	95	95	96.0	7.7
Consolidated						5.0

* *Cash cost per tonne includes all on-site direct and indirect production costs, community relations expenses, concentrate transportation and corporate management fees. It excludes government royalties and workers participation*

** *Cash cost per ounce is calculated using the following metal prices assumptions: Ag = US$30, Au = US$1,700, Pb = US$2,100/t and Zn = US$2,000/t*

2013-2014 Silver and Gold Production Forecast



"We are thankful for the assistance that the Caylloma Mine has given us. Before our alpacas had spots and were underweight. Now the quality of the wool has improved with artificial insemination. The donation of breeding males with high genetic value means we now have better quality alpacas which we sell for higher prices. We thank the Caylloma Mine for the support and hope it continues to the neighbors in the area."

Exaltacion Sapacayo Chipa
Caylloma community alpaca shepherd, Arequipa, Peru

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Historical Milestones

2012
- Annual silver production increases by 60 % to 4.0 million ounces
- Annual gold production increases by 195 % to 20,700 ounces
- San Jose Mine mill expansion to 1,500 tpd commences

2011
- San Jose Mine achieves commercial production on time and on budget at 1,000 tpd
- Annual silver production increases by 31 % to 2.5 million ounces
- Common shares begin trading on the New York Stock Exchange

2010
- Fortuna raises more than CAD$80 million in two bought-deal financings
- Shares upgraded to Toronto Stock Exchange from Toronto Venture Exchange
- San Jose Mine construction commences

2009
- Annual silver production reaches a record 1.7 million ounces
- Fortuna completes acquisition of 100 % interest in the San Jose project
- Environmental Impact Study approved and construction permits received for San Jose Mine

2008
- Caylloma Mine annual silver production increases by 85 %
- Shares begin trading on the Bolsa de Valores de Lima

2007
- Successful drilling at the San Jose Mine significantly increased Ag Eq resources

2006
- Caylloma Mine resumes production at approximately 500 tpd
- Fortuna purchases 76 % interest in the San Jose project

2005
- Fortuna Silver Mines Inc. is established in British Columbia, Canada
- Shares begin trading on the Toronto Venture Exchange
- Fortuna acquires 100 % interest in the Caylloma Mine

"I am proud of working at the Caylloma Mine, contributing to the growth of the operation as well as being able to grow personally and bring progress to my family."

Elias Emiliano Delgado Llacho
Environmental Supervisor, Caylloma Mine, Peru

Sustainability

At Fortuna, we strive to create sustainable value for our employees and their families, for communities near our operations and for society at large. To succeed in today's challenging operating environment, we recognize that we must communicate openly with stakeholders about all aspects of our business. Our goal is to build strong relationships by collaborating with local communities in ways that are both good for business and human development in the countries where we operate.

Caylloma Mine, Peru

Caylloma Mine, Peru

Employee health, safety and wellbeing

We believe that a safe and healthy work environment benefits our employees and our business. For us, this is at the core of our responsibility to employees and their families. We do not tolerate unsafe acts or conditions. As an organization, we are committed to reducing injuries and occupational illnesses and to employing the best safety and health practices.

Our commitment means that we work continuously to ensure a safe workplace and to provide training and safe equipment for employees and contractors. We also encourage and promote a strong safety culture that helps employees understand personal health risks and empowers them to report and address safety issues.

San Jose Mine safety team

Mine rescue training at Caylloma Mine, Peru

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San Jose del Progreso farmers, Oaxaca, Mexico

The environment

Managing our environmental impact is a key aspect of being a good corporate citizen. It is not only part of our overall corporate responsibility, but it also makes good business sense.

Throughout our organization, we interact proactively with authorities and communicate transparently about our activities. Starting at the earliest stages of exploration through to project development, we work directly and collaboratively with local communities to safeguard the environment for future generations.

Community engagement

Wherever we operate, our goal is to contribute to neighboring communities through partnerships, sponsorships and donations that improve health, education and economic development.

Our community relations programs recognize the unique culture, traditions and needs of local communities. By actively engaging with local stakeholders, we seek opportunities where we can establish and participate collaboratively in sustainable community development projects.

Improving health and nutrition

We direct financial and human resources to help build healthier and stronger communities. Our work recognizes the importance of health care and nutrition services for the local population, particularly women and children.

Supporting education

We focus on developing a broad range of work-related skills and on building infrastructure, channeling our efforts into supporting the education of both children and adults. Our activities include providing scholarships for primary and secondary school and college students.

Encouraging economic development

We have implemented several projects aimed at encouraging local economic development. Working alongside local stakeholders, we aim to establish or increase self-sustaining economic activities that improve the quality of life for residents. Our activities include starting and supporting programs such as genetic enhancement of local alpaca herds, trout breeding and prioritizing employment for local residents in our operations.

"The investment made by Fortuna was important to build an ideal, modern daycare facility which contributes to building strong values and foundations for our kids."

Diana Ivet Suarez Vasquez
Director at Estancia Infantil Rivera
San Jose del Progreso Child Daycare Centre, Oaxaca, Mexico

Case Study

Improving communities and the environment

When Fortuna started to plan construction of the San Jose Mine in Oaxaca, Mexico, sourcing water for the 1,500 tonne per day underground operation presented a significant challenge. The mine is located in a semi-arid region that suffers from a long history of water scarcity.

The challenge

The company recognized that sourcing water from traditional water wells or the nearby Atoyac River were not sustainable options. In 2008, Fortuna identified a potential alternative water source: an abandoned grey water treatment plant located in the community of Ocotlan de Morelos about 15 kilometers from the mine site.

The plant had become largely non-functioning because of a lack of investment and maintenance, causing serious environmental and public health problems in the community and surrounding area. These included:

- pollution of the local aquifer from raw sewage discharges
- farmers using overflow from the plant to irrigate crops, causing stomach infections in community residents
- local roads flooded with sewage during the rainy season, polluting neighboring towns and interrupting transit, school attendance and sports activities at the nearby athletics field

The plant also emitted unbearable odors and excessive noise and served as the source for flies, rodents and disease-causing bacteria.

The solution

In January 2010, Fortuna signed a 15-year renewable agreement with the Municipality of Ocotlan to refurbish and operate the plant in exchange for residual grey water to use at the San Jose Mine. Fortuna made the necessary investments to transform the plant into a modern grey water treatment facility and, in October 2010, the upgraded plant became fully operational.

The renovated plant provides approximately 20 % of the make-up water currently required for the San Jose operation. The balance comes from rainwater collected at the tailings dam during the rainy season and from water recycled at the zero-discharge mine site.

The benefits

Community support for the San Jose Mine has been strengthened thanks to the significant environmental, health and social benefits generated by Fortuna's refurbishment of the grey water treatment plant. Today, the facility serves as a new source of employment, hosts community site visits and contributes to improving the surrounding landscape.

Sewage is fully contained and treated according to international standards and flooding has been eliminated. The plant no longer pollutes the environment and health hazards caused from sewage contamination no longer exist. The residents of Ocotlan can now use the athletic facility, attend school and enjoy public gardens surrounding the plant in an eco-friendly environment.

Mineral Reserves & Resources

Mineral Reserves – Proven and Probable

Property	Classification	Tonnes (000)	Ag (g/t)	Au (g/t)	Pb (%)	Zn (%)	Contained Metal Ag (Moz)	Contained Metal Au (koz)
Caylloma Mine, Peru								
Silver Veins	Proven	11	872	0.06	0.43	0.64	0.3	0.0
	Probable	246	386	0.96	0.31	0.51	3.1	7.6
	Proven + Probable	257	407	0.93	0.31	0.51	3.4	7.7
Polymetallic Veins	Proven	1,242	92	0.33	1.48	2.20	3.7	13.2
	Probable	2,809	121	0.33	1.66	2.27	10.9	30.2
	Proven + Probable	4,052	112	0.33	1.60	2.25	14.6	43.4
Combined-All Veins	Proven	1,253	99	0.33	1.47	2.19	4.0	13.2
	Probable	3,055	142	0.38	1.55	2.13	14.0	37.8
	Proven + Probable	4,308	130	0.37	1.52	2.15	17.9	51.1
San Jose Mine, Mexico	Proven	51	246	2.31	N/A	N/A	0.4	3.8
	Probable	3,283	189	1.57	N/A	N/A	20.0	165.7
	Proven + Probable	3,335	190	1.58	N/A	N/A	20.4	169.5
Total	Proven + Probable	7,643	156	0.90	N/A	N/A	38.3	220.6

Mineral Resources – Measured and Indicated

Property	Classification	Tonnes (000)	Ag (g/t)	Au (g/t)	Pb (%)	Zn (%)	Contained Metal Ag (Moz)	Contained Metal Au (koz)
Caylloma Mine, Peru	Measured	431	72	0.30	0.88	1.53	1.0	4.2
	Indicated	1,170	82	0.34	0.75	1.40	3.1	12.8
	Measured + Indicated	1,601	79	0.33	0.79	1.43	4.1	17.0
San Jose Mine, Mexico	Measured	3	71	0.66	N/A	N/A	0.0	0.1
	Indicated	53	74	0.60	N/A	N/A	0.1	1.0
	Measured + Indicated	56	74	0.61	N/A	N/A	0.1	1.1
Total	Measured + Indicated	1,656	79	0.34	N/A	N/A	4.2	18.1

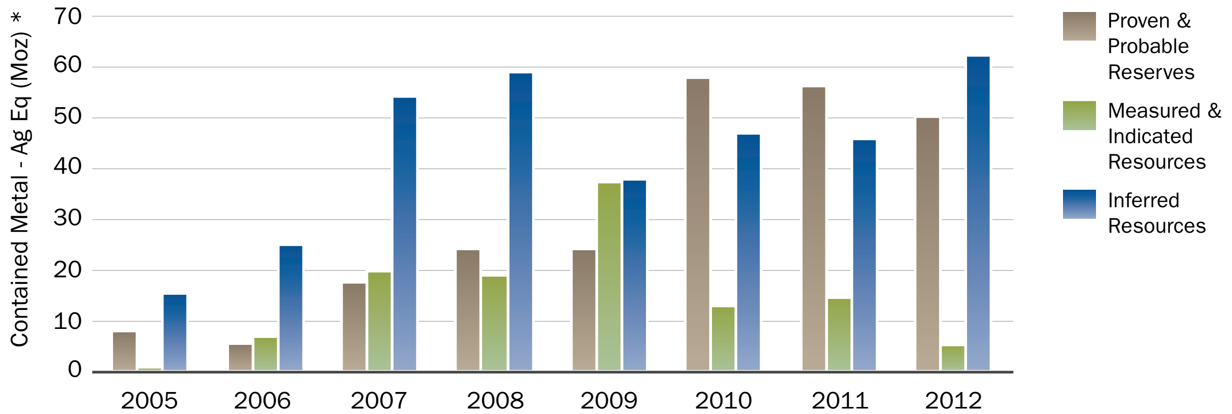
Mineral Resources – Inferred

Property	Classification	Tonnes (000)	Ag (g/t)	Au (g/t)	Pb (%)	Zn (%)	Contained Metal Ag (Moz)	Contained Metal Au (koz)
Caylloma Mine, Peru	Inferred	6,633	101	0.27	1.84	2.58	21.5	58.5
San Jose Mine, Mexico	Inferred	4,257	185	1.57	N/A	N/A	25.3	214.9
Total	Inferred	10,890	134	0.78	N/A	N/A	46.8	273.4

1. *Mineral Reserves and Mineral Resources are as defined by CIM Definition Standards on Mineral Resources and Mineral Reserves*
2. *Mineral Resources are exclusive of Mineral Reserves*
3. *Mineral Resources that are not Mineral Reserves do not have demonstrated economic viability*
4. *There are no known legal, political, environmental, or other risks that could materially affect the potential development of the Mineral Resources or Mineral Reserves at Caylloma or San Jose*
5. *Mineral Resources and Mineral Reserves are estimated as of June 30, 2012 and reported as of December 31, 2012 taking into account production-related depletion for the period of July 1, 2012 through December 31, 2012 with the exception of the Animas and Animas NE veins at Caylloma which were re-estimated using all exploration drilling information as of December 31, 2012*
6. *Metallurgical recovery rates used at Caylloma for estimation of NSR values for sulfide material are 82 % for Ag, 45 % for Au, 93 % for Pb and 88 % for Zn; and for oxide material are 64 % for Ag, 45 % for Au, 46 % for Pb and 30 % for Zn*
7. *Caylloma Mineral Reserves are estimated using break-even cut-off grades based on estimated NSR values using assumed metal prices of US$29.36/oz Ag, US$1,544/oz Au, US$2,245/t Pb and US$2,139/t Zn; metallurgical recovery rates detailed in footnote 6; and historical operating costs adjusted for inflation. Caylloma Mineral Resources are reported based on estimated NSR values using metal prices of US$25.14/oz Ag, US$1,391.63/oz Au, US$2,116/t Pb and US$2,028/t Zn; metallurgical recovery rates detailed in footnote 6; and an NSR cut-off of US$30/t*
8. *San Jose Reserves are estimated using break-even cut-off grades based on assumed metal prices of US$29.36/oz Ag and US$1,544/oz Au, estimated metallurgical recovery rates of 88 % for Ag and 89 % for Au and projected operating costs. San Jose Resources are estimated and reported at a Ag Equivalent cut-off grade of 70 g/t, with Ag Eq in g/t = Ag (g/t) + Au (g/t) * ((US$1,391.63/US$25.14) * (90/88)) = Ag (g/t) + Au (g/t)*56.61*
9. *Totals may not add due to rounding procedures*
10. *N/A = Not Applicable*

San Jose Mine, Mexico

Sustainable Mineral Reserve and Resource Growth



** Ag Eq for Resources calculated using Ag = US$25.14/oz and Au = US$1,391.63/oz*
Ag Eq for Reserves calculated using Ag = US$29.36/oz and Au = US$1,544.00/oz

"It brings great satisfaction to share my knowledge on trout breeding with the Caylloma Trout Breeders Association. This project will give the opportunity to generate capabilities and establish businesses in the town of Caylloma."

Julio Iglesia Monzon
Sierra Exportadora, Caylloma Mine, Peru

CAYLLOMA MINE AT-A-GLANCE

OWNERSHIP

100 % interest

LAND PACKAGE

31,200 hectares

DEPOSIT TYPE

Intermediate-sulphidation epithermal deposit

STATUS

- Mill and underground mine operating at over 1,250 tpd
- Brownfields exploration underway for high-grade silver veins

Caylloma Mine, Peru

Caylloma is an underground silver-lead-zinc mine located in southern Peru in the department of Arequipa. Its two commercial products are silver-lead and zinc concentrates.

2012 results

Caylloma produced 2.0 million ounces of silver in 2012, achieving its production forecast for the year. The mine has met or exceeded our production forecasts every year since 2007, when the mine and mill were upgraded.

In 2012, cash cost per ounce of silver, net of by-product credits, was US$8.07, compared to negative US$0.78 in 2011. Cash cost per tonne was US$87.28, a 26 % increase over 2011. Cash costs increased in 2012 primarily because of higher contractor tariffs and labour costs.

While ore production increased 3 % and silver head grades rose 4 %, silver production increased 1 % year-over-year because of a 5 % decrease in metallurgical recoveries. Following extensive testing, we implemented recommendations to improve metallurgical recoveries, improving silver recovery to 80 % in November and December 2012, with further improvement to 82 % expected in 2013.

Additionally, a new tailings facility was commissioned in January 2013, providing sufficient capacity for approximately 17 years of operation.

Caylloma Mine Management Team:
(L-R) **Alexander Carbajal,** Information Technology Chief; **Fernando Rivera,** Budget and Costs Chief; **Olga Barco,** Logistics Chief; **Rodolfo Robles,** Administration and Finance Manager; **Wilber Zamora,** Core Business Manager; **Alejandro Reategui,** Human and Organizational Development Manager; **Kattya Villanueva,** Legal Chief; **Cesar Fiestas,** Chief Accountant

Outlook for 2013

The mine is scheduled to produce 2 million ounces of silver and 2,700 ounces of gold plus lead and zinc by-products, with ore grading 170 g/t silver and 0.40 g/t gold. Cash cost per ounce of silver is forecast to be US$7.70, net of by-product credits, a decrease of approximately 5 % over 2012.

We have budgeted US$30.7 million in capital expenditures, primarily for camp infrastructure, mine development, tailings dam expansion and an ongoing energy generation project.

"I feel good…as a Caylloma Mine employee, my goal is to achieve personal growth, progress for me and my family as well as to contribute to our country [Peru]."

Bernardo Cayllahue Sapacayo
Warehouse Assistant, Caylloma Mine, Peru

SAN JOSE MINE AT-A-GLANCE

OWNERSHIP

100 % interest

LAND PACKAGE

64,400 hectares

DEPOSIT TYPE

High-grade, low-sulphidation epithermal vein deposit

STATUS

- Mill and mine operating at over 1,000 tpd
- Mill expansion to 1,500 tpd underway with commissioning planned for third quarter
- Exploration for high-grade silver veins underway

San Jose Mine, Mexico

San Jose is an underground silver-gold mine located in southern Mexico in the state of Oaxaca. Its commercial product is a high-grade silver-gold concentrate. Commercial production commenced on September 1, 2011.

2012 results

Following its commissioning in September 2011, San Jose operated at a rate of 1,055 tpd, on average, in 2012. The mine produced 1.95 million ounces of silver and 17,918 ounces of gold, 15 % and 19 %, respectively, above our 2012 production guidance.

Cash cost per ounce of silver was US$3.76, net of by-product credits, compared to US$4.69 in 2011. Cash cost per tonne of processed ore for 2012 was US$74.10, or 6 % above forecast as a result of accelerated mine preparation in the fourth quarter and certain non-recurring items.

We produced more silver and gold than planned in 2012, as higher grade ore was mined ahead of schedule on level 1350, contributing approximately 47 % of mine production during the year.

During 2012, San Jose's first full year of operation, the processing plant performed within design parameters, with silver and gold recoveries averaging 88 % and 87 %, respectively.

As part of our ongoing capital program and community development activities, we completed the final two kilometers of a thirteen kilometer water pipeline in October, connecting the Ocotlan grey water treatment plant with the San Jose Mine site. The pipeline, planned and constructed in collaboration with state and community authorities, is delivering approximately 20 % of the make-up water currently required for the San Jose mill.

San Jose Mine Management Team:

(L-R) **Alberto Gonzalez Ruiz,** Cost Assistant; **Alberto Olmos Carrillo,** Cost Superintendent; **Nestor Ramirez Chavez,** Cost Supervisor; **Alejandro Chavez Hernandez,** Exploration Manager; **Carlos Manrique Bellido,** Operation Manager; **Patricia Gonzalez Pineda,** Chief Metallurgist; **Juan Carlos Gomez Muñoz,** Financial and Administrative Manager; **Eduardo Abad Flores,** Human and Organizational Development Manager; **Javier Castañeda Pedraza,** Community Relations Manager

Outlook for 2013

We expect San Jose to produce 2.4 million ounces of silver and 20,600 ounces of gold, with ore grading 186 g/t silver and 1.60 g/t gold. Cash cost per ounce of silver is forecast to be US$2.90, net of by-product credits, or approximately 23 % lower than in 2012.

The mill expansion to design capacity of 1,500 tpd from 1,000 tpd is on track to be commissioned at the beginning of the third quarter. When completed, San Jose is expected to annually produce approximately 2.9 million ounces of silver and 23,000 ounces of gold, or 4.4 million silver equivalent ounces.

We have budgeted US$22.0 million in capital expenditures at San Jose, primarily for plant expansion, mine development and tailings dam expansion.

"The San Jose Mine is a good place to work because we have the opportunity to develop ourselves. I am happy because I learn something new every day."

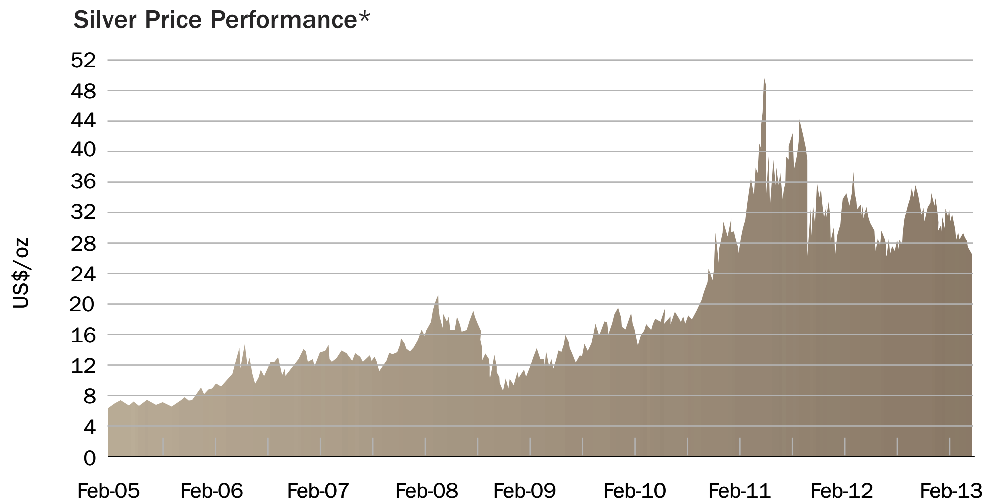
Judith Cecilia Padilla Luis
Dining room, San Jose Mine, Mexico

Silver Market Review and Outlook*

Silver price slips as fabrication demand slows

Silver prices averaged US$31.17 per ounce in 2012, down 11.7 % from 2011, when prices averaged a nominal record high of US$35.29. This was the first annual average decline since 2009, when prices fell 2.0 % from the previous year, and the largest percentage decline since 2001, when prices came off 12.4 %.

Total silver supply rose to 981.6 million ounces in 2012, a 1.5 % year-over-year increase after declining 0.7 % in 2011. Secondary supply was nearly flat compared with 2011, while mine supply rose by 12.4 million ounces.



Daily average Comex through April 3, 2013

Silver production in Mexico continues to grow

Mexico was the largest producer of silver in the world in 2012, with mine output of 136.6 million ounces, up 2.4 % from the record output of 133.4 million ounces in 2011. Chinese mine production rose to 122.2 million ounces last year, up 2.7 % from the previous year. China is now the second largest silver producer in the world. Peruvian silver output increased, for the first time since 2009, to 111.9 million ounces in 2012, compared to 109.8 million ounces in 2011.

Cash costs at primary silver mines continued to increase rapidly in 2012. On a production-weighted basis, annual average cash costs are estimated to have increased 19.0 % to US$10.04 per ounce in 2012. Much of the increase in cash costs is due to external factors being faced by the entire mining industry, such as higher input costs.

Secondary supply of silver, meanwhile, was nearly flat at 283.3 million ounces, compared to 281.5 million ounces in 2011. Lower silver prices in 2012 reduced the level of jewelry and silverware scrap entering the recycling circuit. However, secondary supply was boosted by a three-fold year-over-year increase in Indian scrap flows, which rose to 15.3 million ounces.

Demand slips on lower industrial use

Fabrication demand for silver fell to an estimated 858.9 million ounces in 2012, a decrease of 1.8 % over 2011 levels. Fabrication demand decreased due to declines in demand from the photovoltaics industry, the photography industry and the jewelry and silverware sector.

The slowdown in industrial activity throughout 2012 weighed on demand, slowing demand growth from electronics manufacturers. Silver use in the photography sector continued to decline, as digital cameras commanded a larger share of the market. Silver demand for fabrication of electronics and electrical components rose at a substantially slower pace in 2012 relative to the past two years due to lower computer and mobile phone sales. Demand from the solar panel industry in 2012 declined for the first time in over a decade after multiple years of double-digit growth.

Lower prices boost investment demand

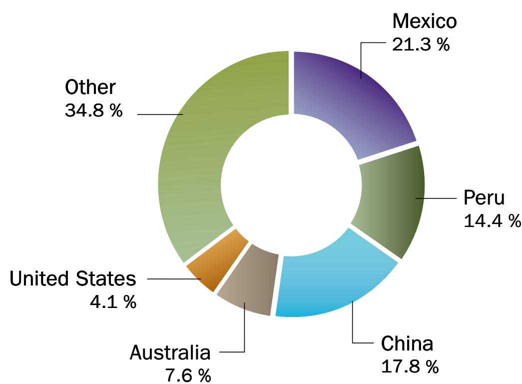
Silver investment demand rose 32.1 % to 122.7 million ounces in 2012. Silver exchange traded product (ETP) holdings rose 51.4 million ounces, a major contributor to higher demand. Despite a downward trend in silver prices, investors aggressively bought silver during price dips. Combined silver ETP holdings stood at 619.1 million ounces at the end of 2012, up 9.1 % from 567.4 million ounces at the end of 2011.

Coin demand is estimated to have declined by about 18 % relative to 2011 levels, with sales of U.S. Mint Silver Eagle coins in 2012 down 15.4 % from a year ago.

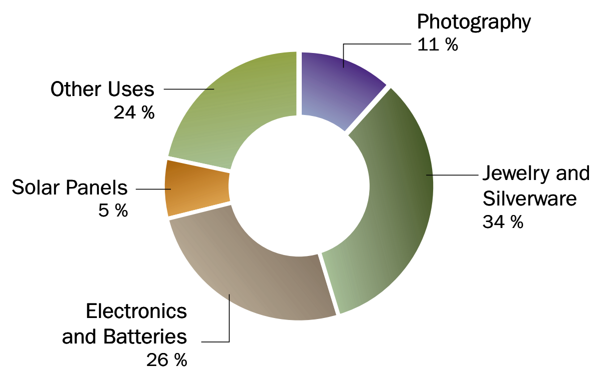
Outlook: Demand growth to resume

In 2013, fabrication demand for silver is forecast to rise 2.1 % due to the resumption of growth in jewelry and photovoltaic demand for the metal. Silver demand from the solar panel manufacturers is expected to improve as the industry's supply overhang declines. Electronics demand growth may continue to slow as the tablet market continues to expand, reducing demand for more conventional computers.

2012 Silver Production by Country
770.9 million ounces



2012 Total Fabrication Demand for Silver
876.3 million ounces



** Source: CPM Group*

"I like working at the San Jose Mine because it employs many women. With that we can develop ourselves and keep our families going. The mine is also concerned about our health, our safety and the environment."

Elia Vasquez Hernandez
Cleaning service, San Jose Mine, Mexico

FINANCIAL REVIEW

MANAGEMENT'S DISCUSSION AND ANALYSIS

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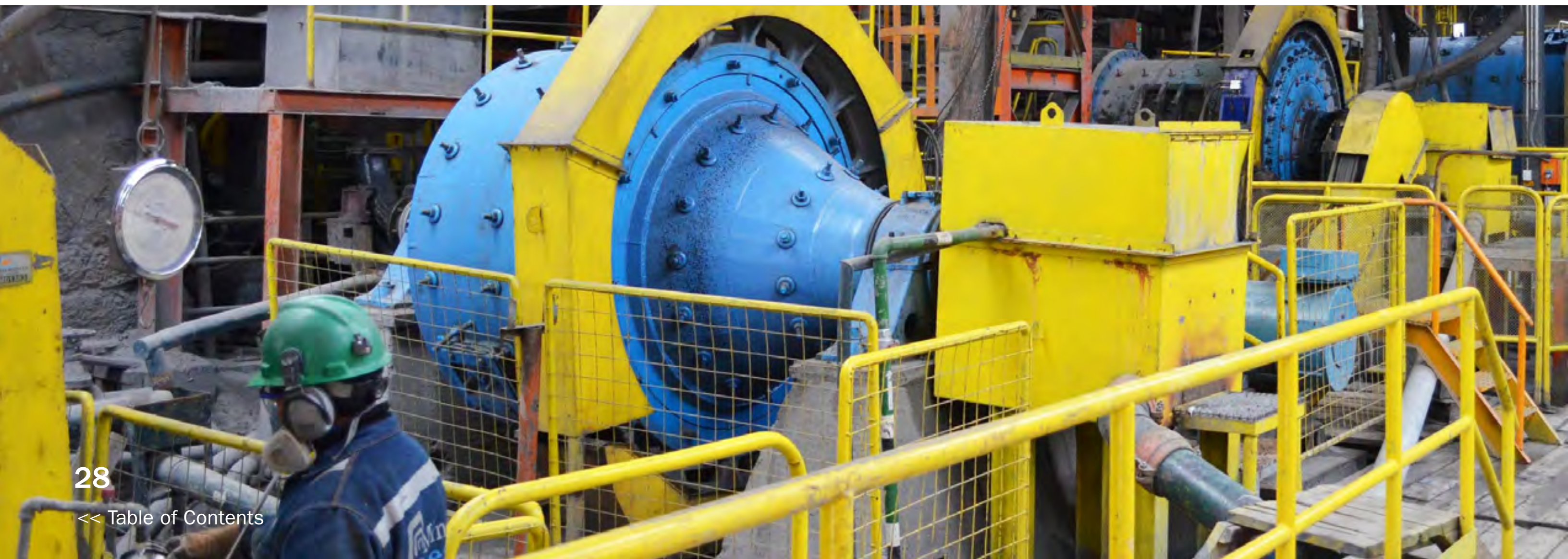
Caylloma Mine, Peru



MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED DECEMBER 31, 2012
As at March 19, 2013
(Dollar amounts expressed in US dollars, unless otherwise indicated)

Management's Discussion and Analysis ("MD&A") is intended to help the reader understand the significant factors that have affected Fortuna Silver Mines Inc. and its subsidiaries' ("Fortuna" or the "Company") performance and such factors that may affect its future performance. This MD&A, which has been prepared as of March 19, 2013, should be read in conjunction with the Company's audited consolidated financial statements for year ended December 31, 2012 and the related notes contained therein. The Company reports its financial position, financial performance and cash flows in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). This MD&A refers to various non-GAAP financial measures, such as cash cost per tonne of processed ore, cash cost per ounce of payable silver, total production cost per tonne, adjusted net income, operating cash flow per share before change in working capital items, income taxes, and interest income, used by the Company to manage and evaluate operating performance and ability to generate cash and are widely reported in the silver mining industry as benchmarks for performance, but do not have a standardized meaning and may differ from methods used by other companies with similar descriptions. The Company believes that certain investors use these non-GAAP financial measures to evaluate the Company's performance. Accordingly, non-GAAP financial measures should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS. To facilitate a better understanding of these measures as calculated by the Company, we have provided detailed descriptions and reconciliations as required.

This document contains forward-looking statements. Please refer to the cautionary language under the heading "Cautionary Statement on Forward-Looking Statements".

Business of the Company

Fortuna is engaged in silver mining and related activities, in Latin America, including exploration, extraction, and processing. The Company operates the Caylloma silver/lead/zinc mine ("Caylloma") in southern Peru and the San Jose silver/gold mine ("San Jose") in Mexico.

Fortuna is a publicly traded company incorporated and domiciled in Canada. Its common shares are listed on the New York Stock Exchange under the trading ticker symbol FSM, on the Toronto Stock Exchange and Lima Stock Exchange, both under the trading ticker symbol FVI, and on the Frankfurt Stock Exchange under the trading symbol F4S.F.

The Company's registered office is located at Suite 650, 200 Burrard Street, Vancouver, British Columbia, Canada, V6C 3L6.

The financial results include the accounts of the Company and its wholly owned subsidiaries: Minera Bateas S.A.C. ("Bateas"); Fortuna Silver (Barbados) Inc. ("Barbados"); Compania Minera Cuzcatlan SA ("Cuzcatlan"); Continuum Resources Ltd. ("Continuum"); Fortuna Silver Mines Peru S.A.C. ("FSM Peru"); and Fortuna Silver Mexico, S.A. de CV. ("FS Mexico").

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2012 Highlights

FULL YEAR FINANCIAL AND OPERATING HIGHLIGHTS

Net income for the year ended December 31, 2012 ("2012") increased by 62% to $31.5 million, compared to $19.5 million for the year ended December 31, 2011 ("2011"). The increase, in spite of an 11% lower silver price, reflects the contribution of San Jose in its first full year of production, and a lower effective income tax rate.

Cash generated by operating activities, before changes in working capital, increased by 59% to $62.2 million attributed to San Jose's strong cash margins and a lower cash tax rate.

Basic earnings per share for the year rose by 56% to $0.25 (2011: $0.16). Operating cash flow per share, before changes in working capital items, increased by 56% to $0.50 (2011: $0.32) (Refer to non-GAAP financial measures).

In 2012, sales were comprised of silver and gold, 67% and 17%, respectively, compared to the prior year of 65% and 6%, respectively.

Silver production increased by 60% to 3,987,757 ounces (2011: 2,486,655 ounces) and gold production rose by 199% to 20,699 ounces (2011: 6,917 ounces), exceeding annual guidance by 8% for silver and 19% for gold.

Consolidated cash cost per ounce of payable silver, net of by-product credits, was $5.96, compared to $0.25 in 2011. The higher cost was primarily at Caylloma, due to higher unit cash costs, higher refining charges, and lower by-product credits. (Refer to non-GAAP financial measures).

FOURTH QUARTER HIGHLIGHTS AND RECENT DEVELOPMENTS

Fourth quarter net income was $8.5 million, compared to a net loss of $1.8 million a year ago. Cash generated by operating activities, before changes in working capital, increased by 35% over the prior period to $11.9 million. The increase in net income and cash generation was driven by higher sales at San Jose, lower effective income tax rate, and lower cash tax rate.

Basic earnings per share for Q4 2012 improved to $0.07, compared to a $0.01 loss per share in Q4 2011. Operating cash flow per share, before change in working capital items, increased by 43% to $0.10, compared to $0.07 in Q4 2011 (Refer to non-GAAP financial measures).

Compared to the third quarter of 2012, cash generated by operating activities, before changes in working capital, decreased by $8.1 million to $11.9 million primarily due to lower sales of $5.9 million driven by lower final sales adjustments of $3.5 million, changes in concentrate inventory, and lower head grades at San Jose, and to higher unit cash cost at Caylloma with an impact of $1.3 million.

Silver production increased by 11% to 1,010,730 ounces (Q4 2011: 913,803 ounces), while gold production rose by 5% to 4,368 ounces (Q4 2011: 4,153 ounces).

Consolidated cash cost per ounce of payable silver, net of by-product credits, was $8.85, compared to $5.20 in Q4 2011, due to higher cash cost per ounce at both Caylloma and San Jose. The main increase comes from San Jose, where unit costs were much lower in Q4 2011 as low cost development ore were consumed by the plant during the first quarter of commercial production. Compared to Q3 2012, consolidated cash cost per ounce of payable silver, net of by-product credits increased by 44% in Q4 2012 due to lower silver and gold head grades at San Jose.

MANAGEMENT CHANGE

The Company appointed Robert Brown as Vice-President, Corporate Development effective August 1, 2012.

MINE ACCIDENT

It is with great sorrow the Company informs that on January 2, 2013, an electrical accident claimed the life of a contractor at the San Jose mine.

2013 Outlook and Guidance

PRODUCTION GUIDANCE

For 2013, the Company forecasts production of 4.4 million ounces of silver and 23,300 ounces of gold, an increase of 10% and 13%, respectively over 2012, or 5.7 million silver equivalent ounces (using $30/oz silver and $1,700/oz gold).

Mine	Silver (M oz)	Gold (k oz)	CAPEX ($ millions)	Cash Cost (*) ($/t)
San Jose, Mexico	2.4	20.6	22.0	70.4
Caylloma, Peru	2.0	2.7	30.7	96.0
Total	**4.4**	**23.3**	**52.7**	**–**

(CAPEX refers to capital expenditure)

For 2013, the Company projects zinc and lead production of 25.1 million pounds and 19.4 million pounds, respectively, an increase over 2012 of 9% and 12%, respectively.

CASH COST QUARTERLY GUIDANCE

Mine	Q1 ($/t)	Q2 ($/t)	Q3 ($/t)	Q4 ($/t)	($/t)	2013 ($/oz)
San Jose	76	78	67	65	70	2.90
Caylloma	96	97	95	95	96	7.70
Consolidated						**5.00**

* *Note: Cash cost per tonne ("$/t") includes all on-site direct and indirect production costs, community relations expenses, concentrate transportation and corporate management fees. It excludes government royalties and workers participation. Cash cost per ounce ("$/oz") is net of by-product credits.*

Cash cost at San Jose for 2013 is expected to decrease by 5% over the 2012 cost of $74.10 per tonne, as mine throughput rises on completion of development activities. Cash cost at Caylloma for 2013 is expected to increase by 10% over the 2012 cost of $87.28 per tonne, due to higher wages, contractor tariffs, and operational items such as higher ground support in level 6 of the Animas and Bateas veins, and increased diesel energy generation. The forecast for 2013 incorporates certain cost containment measures taken by the Company, such as investments required to eliminate energy restrictions from the power grid.

SAN JOSE MINE

In 2013, San Jose is expected to process 451,000 tonnes of ore grading 186 g/t silver and 1.60 g/t gold. Capital expenditures for the year are estimated to be $22.0 million. The mill expansion to 1,500 tonnes per day ("tpd") from 1,000 tpd is on track to be commissioned at the beginning of third quarter. Major capital expenditures include:

- Mine development: $5.7 million
- Plant expansion: $9.1 million
- Tailings dam expansion: $4.4 million

CAYLLOMA MINE

Caylloma is expected to process 464,100 tonnes of ore grading 170 g/t silver and 0.40 g/t gold in 2013. Capital expenditures are estimated to be $30.7 million, including the following major items:

- Mine development: $7.6 million
- Camp infrastructure: $8.6 million
- Tailings dam expansion: $3.6 million
- Power grid: $4.8 million

BROWNFIELDS EXPLORATION

The Company´s brownfields exploration budget for 2013 is estimated at $14.2 million: $7.5 million will be spent at San Jose and $6.7 million at Caylloma.

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Results of Operations

CONSOLIDATED METAL PRODUCTION

	QUARTERLY RESULTS Three months ended December 31,						YEAR TO DATE RESULTS Years ended December 31,					
	2012			2011			2012			2011		
Consolidated Metal Production	Caylloma	San Jose	Consolidated	Caylloma	San Jose	Consolidated	Caylloma	San Jose	Consolidated	Caylloma	San Jose	Consolidated
Silver (oz)	519,549	491,181	1,010,730	536,426	377,377	913,803	2,038,579	1,949,178	3,987,757	2,008,488	478,167	2,486,655
Gold (oz)	514	3,854	4,368	591	3,562	4,153	2,781	17,918	20,699	2,393	4,524	6,917
Lead (000's lb)	4,936	–	4,936	4,396	–	4,396	17,886	–	17,886	19,678	–	19,678
Zinc (000's lb)	6,135	–	6,135	5,688	–	5,688	22,396	–	22,396	23,425		23,425
Copper (000's lb)	–	–	–	–	–	–	48	–	48	36	–	36
Production cash cost (US$/oz Ag)*	9.30	8.38	8.85	6.48	3.34	5.20	8.07	3.76	5.96	(0.78)	4.69	0.25

** Net of by-product credits*

Silver and gold production for the year ended December 31, 2012, totaled 3,987,757 ounces and 20,699 ounces, respectively, exceeding by 8% and 19%, respectively, the Company's production guidance for 2012. When compared to the previous year, silver and gold production increased by 60% and 199%, respectively, as San Jose contributed its first full year of production after commissioning in September 2011.

CONSOLIDATED CASH COST PER OUNCE OF PAYABLE SILVER

Consolidated cash cost per ounce of payable silver for 2012, net of by-product credits, was $5.96 (2011: $0.25) (Refer to non-GAAP financial measures for reconciliation of cash cost to the cost of sales). The higher cost was primarily at Caylloma, which increased from negative $0.78 per ounce in 2011 to $8.07 per ounce in 2012, due to higher unit cash costs (up $4.57), higher refining charges (up $1.24), and lower by-product credits (down $3.04) for an overall increase of $8.85 per ounce. This increase is in line with our forecast for 2012 (See Caylloma Mine Review and San Jose Mine Review for more detail).

Consolidated cash cost per ounce of payable silver in Q4 2012, net of by-product credits, was $8.85, compared to $5.20 in Q4 2011, due to higher cash cost per ounce at both Caylloma and San Jose. The main increase comes from San Jose, where unit costs were much lower in Q4 2011, as the mine completed its commissioning phase and started its first full quarter of commercial production. Cash cost per ounce at Caylloma was higher due to higher unit costs and refining charges. Compared to Q3 2012, consolidated cash cost per ounce increased 44% due mainly to lower silver and gold head grades at San Jose of 7% and 20%, respectively.

During the fourth quarter of 2012, the Company identified through its internal control procedures an inconsistency in San Jose's reported cash cost per ounce of payable silver. The adjusted San Jose cash cost per ounce of payable silver is as follows: Q1 2012 $0.83, Q2 2012 $0.82, and Q3 2012 $4.81. The adjusted consolidated cash cost per ounce of payable silver is as follows: Q1 2012 $3.96, Q2 2012 $4.75, and Q3 2012 $6.15. The Company deems the adjustments not to be material. (Refer to non-GAAP financial measures).

SAN JOSE MINE REVIEW

San Jose is an underground silver-gold mine located in southern Mexico in the State of Oaxaca. Its commercial product is silver-gold concentrate. Commercial production commenced on September 1, 2011. The table below shows the main variables used by management to measure the operating performance of the mine: throughput, grade, recovery, metal production, and unit costs.

San Jose Mine								
	2012					2011		
Mine Production	YTD	Q4	Q3	Q2	Q1	YTD	Q4	Q3
Tonnes milled	369,022	98,348	91,607	92,011	87,056	116,410	87,884	28,526
Average tonnes milled per day	1,055	1,107	1,048	1,034	989	954	955	951
Silver								
Grade (g/t)	188	177	191	187	198	150	159	124
Recovery %	88	88	89	88	85	85	84	89
Production (oz)	1,949,178	491,181	502,835	486,297	468,865	478,167	377,377	100,790
Gold								
Grade (g/t)	1.74	1.39	1.73	1.96	1.92	1.43	1.48	1.25
Recovery %	87	88	89	88	84	85	85	84
Production (oz)	17,918	3,854	4,501	5,065	4,498	4,524	3,562	962
Unit Costs								
Production cash cost (US$/oz Ag)*	3.76	8.38	4.81	0.82	0.83	4.69	3.34	9.72
Production cash cost (US$/tonne)	74.10	82.82	80.59	66.50	65.46	50.73	47.16	61.70
Unit Net Smelter Return (US$/tonne)	209.70	198.53	213.44	207.45	223.07	155.56	160.93	154.58

** Net of by-product credits.*

During 2012, silver and gold production at San Jose was 15% and 19%, respectively, above annual production guidance. The increased production resulted from mining higher grade ore ahead of schedule on level 1350, which contributed approximately 47% of mined ore in the period, or 160% above plan. By accelerating completion of the main access ramp and preparing levels 1350 and 1300 ahead of plan, we added operational flexibility to the mine that will help to sustain production in the face of potential ore variability and to secure the ramp-up of production to 1,500 tpd by the third quarter of 2013. Mine preparation peaked in Q4 2012 at 1,127 meters of underground development, compared to 614 meters, on average, during the first three quarters of the year. In Q4 2012, silver and gold head grades decreased compared to the first nine months of 2012 because of higher production of lower grade development ore from level 1300.

In its first full year of operation, the San Jose processing plant performed within design parameters, with silver and gold recoveries of 88% and 87%, respectively, and average ore throughput of 1,055 tpd.

Cash cost per tonne of processed ore for 2012 was $74.10, or 6% above forecast as a result of accelerated mine preparation in the fourth quarter and certain non-recurring items. Cash cost per payable ounce of silver for 2012 was $3.76, net of by-product credits.

Cash cost per tonne for Q4 2012 was $82.82, or 76% above Q4 2011. The increase is mainly because of the high volume of lower cost development ore treated during Q4 2011, as the mine completed its commissioning phase and started its first full quarter of operations. Cash cost per tonne in Q4 2012 was 12% above the full year due, in part, to the acceleration of mine preparation in Q4 2012. Cash cost per payable ounce of silver in Q4 2012 was 151% above the same period a year ago because of lower unit costs in Q4 2011, as explained above. Cash cost per payable ounce of silver in Q4 2012 was $8.38, or 74% above Q3 2012, due to lower head grades in Q4 2012 (Refer to 2013 Outlook and Guidance for cost estimates for 2013).

Cash cost per ounce of payable silver and cash cost per tonne of processed ore are non-GAAP financial measures (Refer to non-GAAP financial measures for reconciliation of cash cost to the cost of sales).

On October 2012, the Company, working in collaboration with state and community authorities, completed the final two kilometers of a thirteen kilometer, eight inch diameter water pipeline connecting the Ocotlan water treatment plant with the San Jose mine site. The pipeline is delivering approximately 20% of the make-up water currently required for the San Jose mill.

Capital expenditures at San Jose in 2012 were $14.3 million, which is lower than the $30.8 million budgeted mainly due to the postponement of the dore plant project.

CAYLLOMA MINE REVIEW

Caylloma is an underground silver-lead-zinc mine located in southern Peru, in the Arequipa department. Its commercial products are a silver-lead and zinc concentrates. The table below shows the main variables used by management to measure the operating performance of the mine.

	Caylloma Mine									
	2012					2011				
Mine Production	**YTD**	**Q4**	**Q3**	**Q2**	**Q1**	**YTD**	**Q4**	**Q3**	**Q2**	**Q1**
Tonnes milled	462,222	115,522	117,386	115,870	113,444	448,866	116,363	115,574	111,992	104,937
Average tonnes milled per day	1,266	1,256	1,306	1,295	1,260	1,264	1,307	1,270	1,273	1,206
Silver										
Grade (g/t)	177	176	181	181	171	171	177	186	162	158
Recovery %	77	79	77	76	78	81	81	81	82	82
Production (oz)	2,038,579	519,549	524,906	509,897	484,227	2,008,488	536,426	559,959	474,979	437,124
Gold										
Grade (g/t)	0.40	0.34	0.44	0.42	0.39	0.36	0.35	0.35	0.38	0.37
Recovery %	47	40	51	50	45	46	45	43	47	48
Production (oz)	2,781	514	847	780	640	2,393	591	563	638	601
Lead										
Grade (%)	1.99	2.17	1.97	1.85	1.98	2.15	1.85	2.11	2.28	2.36
Recovery %	88	90	87	86	90	93	92	92	94	92
Production (000's lb)	17,886	4,936	4,452	4,055	4,443	19,678	4,396	4,960	5,276	5,046
Zinc										
Grade (%)	2.56	2.78	2.55	2.49	2.43	2.68	2.47	2.58	2.80	2.87
Recovery %	86	87	85	84	88	88	90	88	89	87
Production (000's lb)	22,396	6,135	5,615	5,325	5,321	23,425	5,688	5,815	6,177	5,745
Copper										
Production (000's lb)	48	–	–	48	–	36	–	–	–	36
Unit Costs										
Production cash cost (US$/oz Ag)*	8.07	9.30	7.43	8.49	6.99	(0.78)	6.48	(0.48)	(4.59)	(5.93)
Production cash cost (US$/tonne)	87.28	96.80	85.14	85.55	81.58	69.12	79.68	69.96	63.49	62.50
Unit Net Smelter Return (US$/tonne)	183.29	196.29	180.94	172.95	183.63	221.01	190.95	248.63	234.61	208.58

** Net of by-product credits.*

Silver production for 2012 at Caylloma increased just 1% year over year because of a decrease in metallurgical recoveries of 5%, despite higher ore production (up 3%) and silver head grades (up 4%). Metallurgical recoveries were affected in 2012 by the high oxide content of ore mined in level 6 of the Animas vein, which contributed 30% of ore production during the year. In Q4 2012, the Company implemented recommendations to improve metallurgical recoveries following extensive testing conducted over several months. Positive results were achieved in November and December 2012, with silver recoveries improving to 80%, which are expected to reach 82% in 2013. Lower lead and zinc head grades and recoveries resulted in a year-over-year reduction in lead and zinc production of 9% and 4%, respectively.

Cash cost per tonne at Caylloma for 2012 was $87.28 per tonne of processed ore, an increase of 26% from 2011, but only 1% higher than forecast. The increase resulted mainly from higher contractor tariffs and labor costs. Cash cost per payable ounce of silver for 2012 was $8.07, net of by-product credits, compared to negative $0.78 in the prior year.

Cash cost per tonne for Q4 2012 was $96.80, or 21% above Q4 2011. Throughout the first three quarters of 2012, cost per tonne remained steady and below projections, however, higher costs for some items originally budgeted for 2013 were incurred in Q4 2012, resulting in costs rising 13% compared to forecast. These increases, which are reflected in the 2013 Outlook and Guidance, relate to milder inflation in contractor and transport tariffs and wages, operational items such as higher ground support in level 6 of the Animas and Bateas veins, and increased diesel energy generation as a result of constraints in the power grid. Cash cost per payable ounce of silver in Q4 2012 was $9.30, net of by-product credits, compared to $6.48 in Q4 2011.

Several cost containment initiatives were or are being implemented to help offset cost pressures. These mainly relate to changes in mining methods of high-grade narrow veins that will result in less mine preparation, the concentration of operations under one single contractor, ceasing production at minor peripheral veins, and the ongoing energy project to increase access to energy from the power grid.

Capital expenditures at Caylloma were $16.8 million in 2012, compared to $25.0 million budgeted for the year. The lower expenditures were due mainly to reducing the scope and postponing refurbishment of the processing plant, postponing until 2013 the energy project, and delaying moderately the mine camp project. The new tailings facility was successfully commissioned in January 2013.

CAYLLOMA MINE AND SAN JOSE MINE CONCENTRATES

The table below shows the production and balance of commercial end-products at each of our operating mines.

	Quarterly Results				Year to Date Results			
	Three months ended Decmber 31,				Years ended December 31,			
	2012		2011		2012		2011	
Mine Concentrates	Caylloma	San Jose	Caylloma	San Jose	Caylloma	San Jose	Caylloma	San Jose
Silver Gold								
Opening Inventory (t)	0	424	0	538	0	730	0	0
Production (t)	0	2,723	0	2,277	0	9,647	0	2,958
Sales (t)	0	2,682	0	2,084	0	9,915	0	2,228
Adjustment (t)	0	2	0	0	0	3	0	0
Closing Inventory (t)	0	466	0	730	0	466	0	730
Zinc								
Opening Inventory (t)	589	0	273	0	305	0	258	0
Production (t)	5,351	0	4,964	0	19,588	0	20,569	0
Sales (t)	5,435	0	4,920	0	19,394	0	20,490	0
Adjustment (t)	15	0	-12	0	23	0	-32	0
Closing Inventory (t)	521	0	305	0	521	0	305	0
Lead								
Opening Inventory (t)	261	0	232	0	255	0	191	0
Production (t)	4,155	0	3,599	0	14,803	0	15,767	0
Sales (t)	4,011	0	3,590	0	14,820	0	15,760	0
Adjustment (t)	37	0	14	0	204	0	58	0
Closing Inventory (t)	443	0	255	0	443	0	255	0
Copper								
Opening Inventory (t)	9	0	4	0	4	0	29	0
Production (t)	0	0	0	0	97	0	80	0
Sales (t)*	0	0	0	0	0	0	104	0
Adjustment (t)	-9	0	0	0	-101	0	-1	0
Closing Inventory (t)	0	0	4	0	0	0	4	0

* *Copper concentrate sold as lead concentrate*

Property Option Agreements

MARIO AND DON MARIO PROPERTIES ("MARIO PROJECT")

During the second quarter of 2012, upon completion of a 7,000 meter Phase I drill program at the Mario and Don Mario Properties ("Mario project"), the Company determined the program was not successful in demonstrating the potential to meet the minimum target size established for the project and the Company abandoned its interest in the Mario property resulting in a write-off of $3.9 million.

TLACOLULA PROPERTY

Pursuant to an agreement dated September 14, 2009, as amended December 18, 2012, the Company, through its wholly owned subsidiary, Cuzcatlan, was granted an option (the "Option") to acquire a 60% interest (the "Interest") in the Tlacolula silver project ("property") located in the State of Oaxaca, Mexico from Radius Gold Inc.'s wholly owned subsidiary, Radius (Cayman) Inc. ("Radius").

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The Company can earn the Interest by spending $2.0 million, which includes a commitment to drill 1,500 meters within 12 months after Cuzcatlan has received a permit to drill the property and making staged annual payments totalling $0.25 million cash and providing $0.25 million in common shares of the Company to Radius according to the following schedule:

- $0.02 million cash and $0.02 million cash equivalent in shares upon stock exchange approval;
- $0.03 million cash and $0.03 million cash equivalent in shares by January 15, 2011;
- $0.05 million cash and $0.05 million cash equivalent in shares by January 15, 2012;
- $0.05 million cash and $0.05 million cash equivalent in shares by the January 15, 2013; and,
- $0.10 million cash and $0.10 million cash equivalent in shares within 90 days after Cuzcatlan has completed the first 1,500 meters of drilling on the property.

Upon completion of the cash payments and share issuances, and incurring the exploration expenditures as set forth above, the Company will be deemed to have exercised the Option and acquired a 60% interest in the property, whereupon a joint venture will be formed to further develop the property on the basis of the Company owning 60% and Radius 40%.

As at December 31, 2012, the Company had issued 23,174 common shares of the Company, with a fair market value of $0.10 million and paid $0.10 million cash according to the terms of the option agreement.

Subsequent to December 31, 2012, on January 15, 2013, the Company issued 11,415 common shares of the Company, at a fair market value of $4.38 per share and on January 14, 2013 paid $0.05 million cash according to the terms of the option agreement.

TAVICHE PROPERTY

In 2010, the Company included the idle plant in Taviche as part of the San Jose mine plant as it was more likely than not that the idle plant could be used to treat excess ore from San Jose or from surrounding are as where the company was conducting exploration. On September 1, 2011, the San Jose mine plant commenced commercial production and in the fourth quarter of 2011, achieved an average of 955 tonnes milled per day with the San Jose plant having sufficient capacity for the production. In the fourth quarter of 2011, management reassessed the usability of the idle plant and in conjunction, obtained an independent third party appraisal of various assets acquired under an asset purchase agreement dated 2007 related to the Taviche property.

Management used the fair value less cost to sell method to determine the recoverable amount of the idle plant. Based upon an independent appraisal of the assets, which is in accordance with fair value less cost to sell, the Company took an impairment charge, in 2011, of $1.89 million that comprised of the following impairments: $1.08 million on the tailing dam, $0.14 million on the mine infrastructure, and $0.67 million on equipment, machinery, and buildings. As at December 31, 2011, the net book value of assets related to the Taviche property for machinery and equipment amounted to $0.36 million.

TAVICHE OESTE CONCESSIONS

Subsequent to December 31, 2012, on February 4, 2013, the Company, through its wholly owned subsidiary, Cuzcatlan, acquired, through an option agreement (the "Option") with Plata Pan American S.A. de C.V. ("Plata") (a wholly owned subsidiary of Pan American Silver Corp.), a 55% undivided interest in 6,254 hectare Taviche Oeste Concessions ("concessions") immediately surrounding the San Jose Mine in Oaxaca, Mexico. The Company made a cash payment of $4.0 million. Once a production decision is made to develop ore from the concessions, the Company, through its wholly owned subsidiary, Cuzcatlan, will purchase the remaining 45% undivided interest in the property for $6.0 million. Plata will retain a 2.5% net smelter royalty on ore production from this property.

SAN LUISITO CONCESSIONS

Subsequent to December 31, 2012, in February 2013, the Company, through its wholly owned subsidiary, Cuzcatlan, was granted an option (the "Option") with a third party on concessions in the San Luisito Project, Sonora, Mexico and made a cash payment of $0.05 million. Further payments due are as follows: August 26, 2013 $0.15 million, February 24, 2014 $0.40 million, February 24, 2015 $1.0 million, February 26, 2016 $1.4 million, and February 26, 2017 $12 million. The third party will retain a 2% net smelter royalty on ore produced from this property.

Annual Financial Results

	Years ended December 31,		
Expressed in $000's, except per share data	2012	2011	2010
Sales	161,020	110,004	74,506
Mine operating earnings	70,662	60,974	39,212
Operating income	45,168	38,065	27,728
Net income	31,463	19,533	16,003
Earnings per share, basic	0.25	0.16	0.15
Earnings per share, diluted	0.25	0.16	0.14
Total assets	316,983	271,642	233,871
Leases and long term liabilities	2,250	2,764	3,166

For the year ended December 31, 2012, net income increased by 62% to $31.5 million, compared to $19.5 million in 2011. Mine operating earnings increased by 16% to $70.7 million (2011: $61.0 million) and cash flow from operations, before changes in working capital, rose by 59% to $62.2 million (2011: $39.1 million).

The increase in net income reflects the contribution of San Jose, which commenced commercial operations in September 2011, and a lower effective tax rate, which reduced income taxes by $5.0 million. The full benefit of San Jose was tempered by lower sales and operating margins at Caylloma than in 2011. Caylloma was affected by higher treatment and refining charges and lower base metals sold (down $5.5 million), by lower prices for and, in turn, sales of silver and base metals (down $12.5 million), and an increase in unit cash cost year over year of 26%. However, cash flow from operations before changes in working capital, increased, as did cash flow margins (cash flow from operations, before changes in working capital, over sales), which increased to 39% in 2012 from 36% in 2011 as a result of strong margins at San Jose and a lower cash tax rate. The latter effect relates mainly to San Jose, which incurred no taxes during the year ended December 31, 2012.

Basic earnings per share increased by 56% to $0.25 in 2012, compared to $0.16 in 2011. Operating cash flow per share, before change in working capital items, increased by 56% to $0.50 (2011: $0.32) (Refer to non-GAAP financial measures).

Sales for 2012 increased by 46% to $161.0 million (2011: $110.0 million) primarily because of the contribution from San Jose of $77.3 million (2011: $12.3 million). In respect to metals, higher sales of silver and gold (up 71% and 303%, respectively) were partially offset by lower prices for silver, lead, and zinc (down 11%, 15%, and 12%, respectively), higher consolidated refining charges ($2.06/oz compared to $1.83/oz) and lower lead and zinc sales (down 9% and 5%, respectively).

Net realized prices are calculated from provisional sales, based on contained metals in concentrate sold, before government royalties and after deductions, treatment, and refining charges. Treatment charges are allocated to the base metals in Caylloma and to gold in San Jose. Final pricing for all concentrates takes place one month after the month of sale.

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	YEAR TO DATE RESULTS					
	Years ended December 31,					
	2012			2011		
Sales and Realized Prices	Caylloma	San Jose	Consolidated	Caylloma	San Jose	Consolidated
Provisional Sales (US$)	82,226,303	79,161,972	161,388,274	97,518,505	12,665,147	110,183,652
Adjustments (US$)*	1,470,935	(1,839,272)	(368,338)	221,116	(400,610)	(179,495)
Sales (US$)	83,697,237	77,322,699	161,019,936	97,739,620	12,264,536	110,004,157
Silver						
Provisional Sales (oz)	1,975,984	1,984,902	3,960,886	1,976,301	338,852	2,315,153
Realized Price (US$/oz)**	30.98	30.84	30.91	35.00	31.95	34.83
Net Realized Price (US$/oz)***	26.96	27.83	27.40	31.91	26.29	31.09
Gold						
Provisional Sales (oz)	2,452	18,524	20,976	2,130	3,069	5,199
Realized Price (US$/oz)**	1,667.47	1,657.14	1,648.83	1,560.59	1,680.93	1,631.39
Net Realized Price (US$/oz)***	1,321.92	1,291.80	1,295.32	1,116.09	1,224.19	1,179.90
Lead						
Provisional Sales (000's lb)	17,662	–	17,662	19,460	–	19,460
Realized Price (US$/lb)**	0.94	–	0.94	1.10	–	1.10
Net Realized Price (US$/lb)***	0.63	–	0.63	0.86	–	0.86
Zinc						
Provisional Sales (000's lb)	22,049	–	22,049	23,107	–	23,107
Realized Price (US$/lb)**	0.88	–	0.88	1.00	–	1.00
Net Realized Price (US$/lb)***	0.66	–	0.66	0.66	–	0.66
Copper						
Provisional Sales (000's lb)	–	–	–	47	–	47
Realized Price (US$/lb)**	–	–	–	4.25	–	4.25
Net Realized Price (US$/lb)***	–	–	–	2.65	–	2.65

* *Adjustments consists of mark to market and final price adjustments, and final assay adjustments*

** *Based on provisional sales before final price adjustments*

*** *Net after payable metal deductions, treatment, and refining charges*

Treatment charges are allocated to the base metals in Caylloma and to gold in San Jose

Cost of sales for 2012 increased by 84% to $90.4 million (2011: $49.0 million). The increase is primarily attributable to the contribution by San Jose of $39.1 million (2011: $6.8 million) as results for San Jose in 2012 reflect a full year versus four months in 2011, and to a 26% higher unit production cash costs per tonne of processed ore at Caylloma (Refer to non-GAAP financial measures for reconciliation of cash cost to the cost of sales).

	Expressed in $ millions					
	Years ended December 31,					
	2012			2011		
	Caylloma	San Jose	Total	Caylloma	San Jose	Total
Direct mining costs [1]	$ 40.9	$ 27.5	$ 68.4	$ 34.0	$ 4.7	$ 38.6
Depletion and depreciation	8.9	11.6	20.5	6.9	2.1	9.1
Royalty expenses	1.5	–	1.5	1.3	–	1.3
	$ 51.3	$ 39.1	$ 90.4	$ 42.2	$ 6.8	$ 49.0

[1] *Direct mining costs includes salaries and other short term benefits, contractor charges, energy, consumables and production related costs.*

Selling, general and administrative expenses for 2012 increased by 4% to $20.5 million (2011: $19.8 million). The increase is primarily attributable to an increase of $2.4 million in Cuzcatlan general and administrative expenses as commercial production at San Jose commenced September 1, 2011, to a $1.6 million increase in corporate general and administrative expenses as a result of higher salaries and professional fees related to the growth of the Company, and offset by a $2.6 million decrease in share-based payments. The decrease in share-based payments is attributed to the decline in the fair value of restricted share units and deferred share units. Shared-based payments related to vesting of granted instruments, excluding the mark-to-market effect, amounted to $3.2 million during the year.

Selling, general and administrative expenses consist primarily of corporate office and subsidiary expenses such as salaries and other payroll related costs for executive, administrative, legal, financial, information technology, human and organizational development, and procurement functions, as well as professional service fees.

	Expressed in $ millions	
	Years ended December 31,	
	2012	2011
Corporate general and administrative expenses	$ 11.6	$ 10.0
Bateas general and adminstrative expenses	3.2	3.4
Cuzcatlan general and adminstrative expenses	3.3	0.9
Foreign exchange	(0.1)	0.1
Share-based payments	2.2	4.8
Workers' participation	0.3	0.6
	$ 20.5	$ 19.8

Exploration and evaluation costs for 2012 decreased to $0.8 million (2011: $1.7 million).

	Expressed in $ millions	
	Years ended December 31,	
	2012	2011
Share-based payments	$ 0.1	$ –
Salaries, wages, and benefits	0.5	0.9
Direct costs	0.2	0.8
	$ 0.8	$ 1.7

Net loss (gain) on commodity contract for 2012 was $0.3 million loss compared to a $0.5 million gain in 2011. The loss is related to short term contracts used to fix the final settlement price on metal contained in concentrate delivered throughout the period.

Write-off of mineral properties costs for 2012 was $3.9 million (2011: nil) and relates to the write-off of exploration costs for the Mario project.

Impairment of mineral properties, plant and equipment for 2012 was nil. This compares to an impairment charge in 2011 of $1.9 million related to the Taviche property comprised of: $1.1 million on the tailings dam, $0.1 million on mine infrastructure, and $0.7 million on equipment, machinery, and buildings.

Interest income for 2012 decreased by 25% to $0.6 million (2011: $0.8 million) primarily due to a reduction in cash balances.

Interest expense for 2012 remained unchanged at $0.6 million (2011: $0.6 million). Expenses for 2012 result from the accretion of the decommissioning and restoration of the San Jose property, offset by a reduction in interest on leases.

Income taxes for the year decreased by 27% to $13.8 million (2011: $18.8 million). The effective tax rate for the years ended December 31, 2012 and 2011 was 30.43% and 49.05%, respectively. The change in the effective tax rate was primarily attributable to the geographical mix of income and the impact of foreign exchange on the tax basis on non-monetary assets.

The income tax provision comprised $5.5 million (2011: $14.6 million) of current income tax expense arising mainly from our Peruvian operations and $8.3 million (2011: $4.2 million) of deferred income tax expense arising from our Peruvian and Mexican operations.

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Quarterly Information

The following table provides information for the eight fiscal quarters ended December 31, 2012:

	Quarters ended							
Expressed in $000's, except per share data	31-Dec-12	30-Sep-12	30-Jun-12	31-Mar-12	31-Dec-11	30-Sep-11	30-Jun-11	31-Mar-11
Sales	37,895	43,835	38,689	40,601	31,047	32,543	24,528	21,886
Mine operating earnings	13,264	19,239	17,078	21,081	13,265	19,811	14,847	13,052
Operating income	7,976	12,262	8,397	16,533	4,436	14,886	10,667	8,076
Net income (loss)	8,472	8,026	3,854	11,111	(1,756)	10,309	6,199	4,781
Earnings per share, basic	0.07	0.06	0.03	0.09	(0.01)	0.08	0.05	0.04
Earnings per share, diluted	0.07	0.06	0.03	0.09	(0.01)	0.08	0.05	0.04
Total assets	316,983	304,612	288,686	280,825	271,641	270,289	253,350	242,566
Leases and long term liabilities	2,250	2,766	1,658	2,237	2,764	2,873	2,988	3,384

Sales growth from Q1 2011 to Q4 2012 reflects the surge in silver price since the beginning of 2010 and the commencement of commercial production at San Jose starting in September 2011.

The following table provides the realized prices from sales for the past eight quarters and the years ended December 31, 2012 and 2011:

Realized Prices from Sales

	2012					2011				
	YTD	Q4	Q3	Q2	Q1	YTD	Q4	Q3	Q2	Q1
Silver										
Realized Prices										
Silver (US$/oz)**										
Caylloma	30.98	32.56	29.96	29.40	32.19	35.00	32.09	38.33	37.88	30.94
San Jose	30.84	32.73	30.29	28.89	31.90	31.95	31.57	37.96	–	–
Consolidated	30.91	32.64	30.11	29.12	32.05	34.83	31.98	38.70	37.88	30.94
Net Realized Prices										
Silver (US$/oz)***										
Caylloma	26.96	28.30	26.06	25.66	27.99	31.91	28.58	35.28	34.86	28.26
San Jose	7.83	29.71	27.35	26.02	28.63	26.29	25.95	31.59	–	–
Consolidated	27.40	29.01	26.67	25.86	28.30	31.09	27.59	35.15	34.86	28.26
Gold										
Realized Prices										
Gold (US$/oz)**										
Caylloma	1,667.47	1,714.36	1,660.62	1,603.01	1,680.97	1,560.59	1,694.98	1,682.50	1,487.72	1,380.01
San Jose	1,657.14	1,707.87	1,667.93	1,598.37	1,663.73	1,680.93	1,675.70	1,763.44	–	–
Consolidated	1,648.83	1,718.91	1,661.73	1,598.54	1,656.09	1,631.39	1,673.38	1,703.29	1,487.72	1,380.01
Net Realized Prices										
Gold (US$/oz)***										
Caylloma	1,321.92	1,206.60	1,382.27	1,318.12	1,332.77	1,116.08	1,245.13	1,153.99	1,063.98	1,000.52
San Jose	1,291.80	1,279.55	1,288.74	1,269.71	1,333.49	1,224.19	1,221.05	1,273.67	–	–
Consolidated	1,295.32	1,271.81	1,302.14	1,274.62	1,333.40	1,179.90	1,224.79	1,185.07	1,063.98	1,000.52
Lead										
Realized Prices										
Lead (US$/lb)**										
Caylloma	0.94	1.00	0.90	0.90	0.95	1.10	0.91	1.13	1.17	1.18
Consolidated	0.94	1.00	0.90	0.90	0.95	1.10	0.91	1.13	1.17	1.18
Net Realized Prices										
Lead (US$/lb)***										
Caylloma	0.63	0.68	0.62	0.58	0.63	0.86	0.67	0.89	0.92	0.94
Consolidated	0.63	0.68	0.62	0.58	0.63	0.86	0.67	0.89	0.92	0.94
Zinc										
Realized Prices										
Zinc (US$/lb)**										
Caylloma	0.88	0.89	0.86	0.88	0.92	1 .00	0.86	1.01	1.03	1.09
Consolidated	0.88	0.89	0.86	0.88	0.92	1 .00	0.86	1.01	1.03	1.09
Net Realized Prices										
Zinc (US$/lb)***										
Caylloma	0.66	0.65	0.65	0.67	0.68	0.66	0.57	0.67	0.68	0.71
Consolidated	0.66	0.65	0.65	0.67	0.68	0.66	0.57	0.67	0.68	0.71

** *Based on provisional sales before final price adjustments*

****Net after payable metal deductions, treatment, and refining charges*

Treatment charges are allocated to the base metals in Caylloma and to gold in San Jose

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Fourth Quarter 2012 Financial Results

During Q4 2012, the Company generated net income of $8.5 million, compared to a net loss in the prior year of $1.8 million. Mine operating earnings remained at $13.3 million (Q4 2011: $13.3 million) while cash flow from operations, before changes in working capital, increased by 35% to $11.9 million (Q4 2011: $8.8 million).

The higher net income resulted mainly from higher sales at San Jose, lower income taxes in the quarter comprising a $6.4 million reduction of deferred tax provision, and a one-time $1.9 million write-off of the Taviche idle plant that was recorded in the prior year. The full contribution of San Jose was curtailed by a $1.3 million negative final assay adjustment to sales and by higher costs related to accelerated mine preparation prior to the mine's expansion. Mine operating earnings remained flat due to lower results from Caylloma, which were affected by higher depletion and depreciation charges, an inventory build-up, and a rise in unit cash cost, reflecting the trend of our cost guidance for 2013.

The increase in cash flow from operations, before changes in working capital, reflects the positive contribution of San Jose to cash margins as well as lower cash tax rate in the period.

Basic earnings per share for Q4 2012 was $0.07 (Q4 2011: $0.01 loss). Operating cash flow per share, before change in working capital items, was $0.10 (Q4 2011: $0.07) (Refer to non-GAAP financial measures).

Sales for Q4 2012 increased by 22% to $37.9 million (Q4 2011: $31.0 million). The increase is due primarily to the contribution from San Jose of $16.7 million (Q4 2011: $11.4 million). In respect to metals, the sales increase was driven by higher provisional sales of silver, gold, and zinc, up 11%, 21%, and 12%, respectively, and partially offset by $1.3 million of negative assay adjustments at San Jose.

Net realized prices are calculated from provisional sales, based on contained metals in concentrate sold, before government royalties and after deductions, treatment, and refining charges. Treatment charges are allocated to the base metals in Caylloma and to gold in San Jose. Final pricing for all concentrates takes place one month after the month of sale.

	QUARTERLY RESULTS					
	Three months ended December 31,					
	2012			2011		
Sales and Realized Prices	Caylloma	San Jose	Consolidated	Caylloma	San Jose	Consolidated
Provisional Sales (US$)	20,980,783	18,707,113	39,687,896	21,742,179	11,792,088	33,534,267
Adjustments (US$)*	223,218	(2,016,662)	(1,793,444)	(2,086,580)	(400,610)	(2,487,190)
Sales (US$)	21,204,001	16,690,451	37,894,452	19,655,599	11,391,478	31,047,077
Silver						
Provisional Sales (oz)	466,492	469,858	936,350	526,096	318,593	844,689
Realized Price (US$/oz)**	32.56	32.73	32.64	32.09	31.57	31.98
Net Realized Price (US$/oz)***	28.30	29.71	29.01	28.58	25.95	27.59
Gold						
Provisional Sales (oz)	40	3,710	4,150	5 30	2,886	3,416
Realized Price (US$/oz)**	1,714.36	1,707.87	1,718.91	1,694.98	1,675.70	1,673.38
Net Realized Price (US$/oz)***	1,206.60	1,279.55	1,271.81	1,245.13	1,221.05	1,224.79
Lead						
Provisional Sales (000's lb)	4,698	–	4,698	4,340	–	4,340
Realized Price (US$/lb)**	1.00	–	1.00	0 .91	–	0.91
Net Realized Price (US$/lb)***	0.68	–	0.68	0 .67	–	0.67
Zinc						
Provisional Sales (000's lb)	6,223	–	6,223	5,565	–	5,565
Realized Price (US$/lb)**	0.89	–	0.89	0.86	–	0.86
Net Realized Price (US$/lb)***	0.65	–	0.65	0.57	–	0.57

* *Adjustments consists of mark to market and final price adjustments, and final assay adjustments*

** *Based on provisional sales before final price adjustments*

***Net after payable metal deductions, treatment, and refining charges*

Treatment charges are allocated to the base metals in Caylloma and to gold in San Jose

Cost of sales for Q4 2012 increased by 39% to $24.6 million, compared to $17.8 million in Q4 2011. The increase is primarily attributable to higher concentrate sales and unit cash costs at both San Jose and Caylloma. Refer to non-GAAP financial measures for reconciliation of cash cost to the cost of sales.

	Expressed in $ millions					
	Three months ended December 31,					
	2012			2011		
	Caylloma	San Jose	Total	Caylloma	San Jose	Total
Direct mining costs [1]	$ 11.3	$ 8.1	$ 19.4	$ 9.6	$ 4.0	$ 13.6
Depletion and depreciation	2.8	2.0	4.8	1.8	2.0	3.8
Royalty expenses	0.4	–	0.4	0.4	–	0.4
	$ 14.5	$ 10.1	$ 24.6	$ 11.8	$ 6.0	$ 17.8

[1] *Direct mining costs includes salaries and other short term benefits, contractor charges, energy, consumables and production related costs.*

Selling, general and administrative expenses for Q4 2012 decreased by 12% to $5.1 million (Q4 2011: $5.9 million). The decrease is primarily attributable to lower share-based payments of $0.9 million and foreign exchange of $0.3 million, offset by higher general and administrative expenses in Cuzcatlan ($0.1 million) and corporate general and administrative expenses ($0.3 million), mainly as a result of higher salaries and professional fees related to growth of the Company. The decrease in share-based payments is attributed to the decrease in the fair value of restricted share units and deferred share units. Shared-based payments related to vesting of granted instruments, excluding the mark-to-market effect, amounted to $1.0 million during the quarter.

Selling, general and administrative expenses consist primarily of corporate office and subsidiary expenses such as salaries and other payroll related costs for executive, administrative, legal, financial, information technology, human and organizational development, and procurement functions, as well as professional service fees.

	Expressed in $ millions	
	Three months ended December 31,	
	2012	2011
Corporate general and administrative expenses	$ 3.2	$ 2.9
Bateas general and adminstrative expenses	0.8	0.8
Cuzcatlan general and adminstrative expenses	0.8	0.7
Foreign exchange	(0.1)	0.2
Share-based payments	0.3	1.2
Workers' participation	0.1	0.1
	$ 5.1	$ 5.9

Exploration and evaluation costs for Q4 2012 decreased by 75% to $0.2 million (Q4 2011: $0.6 million).

	Expressed in $ millions	
	Three months ended December 31,	
	2012	2011
Salaries, wages, and benefits	$ 0.1	$ 0.3
Direct costs	0.1	0.3
	$ 0.2	$ 0.6

Net loss on commodity contract for Q4 2012 was nil compared to a loss of $0.4 million in Q4 2011, which is related to short term contracts used to fix the final settlement price on metal contained in concentrate delivered throughout the period.

Interest income for Q4 2012 remained flat at $0.2 million (Q4 2011: $0.2 million), as cash balances were reduced.

Interest expense for Q4 2012 remained unchanged at $0.1 million (Q4 2011: $0.1 million).

Income taxes for Q4 2012 decreased by 108% to a recovery of $0.5 million (Q4 2011: $6.2 million expense). The change was primarily attributable to the impact of foreign exchange on the tax basis on non-monetary assets.

Income tax provision is comprised of $1.7 million (Q4 2011: $1.9 million) of current income tax expense, arising mainly from our Peruvian operations, and a $2.2 million recovery (Q4 2011: $4.3 million expense) of deferred income tax arising from our Peruvian and Mexican operations.

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Non-GAAP Financial Measures

ADJUSTED NET INCOME (NON-GAAP FINANCIAL MEASURE)

	Expressed in $ millions	
	Years ended December 31,	
	2012	2011
NET INCOME FOR THE YEAR	$ 31.5	$ 19.5
Items of note, net of tax:		
Mark-to-Market effect on derivatives	–	(0.1)
Write-off of mineral properties	2.6	–
Impairment of mineral properties, plant and equipment	–	1.3
ADJUSTED NET INCOME FOR THE YEAR [1]	$ 34.1	$ 20.7

[1] *A non-GAAP financial measure*

OPERATING CASH FLOW PER SHARE BEFORE CHANGE IN WORKING CAPITAL ITEMS (NON-GAAP FINANCIAL MEASURE)

	Expressed in $'000's (except per share measures)			
	Three months ended December 31,		Years ended December 31,	
	2012	2011	2012	2011
Net income for the period	$ 8,472	$ (1,755)	$ 31,463	$ 19,533
Items not involving cash	4,392	13,680	40,885	33,821
	$ 12,864	$ 11,925	$ 72,348	$ 53,354
Income taxes paid	(1,141)	(3,274)	(10,703)	(15,007)
Interest expense paid	(8)	(21)	(31)	(80)
Interest income received	150	155	611	837
Cash generated by operating activities before changes in working capital	$ 11,865	$ 8,785	$ 62,225	$ 39,104
Divided by Weighted average number of shares ('000's)	124,412	124,090	123,585	123,295
Operating cash flow per share before change in working capital items [1]	$ 0.10	$ 0.07	$ 0.50	$ 0.32

[1] *A non-GAAP financial measure*

CASH COST PER OUNCE OF PAYABLE SILVER AND CASH COST PER TONNE OF PROCESSED ORE (NON-GAAP FINANCIAL MEASURE)

Cash cost per ounce of payable silver and cash cost per tonne of processed ore are key performance measures that management uses to monitor performance. In addition, cash costs are presented as they represent an industry standard method of comparing certain costs on a per unit basis but do not have a standardized meaning and may differ from methods used by other companies with similar descriptions. Management believes that certain investors use these non-GAAP financial measures to evaluate the Company's performance. These performance measures have no meaning under International Financial Reporting Standards ("IFRS") and, therefore, amounts presented may not be comparable to similar data presented by other mining companies.

The following tables present a reconciliation of cash costs per tonne of processed ore and cash cost per ounce of payable silver to the cost of sales in the consolidated financial statements for the past eight quarters and the years ended December 31, 2012 and 2011.

Consolidated Mine Cash Cost

	Expressed in $'000's									
	2012					2011				
	YTD	Q4	Q3	Q2	Q1	YTD	Q4	Q3	Q2	Q1
Cost of sales [1]	90,358	24,631	24,596	21,611	19,520	49,030	17,782	12,732	9,682	8,834
Add / (Subtract)										
Change in concentrate inventory	430	394	(872)	(320)	1,228	2,142	415	1,168	(4)	563
Depletion and depreciation in concentrate inventory	23	(41)	227	233	(396)	(717)	(207)	(403)	22	(129)
Government royalties and mining taxes	(1,491)	(399)	(320)	(170)	(602)	(1,322)	(385)	(463)	(260)	(214)
Workers participation	(1,153)	(379)	(428)	52	(398)	(3,141)	(436)	(1,132)	(852)	(721)
Depletion and depreciation	(20,477)	(4,879)	(5,826)	(5,374)	(4,398)	(9,060)	(3,752)	(2,056)	(1,478)	(1,774)
Cash cost (A)	67,690	19,327	17,377	16,032	14,954	36,932	13,417	9,846	7,110	6,559
Cash cost (A)	67,690	19,327	17,377	16,032	14,954	36,932	13,417	9,846	7,110	6,559
Add / (Subtract)										
By-product credits	(52,899)	(12,878)	(13,359)	(13,388)	(13,274)	(40,644)	(11,184)	(10,207)	(9,720)	(9,533)
Refining charges	7,790	2,051	1,986	1,849	1,904	4,308	2,242	1,015	541	510
Cash cost applicable per payable ounce (B)	22,581	8,500	6,004	4,493	3,584	596	4,475	654	(2,069)	(2,464)
Payable ounces of silver production (C)	3,788,369	960,194	976,355	946,384	905,436	2,352,759	860,566	625,696	451,230	415,267
Cash cost per ounce of payable silver ($/oz) (B/C)	5.96	8.85	6.15	4.75	3.96	0.25	5.20	1.05	(4.59)	(5.93)

[1] *Includes depletion, depreciation, distribution, community relations, government royalties and mining taxes, and workers participation*

San Jose Mine Cash Cost

	Expressed in $000's							
	2012					2011		
Mine Production	YTD	Q4	Q3	Q2	Q1	YTD	Q4	Q3
Cost of sales [1]	39,126	10,090	11,184	10,147	7,705	6,794	6,005	789
Add / (Subtract)								
Change in concentrate inventory	(269)	115	(384)	(957)	957	1,936	323	1,613
Depletion and depreciation in concentrate inventory	146	16	150	338	(358)	(684)	(195)	(489)
Workers participation	(41)	(41)	–	–	–	–	–	–
Depletion and depreciation	(11,616)	(2,035)	(3,567)	(3,409)	(2,605)	(2,141)	(1,988)	(153)
Cash cost (A)	27,346	8,145	7,383	6,119	5,699	5,905	4,145	1,760
Total processed ore (tonnes) (B)	369,022	98,348	91,607	92,011	87,056	116,410	87,885	28,525
Cash cost per tonne of processed ore ($/t) (A/B)	74.10	82.82	80.59	66.50	65.46	50.73	47.16	61.70
Cash cost (A)	27,346	8,145	7,383	6,119	5,699	5,905	4,145	1,760
Add / (Subtract)								
By-product credits	(23,146)	(4,916)	(5,800)	(6,432)	(5,998)	(5,539)	(4,313)	(1,226)
Refining charges	2,757	679	717	693	668	1,718	1,341	377
Cash cost applicable per payable ounce (C)	6,957	3,908	2,300	380	369	2,084	1,173	911
Payable ounces of silver production (D)	1,851,718	466,622	477,694	461,981	445,421	444,695	350,960	93,735
Cash cost per ounce of payable silver ($/oz) (C/D)	3.76	8.38	4.81	0.82	0.83	4.69	3.34	9.72
Mining cost per tonne	33.43	40.36	35.51	28.84	28.26	17.37	15.03	24.57
Milling cost per tonne	17.96	17.84	20.10	15.76	18.15	14.64	15.16	13.07
Indirect cost per tonne	15.53	15.99	17.47	14.24	14.37	11.54	11.33	12.12
Community relations cost per tonne	2.09	3.52	2.33	2.29	0.02	4.47	2.27	11.24
Distribution cost per tonne	5.09	5.11	5.18	5.37	4.66	2.71	3.37	0.70
Total production cost per tonne	74.10	82.82	80.59	66.50	65.46	50.73	47.16	61.70

[1] *Includes depletion, depreciation, distribution, community relations, government royalties and mining taxes, and workers participation*

Caylloma Mine Cash Cost

	Expressed in $000's									
	2012					2011				
	YTD	Q4	Q3	Q2	Q1	YTD	Q4	Q3	Q2	Q1
Cost of sales [1]	51,232	14,541	13,412	11,464	11,815	42,236	11,777	11,943	9,682	8,834
Add / (Subtract)										
Change in concentrate inventory	699	279	(488)	637	271	206	92	(445)	(4)	563
Depletion and depreciation in concentrate inventory	(123)	(57)	77	(105)	(38)	(33)	(12)	86	22	(129)
Government royalties and mining taxes	(1,491)	(399)	(320)	(170)	(602)	(1,322)	(385)	(463)	(260)	(214)
Workers participation	(1,112)	(338)	(428)	52	(398)	(3,141)	(436)	(1,132)	(852)	(721)
Depletion and depreciation	(8,861)	(2,844)	(2,259)	(1,965)	(1,793)	(6,919)	(1,764)	(1,903)	(1,478)	(1,774)
Cash cost (A)	40,344	11,182	9,994	9,913	9,255	31,027	9,272	8,086	7,110	6,559
Total processed ore (tonnes) (B)	462,222	115,522	117,386	115,870	113,444	448,866	116,363	115,574	111,992	104,937
Cash cost per tonne of processed ore ($/t) (A/B)	87.28	96.80	85.14	85.55	81.58	69.12	79.68	69.96	63.49	62.50
Cash cost (A)	40,344	11,182	9,994	9,913	9,255	31,027	9,272	8,086	7,110	6,559
Add / (Subtract)										
By-product credits	(29,753)	(7,962)	(7,559)	(6,956)	(7,276)	(35,105)	(6,871)	(8,981)	(9,720)	(9,533)
Refining charges	5,033	1,372	1,269	1,156	1,236	2,590	901	638	541	510
Cash cost applicable per payable ounce (C)	15,624	4,592	3,704	4,113	3,215	(1,488)	3,302	(257)	(2,069)	(2,464)
Payable ounces of silver production (D)	1,936,651	493,572	498,661	484,403	460,015	1,908,064	509,606	531,961	451,230	415,267
Cash cost per ounce of payable silver ($/oz) (C/D)	8.07	9.30	7.43	8.49	6.99	(0.78)	6.48	(0.48)	(4.59)	(5.93)
Mining cost per tonne	39.78	40.04	39.76	40.64	38.67	32.05	38.02	31.84	28.71	29.23
Milling cost per tonne	14.05	15.69	14.13	12.66	13.73	11.54	12.49	11.64	10.86	11.12
Indirect cost per tonne	24.83	27.82	24.29	25.13	22.00	18.80	21.92	19.80	17.44	15.70
Community relations cost per tonne	1.46	4.61	0.43	0.48	0.32	0.67	1.01	0.59	0.28	0.78
Distribution cost per tonne	7.16	8.64	6.53	6.64	6.86	6.06	6.24	6.09	6.20	5.67
Total production cost per tonne	87.28	96.80	85.14	85.55	81.58	69.12	79.68	69.96	63.49	62.50

Liquidity and Capital Resources

FULL YEAR LIQUIDITY AND CAPITAL RESOURCES

The capital of the Company consists of equity and available credit facility, net of cash. The Board of Directors does not establish a quantitative return on capital criteria for management. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets.

The Company's cash and cash equivalents as at December 31, 2012 totalled $58.7 million (2011: $38.7 million), and short term investments totalled $6.0 million (2011: $17.0 million).

The $20.0 million increase (2011: $31.9 million decrease) in cash and cash equivalents at December 31, 2012 is due to the cash provided by operating activities of $53.9 million, net cash used in investing activities of $33.0 million and net cash used in financing activities of $0.9 million, and the effect of exchange rate changes on cash and cash equivalents of $0.1 million. Compared to 2011, the Company's expenditures on mineral properties, plant and equipment declined by $31.8 million and redemptions of short term investments declined by $36.4 million and cash provided by operating activities increased by $18.9 million attributable to the commissioning of San Jose mine on September 1, 2011.

Working capital for the year increased $23.5 million to $87.4 million reflecting increases in accounts receivable and other assets of $7.9 million, prepaid expenses of $0.1 million, inventories of $1.6 million, assets held for sale of $0.1 million, and decreases in due to related parties of $0.2 million, derivative liabilities of $0.1 million, provisions of $0.3 million, income tax payable of $3.7 million, current portion of long term liabilities of $1.1 million; offset by decreases in short term investments of $11.0 miilion, derivative assets of $0.1 million, due from related parties and increases in trade and other payables of 0.2 million.

During the year ended December 31, 2012, cash generated by operating activities before changes in non-cash working capital items, income taxes paid, and interest income paid and received was $62.2 million (2011: $39.1 million). Changes in non-cash working capital items amounted to $8.4 million (2011: $4.1 million), and income taxes paid and interest income paid and received amounted to $10.1 million (2011: $14.3 million), resulting in net cash provided by operating activities of $53.9 million (2011: $35.0 million).

Cash used by the Company for the year ended December 31, 2012, in investing activities totalled $33.0 million (2011: $69.3 million) comprised of $11.0 million (2011: $3.7 million) net redemptions of short term investments, $0.7 million (2011: $3.6 million) net receipts on deposits on long term assets, $0.1 million (2011: nil) proceeds on disposal of mineral properties, plant and equipment, and offset by $44.8 million (2011: $76.7 million) expenditures on mineral properties, plant and equipment.

During the year ended December 31, 2012, cash used by financing activities totalled $0.9 million (2011: provided $2.5 million) with net repayment of long term debt of $0.8 million (2011: nil), repayment of finance lease obligations of $0.8 million (2011: $1.2 million), and offset by net proceeds on the issuance of common shares of $0.7 million (2011: $3.7 million).

FOURTH QUARTER LIQUIDITY AND CAPITAL RESOURCES

During Q4 2012, cash generated by operating activities before changes in non-cash working capital items, income taxes paid, and interest income paid and received was $11.9 million (Q4 2011: $8.8 million). Changes in non-cash working capital items amounted to $5.7 million (Q4 2011: $1.2 million), and income taxes paid and interest income paid and received amounted to $1.0 million (Q4 2011: $3.1 million), resulting in net cash provided by operating activities of $17.6 million (Q4 2011: $7.6 million).

Cash used by the Company in Q4 2012 for investing activities totalled $19.2 million (Q4 2011: $31.9 million), with $15.8 million (Q4 2011: $16.2 million) for expenditures on mineral properties, plant and equipment, $0.6 million (Q4 2011: $0.6 million net advances) in net receipts on deposits on long term assets, and $4.0 million (Q4 2011: $15.0 million) for net purchases of short term investments.

During Q4 2012, cash used by financing activities was $0.1 million, compared to $2.0 million provided by such activities in Q4 2011, and included repayment of finance lease obligations of $0.1 million (Q4 2011: $0.2 million), offset by net proceeds on the issuance of common shares of nil (Q4 2011: $2.2 million).

In 2010, the Company entered into a credit agreement with the Bank of Nova Scotia for a $20 million senior secured revolving credit facility ("credit facility") to be refinanced or repaid on or within two and one-half years or before February 6, 2013. The credit facility is secured by a first ranking lien on Bateas and its assets and bears interest and fees at prevailing market rates. In the event that utilization under the credit facility is less than $10 million, a commitment fee of 1.50% per annum is payable quarterly on the unutilized portion of the available credit facility. No funds have been drawn from this credit facility.

In February 2013, the Bank of Nova Scotia extended the credit facility maturity date to February 6, 2013 and then to February 27, 2013. On March 15, 2013, the Bank of Nova Scotia extended the credit facility maturity date to March 28, 2013. No funds were drawn from this credit facility.

The Company has raised funds from two prospectus financings in 2010. The details of the expected use of proceeds and actual use of proceeds are discussed below.

Prospectus February 18, 2010 Closed March 2, 2010
San Jose Project Financing

			Expressed in CAD $ millions
	Expected use of proceeds*	Actual use of proceeds**	Variance
Mine development	$ 6.7	$ 11.2	$ (4.5)
Processing plant	16.6	30.4	(13.8)
Tailings dam	1.9	4.4	(2.5)
Water and Infrastructure	3.0	3.5	(0.5)
Energy supply	–	2.5	(2.5)
Construction management	–	2.5	(2.5)
Total	**$ 28.2**	**$ 54.5**	**$ (26.3)**

* *excludes over-allotment*
** *US CAD FX rate at 1.0*

Prospectus December 17, 2010 Closed December 23, 2010
San Jose Project Financing**

			Expressed in CAD $ millions
	Expected use of proceeds*	Actual use of proceeds**	Variance
Planned expansion	$ 14.5	$ –	$ 14.5
Exploration programs	5.5	11.4	(5.9)
Working capital	17.7	26.3	(8.6)
Total	**$ 37.7**	**$ 37.7**	**$ –**

* *excludes over-allotment*
** *funds to be utilized post development*

Management believes that the Company's current operational requirements and capital projects can be funded from existing cash and cash equivalents, cash generated from operations, and the available credit facility. If future circumstances dictate an increased cash requirement and we elect not to delay, limit, or eliminate some of our plans, we may raise additional funds through debt financing, the issuance of hybrid debt-equity securities, or additional equity securities. If the Company needs to access the capital markets for additional financial resources, managements believes the Company will be able to do so at prevailing market rates.

CONTRACTUAL OBLIGATIONS

					Expressed in $ millions
	Expected payments due by period as at December 31, 2012				
	Less than 1 year	1–3 years	4–5 years	After 5 years	Total
Trade and other payables	$ 17.3	$ –	$ –	$ –	$ 17.3
Due to related parties	0.1	–	–	–	0.1
Income tax payable	0.2	–	–	–	0.2
Long term liabilities	0.5	2.3	–	–	2.8
Operating leases	0.7	1.3	0.9	0.1	3.0
Provisions	0.5	0.5	0.5	11.3	12.8
	$ 19.3	**$ 4.1**	**$ 1.4**	**$ 11.4**	**$ 36.2**

CAPITAL COMMITMENTS (EXPRESSED IN $'000'S)

As at December 31, 2012, $5,613 of capital commitments not disclosed elsewhere in the consolidated financial statements, and forecasted to be expended within one year, includes the following: $4,280 mine and tailing dam development at the San Jose property; and, $1,333 for the tailings dam transport system, concentrator plant, electrical infrastructure renewal, and camp infrastructure at Caylloma.

OTHER COMMITMENTS (EXPRESSED IN $'000'S)

The Company has a contract to guarantee power supply at its Caylloma mine. Under the contract, the seller is obligated to deliver a "maximum committed demand" (for the present term this stands at 3,500 Kw) and the Company is obligated to purchase subject to exemptions under provisions of "Force Majeure". The contract is automatically renewed every two years for a period of 10 years and expiring in 2017. Renewal can be avoided without penalties by notification 10 months in advance of renewal date.

Tariffs are established annually by the energy market regulator in accordance with applicable regulations in Peru.

The Company acts as guarantor to finance lease obligations held by two of its mining contractors. These finance lease contracts are related to the acquisition of mining equipment deployed at the Caylloma mine. As at December 31, 2012, these obligations amounted to $13 and mature in 2013.

On May 24, 2010, the Company entered into a seven year office premise lease located in Peru. The annual rent payable on 1,717 rentable square meters for office space is as follows:

- year one $289;
- year two $297;
- year three $306; and,
- years four through seven, the lease is subject a minimum annual increase of 3% or the Consumer Price Index published by Bureau of Labor Statistics of the United States Department of Labor, whichever is higher.

The lease also includes the use of additional space for mini-warehouse and parking spots, the obligation for which is $58 per annum for the first year and is subject to an annual increase of 3% as stated above until the end of the lease. During 2011, the Company provided a security deposit of $44.

On September 30, 2012, the Company entered into a one year office premise lease in Mexico effective September 30, 2012, with an annual lease obligation of $16.

The expected payments due by period as at December 31, 2012 are as follows:

	Expressed in $'000's				
	Expected payments due by period as at December 31, 2012				
	Less than 1 year	1–3 years	4–5 years	After 5 years	Total
Office premises – Canada	$ 148	$ 443	$ 306	$ 147	$ 1,044
Office premises – Peru	373	781	580	–	1,734
Office premises – Mexico	14	–	–	–	14
Total office premises	**$ 535**	**$ 1,224**	**$ 886**	**$ 147**	**$ 2,792**
Computer equipment – Peru	149	64	–	–	213
Computer equipment – Mexico	18	17	–	–	35
Total computer equipment	**$ 167**	**$ 81**	**$ –**	**$ –**	**$ 248**
Total operating leases	**$ 702**	**$ 1,305**	**$ 886**	**$ 147**	**$ 3,040**

OTHER CONTINGENCIES

The Company is subject to various investigations, claims and legal and tax proceedings covering matters that arise in the ordinary course of business activities. Each of these matters is subject to various uncertainties and it is possible that some of these matters may be resolved unfavorably to the Company. Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Company. In the opinion of management none of these matters are expected to have a material effect on the results of operations or financial conditions of the Company.

During the year ended December 31, 2012, the Ministry of Mining and Energy (MEM) in Peru made an update to the approved Mining Environmental Liabilities List. The Company is currently in the process of evaluating its mining concessions which are currently included on the list and as at the date of the issuance of the financial statements an estimate of liability cannot be determined.

GUARANTEES AND INDEMNIFICATIONS (EXPRESSED IN $'000'S)

The Company may provide guarantees and indemnifications in conjunction with transactions in the normal course of operations. These are recorded as liabilities when reasonable estimates of the obligations can be made. Indemnifications that the Company has provided include obligation to indemnify:

- directors and officers of the Company and its subsidiaries for potential liability while acting as a director or officer of the Company, together with various expenses associated with defending and settling such suits or actions due to association with the Company;
- certain vendors of acquired company for obligations that may or may not have been known at the date of the transaction; and,
- the dollar value cannot be reasonably estimated.

The Caylloma mine closure plan was approved in November 2009 with total closure costs of $3,587 of which $1,756 is subject to annual collateral in the form of a letter of guarantee, to be awarded each year in increments of $146 over 12 years based on the estimated life of the mine.

Scotiabank Peru, a third party, has established a bank letter of guarantee on behalf of Bateas in favor of the Peruvian mining regulatory agency in compliance with local regulation associated with the approved Bateas' mine closure plan, for the sum of $585. This bank letter of guarantee expires 360 days from December 2012.

Banco Bilbao Vizcaya Argentaria, S.A. had also established bank letters of guarantee totalling $54 to provide an annual guarantee associated with an office lease contract and truck rentals. These bank letters of guarantee were renewed in June 2011 with expiry 360 days to June 2012. This guarantee expired in June 2012.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements or commitments that are expected to have a current or future effect on our financial condition, results of operations, liquidity, capital expenditures, or capital resources that are material to investors, other than those disclosed in this MD&A and the consolidated financial statements and the related notes.

Related Party Transactions

(expressed in $'000's)

A) PURCHASE OF GOODS AND SERVICES

The Company entered into the following related party transactions:

	Expressed in $'000's	
	Years ended December 31,	
Transactions with related parties	**2012**	**2011**
Salaries and wages [1,2]	$ 135	$ 173
Other general and administrative expenses [2]	308	292
Leasehold improvements [2]	23	93
	$ 466	$ 558

1 *Salaries and wages includes employees' salaries and benefits charged to the Company based on a percentage of the estimated hours worked for the Company.*

2 *Radius Gold Inc. ("Radius") has directors in common with the Company and shares office space, and is reimbursed for salaries, wages, general administration costs, and leasehold improvements incurred on behalf of the Company to June 30, 2012. Gold Group Management Inc. ("Gold Group"), which is owned by a director in common with the Company, provides various administrative, management, and other related services effective July 1, 2012.*

In January 2012, the Company issued 8,605 (2011: 6,756) common shares, at a fair market value of $5.81 (2011: $4.44) per share and paid $50 (2011: $30) cash to Radius, under the option to acquire a 60% interest in Tlacolula silver project located in the State of Oaxaca, Mexico.

In October 2012, the Company entered into a services agreement, effective July 1, 2012, with Gold Group Management Inc. ("Gold Group"), which is owned by a director in common with the Company. The services agreement provides that Gold Group provides various administrative, management and other related services.

Subsequent to December 31, 2012, on January 14, 2013 the Company issued 11,415 common shares of the Company, at a fair market value of $4.38 per share and paid $50 cash to Radius, under the option to acquire a 60% interest in the Tlacolula silver project located in the State of Oaxaca, Mexico.

B) KEY MANAGEMENT COMPENSATION

Key management includes all persons named or performing the duties of Vice-President, Chief Financial Officer, President, Chief Executive Officer, and non-executive Directors of the Company. The compensation paid or payable to key management for services is shown below:

	Expressed in $'000's	
	Years ended December 31,	
	2012	2011
Salaries and other short term employee benefits	$ 2,789	$ 3,492
Directors fees	388	333
Consulting fees	180	416
Share-based payments	1,629	4,398
	$ 4,986	$ 8,639

The share-based payments includes the change in the deferred share unit ("DSU") and restricted share unit ("RSU") fair value over each reporting period and payments made under the DSU and RSU plans and the non-cancellation of share options.

Consulting fees includes fees paid to two non-executive directors in both 2012 and 2011.

C) YEAR END BALANCES ARISING FROM PURCHASES OF GOODS/SERVICES

	Expressed in $'000's	
Amounts due from related parties	December 31, 2012	December 31, 2011
Owing from a director and officer [3]	$ –	$ 36
Owing from a company with common director [3]	5	–
	$ 5	$ 36

[3] *Owing from a director includes non-interest bearing advances to a company controlled by a director of the company at December 31, 2012 and to director and officers at December 31, 2011.*

	Expressed in $'000's	
Amounts due to related parties	December 31, 2012	December 31, 2011
Owing to company(ies) with common directors [4]	$ 54	$ 205

[4] *2012 Owing to Radius Gold Inc. ("Radius") and Gold Group Management Inc. ("Gold Group") whom have directors in common with the Company and 2011 to Radius.*

On October 10, 2012, the Company paid Gold Group Management Inc., which is owned by a director in common with the Company, a retainer of $61 representing three months deposit under a services agreement effective July 1, 2012.

Significant Accounting Judgments and Estimates

The preparation of these consolidated financial statements requires management to make judgments and estimates that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these judgments and estimates. The consolidated financial statements include judgments and estimates which, by their nature, are uncertain. The impacts of such judgments and estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and the revision affects both current and future periods. Significant assumptions about the future and other sources of judgments and estimates that management has made at the statement of financial position date, that could result in a material adjustment to the carrying amounts of assets and liabilities, in the event that actual results differ from assumptions made, relate to, but are not limited to, the following:

i. Critical Judgments

- The analysis of the functional currency for each entity of the Company. In concluding that the United States dollar functional currency for its Peruvian and Mexican entities and the Canadian and Barbados entities have a Canadian dollar functional currency, management considered the currency that mainly influences the cost of providing goods and services in each jurisdiction in which the Company operates. As no single currency was clearly dominant the Company also considered secondary indicators including the currency in which funds from financing activities are denominated and the currency in which funds are retained.
- In concluding when commercial production has been achieved, the Company considered the following factors:
  - all major capital expenditures to bring the mine to the condition necessary for it to be capable of operating in the manner intended by management have been completed;
  - the mine or mill is operating within eighty percent of design capacity;
  - metallurgical recoveries are achieved within eighty percent of projections; and,
  - the ability to sustain ongoing production of ore at a steady or increasing level.
- The identification of reportable segments, basis for measurement and disclosure of the segmented information.
- The determination of estimated useful lives and residual values of tangible and long-lived assets and the measurement of depreciation expense.
- The identification of impairment indicators, cash generating units and determination of value in use and the write down of tangible and long lived assets.
- Measurement of financial instruments involve significant judgments related to interpretation of the terms of the instrument, identification, classification, impairment and the overall measurement to approximate fair values.

ii. Estimates

- the recoverability of amounts receivable which are included in the consolidated statements of financial position;
- the estimation of assay grades of metal concentrates sold in the determination of the carrying value of accounts receivable which are included in the consolidated statements of financial position and included as sales in the consolidated statements of income;
- the carrying value of the short term investments and the recoverability of the carrying value which are included in the consolidated statements of financial position;
- the determination of net realizable value of inventories on the consolidated statements of financial position;
- the estimated useful lives of property, plant and equipment which are included in the consolidated statements of financial position and the related depreciation included in the consolidated statements of income;
- the determination of mineral reserves, carrying amount of mineral properties, and depletion of mineral properties included in the consolidated statements of financial position and the related depletion included in the consolidated statements of income;
- review of tangible and intangible assets carrying value, the determination of whether these assets are impaired and the measurement of impairment charges or reversals which are included in the consolidated statements of income;
- the determination of the fair value of financial instruments and derivatives included in the consolidated statements of financial position;

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- the fair value estimation of share-based awards included in the consolidated statements of financial position and the inputs used in accounting for share-based compensation expense in the consolidated statements of income;
- the provision for income taxes which is included in the consolidated statements of income and composition of deferred income tax asset and liabilities included in the consolidated statement of financial position;
- the recognition of deferred income tax assets, amounts recorded for uncertain tax positions, the measurement of income tax expense and indirect taxes included in the consolidated statement of financial position;
- the inputs used in determining the net present value of the liability for provisions related to decommissioning and restoration included in the consolidated statements of financial position;
- the inputs used in determining the various commitments and contingencies accrued in the consolidated statements of financial position; and,
- the assessment of indications of impairment of each mineral properties and related determination of the net realizable value and write-down of those properties where applicable.

Financial Instruments and Related Risks

(expressed in '000's)

The Company is exposed to certain financial risks, including currency risk, credit risk, liquidity risk, interest risk, and price risk. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework and reviews the Company's policies on an ongoing basis.

A) FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying value of cash and cash equivalents, short term investments, derivative assets, trade receivable from concentrate sales, other accounts receivables, due from related parties, trade and other payables, due to related parties, and derivative liabilities approximate their fair value due to the relatively short periods to maturity and the terms of these financial instruments. Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument.

The amortized value of long term receivables approximates their fair value as these are measured at the amortized cost using the effective interest method. The fair value of the lease and long term liabilities is $2,723 as at December 31, 2012.

The analysis of financial instruments that are measured subsequent to initial recognition at fair value can be categorized into Levels 1 to 3 based upon the degree to which the fair value is observable.

- Level 1 - inputs to the valuation methodology are quoted (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - inputs to valuation methodology include quoted market prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The Company has classified the determination of fair value of trade receivable concentrate sales, and derivatives as Level 2, as the valuation method used by the Company includes an assessment of assets in quoted markets with significant observable inputs.

				Expressed in $'000's
	Financial assets (liabilities) at fair value as at December 31, 2012			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 58,720	$ –	$ –	$ 58,720
Short term investments	6,019	–	–	6,019
Trade receivable from concentrate sales	–	15,158	–	15,158
	$ 64,739	$ 15,158	$ –	$ 79,897

There were no changes in the levels during the year ended December 31, 2012.

	Expressed in $'000's			
	Financial assets (liabilities) at fair value as at December 31, 2011			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 38,730	$ –	$ –	$ 38,730
Short term investments	17,000	–	–	17,000
Trade receivable from concentrate sales	–	11,287	–	11,287
Derivatives assets	–	70	–	70
Derivatives liabilities	–	(87)	–	(87)
	$ 55,730	$ 11,270	$ –	$ 67,000

There were no changes in the levels during the year ended December 31, 2011.

Accounts receivable includes trade receivable from concentrate sales, provisional price adjustments, and final price adjustments. The fair value of accounts receivable resulting from provisional pricing reflect observable market commodity prices. Resulting fair value changes to accounts receivable are through sales. Transactions involving accounts receivable are with counterparties the Company believes are creditworthy. As such, these accounts receivable are classified within Level 2 of the fair value hierarchy.

Derivatives are carried at their fair value, which is determined based on internal valuation models that reflect observable forward market commodity prices. Resulting fair value changes to derivatives are through net gain (loss) on commodity contracts. Transactions involving derivatives are with counterparties the Company believes to be creditworthy.

During the year ended December 31, 2012, there have been no changes in the classification of financial assets and liabilities in Levels 1, 2, and 3 of the hierarchy.

B) CURRENCY RISK

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada, Peru and Mexico and a portion of its expenses are incurred in Canadian dollars, nuevo soles, and Mexican pesos. A significant change in the currency exchange rates between the United States dollar relative to the other currencies could have a material effect on the Company's income, financial position, or cash flows. The Company has not hedged its exposure to currency fluctuations.

As at December 31, 2012, the Company is exposed to currency risk through the following assets and liabilities denominated in Canadian dollars, nuevo soles and Mexican pesos (all amounts are expressed in thousands of Canadian dollars, thousands of nuevo soles or thousands of Mexican pesos):

	Expressed in $'000's					
	December 31, 2012			December 31, 2011		
	Canadian Dollars	Nuevo Soles	Mexican Pesos	Canadian Dollars	Nuevo Soles	Mexican Pesos
Cash and cash equivalents	$ 4,231	S/. 1,389	$ 6,136	$ 18,457	S/. 1,396	$ 1,758
Short term investments	6,000	–	–	–	–	–
Accounts receivable and other assets	77	3,097	98,147	42	5,657	58,939
Due from related parties	–	–	–	–	4,434	–
Trade and other payables	(1,225)	(12,300)	(49,779)	(1,580)	(17,993)	(24,310)
Due to related parties	(54)	–	–	(209)	–	–
Provisions, current	–	(284)	(4,502)	–	(1,351)	(3,163)
Income tax payable	–	(326)	–	–	(10,581)	–
Leases and long term liabilities	(1,998)	–	(245)	(2,691)	–	–
Provisions	–	(19,560)	(39,323)	–	(8,079)	(17,494)
Total	$ 7,031	S/. (27,984)	$ 10,434	$ 14,019	S/. (26,517)	$ 15,730
Total US$ equivalent	$ 7,053	$ (10,970)	$ 802	$ 13,745	$ (9,832)	$ 1,125

Based on the above net exposure as at December 31, 2012, and assuming that all other variables remain constant, a 10% depreciation or appreciation of the US dollar against the above currencies would result in an increase or decrease, as follows: impact to other comprehensive income of $784 (2011: $1,527) and a net loss of $1,130 (2011: $967).

C) CREDIT RISK

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The Company's cash and cash equivalents and short term investments are held through large Canadian, international and foreign national financial institutions. These investments mature at various dates within one year. All of the Company's trade accounts receivables are held with large international metals trading companies.

The Company holds derivative contracts with financial institutions and in this regard is exposed to counterparty risk. The Company mitigates this risk by transacting only with reputable financial institutions to minimize credit risk.

The Company's maximum exposure to credit risk at December 31, 2012 is as follows:

		Expressed in $'000's
	December 31, 2012	December 31, 2011
Cash and cash equivalents	$ 58,720	$ 38,730
Short term investments	6,019	17,000
Accounts receivable and other assets	27,032	19,167
Derivative assets	–	70
Due from related parties	5	36
	$ 91,776	$ 75,003

The carrying amount of financial assets recorded in the financial statements represents the Company's maximum exposure to credit risk. The Company believes it is not exposed to significant credit risk and overall, the Company's credit risk has not declined significantly from the prior year.

D) LIQUIDITY RISK

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages liquidity risk by continuing to monitor forecasted and actual cash flows. The Company has in place a planning and budgeting process to help determine the funds required to support the Company's normal operating requirements on an ongoing basis and its development plans. The Company strives to maintain sufficient liquidity to meet its short term business requirements, taking into account its anticipated cash flows from operations, its holdings of cash, short term investments, and its committed liabilities.

(Refer to Contractual Obligations for the expected payments due as at December 31, 2012.)

Derivatives

				Expressed in $ millions
	December 31, 2012		December 31, 2011	
	Assets	Liabilities	Assets	Liabilities
Lead forward contracts	$ –	$ –	–	$ 0.1
Zinc forward contracts	–	–	$ 0.1	–
Silver forward contracts	–	–	–	–
Total	$ –	$ –	$ 0.1	$ 0.1

The Company occasionally enters into forward commodity contracts as well as put and call option commodity arrangements to secure a minimum price level on part of its zinc and lead metal production. As at the end of the period no such contracts are outstanding.

In 2011, the Company entered into short term forward and option contracts to fix the final settlement price of metal delivered in concentrates, where the final settlement price is yet to be set at a future quotational period according to contract terms. The forward sale and option contracts were settled against the arithmetic average of metal spot prices over the month in which the contract matures. No initial premium associated with these trades had been paid.

Significant Accounting Policy

OPERATIONAL MINING PROPERTIES AND MINE DEVELOPMENT

For operating mines, all exploration within the mineral deposit is capitalized and amortized on a unit-of-production basis over proven and probable reserves and the portion of resources expected to be extracted economically as part of the production cost.

Costs of producing properties are amortized on a unit-of-production basis over proven and probable reserves and the portion of resources expected to be extracted economically, and costs of abandoned properties are written-off.

The company has made a change in estimate and commencing in the fourth quarter of 2012, the amortization on a unit-of-production basis will be over the portion of resources, in addition to the proven and probable reserves, expected to be extracted economically. The change in estimate is applied prospectively and impacts the depletion of the mineral deposit for the current and future periods.

Significant Changes in Accounting Policies including Initial Adoption

IFRS 7 *Financial Instruments: Disclosures* (Amendment)

The amendment, effective for annual periods beginning on or after July 1, 2011, with early application permitted, requires additional quantitative and qualitative disclosures relating to transfers of financial assets, where: financial assets are derecognized in their entirety, but where the entity has a continuing involvement in them; financial assets that are not derecognized in their entirety. The Company has adopted the amendment to IFRS 7 and the amendment did not have a material impact on the Company's consolidated financial statements.

IAS 12 *Income Taxes* (Amendment)

IAS 12 *Income Taxes,* amendments regarding Deferred Tax: Recovery of Underlying Assets introduces an exception to the existing principle for the measurement of deferred tax assets and liabilities arising on investment property measured at fair value, and the requirement that deferred tax on non-depreciable assets measured using the revaluation model in IAS 16 should always be measured on a sale basis. The amendment is effective for annual periods beginning on or after January 1, 2012. The Company has adopted the amendment to IAS 12 and the amendment did not have a material impact on the Company's consolidated financial statements.

New Accounting Standards

The Company is currently assessing the impact of adopting the new accounting standards, noted below, on our consolidated financial statements.

The following standards and amendments to existing standards have been published and are mandatory for the Company's annual accounting periods beginning on or after July 1, 2012 or later:

i) New Accounting Standards Impacting on or after July 1, 2012

IAS 1 *Presentation of Financial Statements* (Amendment)

The amendments to IAS 1 *Presentation of Financial Statements* retain the 'one or two statement' approach at the option of the entity and only revise the way other comprehensive income ("OCI") is presented: requiring separate subtotals for those elements which may be 'recycled' (e.g. cash-flow hedging, foreign currency translation), and those elements that will not (e.g. fair value through OCI items under IFRS 9) to the statement of income. In addition, the tax associated with items presented before tax to be shown separately for each of the two groups of OCI items (without changing the option to present items of OCI either before tax or net of tax).

ii) New Accounting Standards Impacting on or after January 1, 2013

On May 17, 2012, the IASB issued Annual Improvements to IFRSs: 2009-2011 Cycle, incorporating amendments to five IFRSs; ***IFRS 1 First-time Adoption of International Reporting Standards, IAS 1 Presentation of Financial Statements, IAS 16 Property, Plant and Equipment, IAS 32 Financial Statements: Presentation, IAS 34 Interim Financial Reporting.*** The amendments are effective for annual periods beginning on or after January 1, 2013, with early application permitted, and must be applied retrospectively.

IFRS 1 *First-time Adoption of International Financial Reporting Standards* (Amendment)

IFRS 1 is amended to clarify the repeated application of IFRS 1 and the treatment of borrowing costs incurred on or after the date of transition to IFRSs. This is not applicable as the company has already transitioned to IFRS.

IAS 1 *Presentation of Financial Statements* (Amendment)

IAS 1 is amended to clarify that only one comparative period – which is the preceding period – is required for a complete set of financial statements.

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IAS 16 *Property, Plant, and Equipment* (Amendment)
IAS 16 is amended to clarify the classification of servicing equipment. Spare parts, stand-by equipment and servicing equipment should be classified as property, plant, and equipment when they meet the definition of property, plant, and equipment in IAS 16 and otherwise as inventory using IAS 2 *Inventories.*

IAS 32 *Financial Instruments: Presentation* (Amendment)
IAS 32 is amended to clarify that IAS 12 *Income Taxes* applies to the account for income taxes relating to distributions to holders of equity instruments and transaction costs of equity transactions.

IAS 34 *Interim Financial Reporting* (Amendment)
IAS 34 is amended to clarify that the total assets and total liabilities for a particular reportable segment would be separately disclosed in interim financial reporting only when the amounts are regularly provided to the chief operating decision maker and there has been a material change from the amounts disclosed in the last annual financial statements for the reportable segment.

The Company does not anticipate these amendments to have a significant impact on its consolidated financial statements.

IFRS 7 *Financial Instruments: Disclosures in Respect of Offsetting* (Amendment)
At its meeting on December 13-15, 2011, the IASB approved amendments to IFRS 7, *Financial Instruments:* Disclosures, with respect to offsetting financial assets and financial liabilities. The common disclosure requirements issued by the IASB and the FASB in December 2011 are intended to help investors and other users to better assess the effect or potential effect of offsetting arrangements on a company's financial position. Companies and other entities are required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The required disclosures should be provided retrospectively. The Company does not anticipate this amendment to have a significant impact on its consolidated financial statements.

IFRS 10 *Consolidated Financial Statements*
IFRS 10 *Consolidated Financial Statements* replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements, and SIC12 *Consolidation - Special Purpose Entities.* IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. This standard (i) requires a parent entity (an entity that controls one or more other entities) to present consolidated financial statements; (ii) defines the principle of control, and establishes control as a basis for consolidation; (iii) sets out how to apply the principle of control whether an investor controls an investee and therefore must consolidate the investee; and (iv) sets out the accounting requirements for the preparation of consolidated financial statements. IFRS 10 is effective for annual periods beginning on or after January 1, 2013. The Company does not anticipate the application of IFRS 10 to have a significant impact on its consolidated financial statements.

IFRS 11 *Joint Arrangements*
IFRS 11 replaces IAS 31 *Interest in Joint Ventures* and SIC-13 *Jointly-Controlled Entities-Non-Monetary Contributions by Venturers.* This standard establishes the core principle that a party to a joint arrangement determines the type of joint arrangement in which it is involved by assessing its rights and obligations and accounts for those rights and obligations in accordance with that type of joint arrangement (joint operations or joint ventures). This standard is effective for annual periods on or after January 1, 2013.

IFRS 12 *Disclosure of Interests in Other Entities*
IFRS 12 combines the disclosure requirements for an entity's interest in subsidiaries, joint arrangements, associates and structured entities into one comprehensive disclosure standard. This standard requires the disclosure of information that enable users of financial statements to evaluate the nature of, and risks associated with, its interest in other entities and the effects of those interests on its financial position, financial performance and cash flows. This standard is effective for annual periods beginning on or after January 1, 2013.

The Company does not anticipate these amendments to have a significant impact on its consolidated financial statements.

IFRS 13 *Fair Value Measurement*
IFRS 13 *Fair Value Measurement* provides guidance on how to measure fair value, but does not change when fair value is required or permitted under IFRS. IFRS 13 defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 applies when another IFRS requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except for: share-based payment transactions within the scope of IFRS 2 *Share-based Payment;* leasing transactions with the scope of IAS 17 *Leases*; measurements that have some similarities to fair value that are not fair value, such as net realizable value in IAS 2 *Inventories*; or value

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in use IAS 36 Impairment of Assets. This standard is effective for annual periods beginning on or after January 1, 2013. The Company does not anticipate the application of IFRS 13 to have a significant impact on its consolidated financial statements.

IFRS 10 *Consolidated Financial Statements,* IFRS 11 *Joint Arrangements, and* IFRS 12 *Disclosure of Interests in Other Entities: Transition Guidance*

The amendments provide additional transition relief, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. For disclosures related to unconsolidated structured entities, the amendments will remove the requirement to present comparative information for periods before IFRS 12 is first applied. The effective date of the amendments is annual periods beginning on or after January 1, 2013, which is aligned with the effective date of IFRS 10, IFRS 11, and IFRS 12. The Company does not anticipate these amendments to have a significant impact on its consolidated financial statements.

IAS 19 *Employee Benefits*

On June 16, 2011, the IASB issued amendments to IAS 19, *Employee Benefits*, in order to improve the accounting for employment benefits.

The amendments make important improvements by:

- eliminating the option to defer the recognition of gains and losses, known as the 'corridor method' or the "deferral and amortization approach";
- streamlining the presentation of changes in assets and liabilities arising from defined benefit plans, including requiring re-measurements to be presented in OCI, thereby separating those changes from changes that many perceive to be the result of an entity's day-to-day operations;
- enhancing the disclosure requirements for defined benefit plans, providing better information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in those plans.

The amendments are effective for financial years beginning on or after January 1, 2013. The Company does not anticipate the application of IFRS 13 to have a significant impact on its consolidated financial statements

IAS 27 *Separate Financial Statements*

IAS 27 has the objective of setting standards to be applied in accounting for investments in subsidiaries, jointly controlled entities, and associates when an entity elects, or is required by local regulations, to present separate (non-consolidated) financial statements. This standard is effective for annual periods beginning on or after January 1, 2013. This standard will not have an impact on the consolidated financial statements.

IAS 28 *Investments in Associates and Joint Ventures*

IAS 28 prescribes the accounting for investments in associates and to set the requirements for the application of the equity method when accounting for investments in associates and joint ventures. This standard is effective for annual periods beginning on or after January 1, 2013. This standard will not have an impact on the consolidated financial statements.

iii) New Accounting Standards Impacting on or after January 1, 2014

IAS 32 *Financial Instruments - Presentation in Respect of Offsetting* (Amendment)

The amendments to IAS 32 address inconsistencies in current practice when applying the requirements with regards to the offsetting of financial assets and financial liabilities. The amendments are effective for annual periods beginning on or after January 1, 2014 and are required to be applied retrospectively.

iv) New Accounting Standards Impacting on or after January 1, 2015

IFRS 9 *Financial Instruments - Classification and Measurement*

IFRS 9, *Financial Instruments:* IFRS 9 introduces the new requirements for the classification, measurement and de-recognition of financial assets and financial liabilities. The amendments are effective for annual periods beginning on or after January 1, 2015, with earlier application permitted.

Other Data

Additional information related to the Company is available for viewing at www.sedar.com and the Company's website at www.fortunasilver.com.

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Share Position and Outstanding Warrants and Options

The Company's outstanding share position as at March 19, 2013 is 125,305,166 common shares. In addition, 6,091,610 incentive stock options are currently outstanding as follows:

Type of Security	No. of Shares	Exercise Price (CAD$)	Expiry Date
Incentive Stock Options:	1,663,651	$4.46	June 8, 2014
	2,047,542	$4.03	May 29, 2015
	200,000	$1.35	February 5, 2016
	50,000	$2.29	March 30, 2016
	10,000	$1.75	May 8, 2016
	2,500	$0.85	July 5, 2016
	225,000	$1.55	July 5, 2016
	225,000	$1.66	July 10, 2016
	10,000	$0.85	January 11, 2017
	350,000	$2.22	January 11, 2017
	184,138	$6.67	February 20, 2017
	38,000	$0.85	June 27, 2017
	380,779	$3.79	July 31, 2017
	25,000	$0.85	October 24, 2017
	250,000	$0.85	October 5, 2018
	230,000	$0.85	November 5, 2018
	200,000	$0.83	July 6, 2019
TOTAL OUTSTANDING OPTIONS	**6,091,610**		

Other Risks and Uncertainties

There have been no major changes from the reported risks factors outlined in the Annual Information Form for the financial year ended December 31, 2012.

Controls and Procedures

DISCLOSURE CONTROLS AND PROCEDURES

The Company's management, with the participation of the Chief Executive Officer and the Chief Financial Officer, have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in the rules of the SEC and the Canadian Securities Administrators ("CSA") as of December 31, 2012, and have concluded that such disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 and Canadian securities laws is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and Canadian securities laws and (ii) accumulated and communicated to them Company's management, including its principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.

INTERNAL CONTROL OVER FINANCIAL REPORTING

The Company's management, with the participation of its CEO and CFO, are responsible for establishing a system of internal control over financial reporting to provide reasonable assurance regarding the reliability and integrity of the Company's financial information and the preparation of its financial statements in accordance with IFRS as issued by the IASB.

The Company's management, including its CEO and CFO, believe that due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis. Also, projection of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

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There has been no change in the Company's internal control over financial reporting that occurred during the year that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

Management concludes that, as of December 31, 2012, the Company's internal control over financial reporting was effective and no material weaknesses were identified.

Cautionary Statement on Forward-Looking Statements

Certain statements contained in this MD&A and any documents incorporated by reference into this MD&A constitute forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995 and Section 21E of the United States Securities Exchange Act of 1934, as amended, and forward-looking information within the meaning of applicable Canadian securities legislation (collectively, "forward-looking statements"). Forward-looking statements express or involve discussions with respect to predictions, expectations, beliefs, plans, projections, objectives, assumptions or future events or performance (often, but not always, identified using words or phrases such as "expects", "is expected", "anticipates", "believes", "plans", "projects", "estimates", "assumes", "intends", "strategies", "targets", "goals", "forecasts", "objectives", "budgets", "schedules", "potential" or variations thereof or stating that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved, or the negative of any of these terms and similar expressions) and are not statements of historical fact. Forward-looking statements relate to, among other things:

- mineral "reserves" and "resources" as they involve the implied assessment, based on estimates and assumptions that the reserves and resources described exist in the quantities predicted or estimated and can be profitably produced in the future;
- timing of the completion of construction activities at the Company's properties and their completion on budget;
- production rates at the Company's properties;
- cash cost estimates;
- timing to achieve full production capacity at the Company's properties;
- timing for completion of infrastructure upgrades related to the Company's properties;
- timing for delivery of materials and equipment for the Company's properties; and
- the sufficiency of the Company's cash position and its ability to raise equity capital or access debt facilities.

Forward-looking statements are necessarily based upon a number of estimates and assumptions that, while considered reasonable by the Company as at the date of such statements, are inherently subject to significant business, economic, social, political and competitive uncertainties and contingencies and other factors that could cause actual results or events to differ materially from those projected in the forward-looking statements. The estimates and assumptions of the Company contained or incorporated by reference in this MD&A which may prove to be incorrect, include, but are not limited to, (1) that all required third party contractual, regulatory and governmental approvals will be obtained for the development, construction and production of its properties, (2) there being no significant disruptions affecting operations, whether due to labor disruptions, supply disruptions, power disruptions, damage to equipment or otherwise; (3) permitting, development, expansion and power supply proceeding on a basis consistent with the Company's current expectations; (4) currency exchange rates being approximately consistent with current levels; (5) certain price assumptions for silver, lead, zinc and copper; (6) prices for and availability of natural gas, fuel oil, electricity, parts and equipment and other key supplies remaining consistent with current levels; (7) production forecasts meeting expectations; (8) the accuracy of the Company's current mineral resource and reserve estimates; (9) labor and materials costs increasing on a basis consistent with the Company's current expectations; and (10) assumptions made and judgments used in engineering and geological interpretation.

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In addition, there are known and unknown risk factors which could cause the Company's actual results, performance or achievements to differ materially from any future results, performance or achievements expressed or implied by the forward-looking statements. Known risk factors include, risks associated with project development; the need for additional financing; operational risks associated with mining and mineral processing; changes in national and local government legislation, taxation, controls, regulations and political or economic developments in Canada, Mexico, the United States, Peru or other countries in which the Company does or may carry on business; the possibility of cost overruns or unanticipated expenses; fluctuations in silver, lead, zinc and copper prices; title matters; uncertainties and risks related to carrying on business in foreign countries; environmental liability claims and insurance; reliance on key personnel; currency exchange rate fluctuations; competition; and other risks and uncertainties, including those described in the "Risks and Uncertainties" section in the MD&A and in the "Risk Factors" section in the Company's Annual Information Form for the financial year ended December 31, 2011 filed with the Canadian Securities Administrators and the U.S. Securities and Exchange Commission and available at www.sedar.com and www.edgar.gov.

Although the Company has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors that cause actions, events or results not to be as anticipated, estimated or intended. These forward-looking statements are made as of the date of this MD&A. There can be no assurance that forward looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers are cautioned not to place undue reliance on forward-looking statements. Except as required by law, the Company does not assume the obligation to revise or update these forward looking statements after the date of this document or to revise them to reflect the occurrence of future unanticipated events.

Report of Independent Registered Chartered Accountants

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF FORTUNA SILVER MINES INC.

We have audited the accompanying consolidated financial statements of Fortuna Silver Mines Inc., which comprise the consolidated statements of financial position as at December 31, 2012 and 2011 and the consolidated statements of income, statements of changes in equity, comprehensive income and cash flows for the years then ended and a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Fortuna Silver Mines Inc.as at December 31, 2012 and 2011 and its financial performance and its cash flows for the years ended December 31, 2012 and 2011 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Deloitte LLP

Independent Registered Chartered Accountants
March 19, 2013
Vancouver, Canada

Consolidated Statements of Income

FOR THE YEARS ENDED DECEMBER 31,

(Expressed in thousands of US Dollars, except for share and per share amounts)

	Notes	2012	2011
Sales	19	$ 161,020	$ 110,004
Cost of sales	20	90,358	49,030
Mine operating income		70,662	60,974
Other expenses			
Selling, general and administrative expenses	11 a), 11 b), 21	20,541	19,840
Exploration and evaluation costs	22	777	1,715
Net loss (gain) on commodity contracts		339	(481)
Gain on disposal of mineral properties, property, plant and equipment		(50)	(59)
Write-off of mineral properties, plant and equipment 9 a), 9 b)	9 a), 9 b)	3,887	–
Impairment of mineral properties, property, plant and equipment	9 d)	–	1,894
Operating income		45,168	38,065
Finance items			
Interest income		620	830
Interest expense		(562)	(560)
Net finance income (expense)	23	58	270
Income before tax		45,226	38,335
Income taxes	14	13,763	18,802
Net Income for the year		$ 31,463	$ 19,533
Earnings per Share – Basic	15 e) i	$ 0.25	$ 0.16
Earnings per Share – Diluted	15 e) ii	$ 0.25	$ 0.16
Weighted average number of shares outstanding – Basic	15 e) i	123,584,611	123,295,063
Weighted average number of shares outstanding – Diluted	15 e) ii	125,232,663	124,711,984

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Comprehensive Income

FOR THE YEARS ENDED DECEMBER 31,
(Expressed in thousands of US Dollars)

	Notes	2012	2011
Net Income for the year		$ 31,463	$ 19,533
Other comprehensive income (loss)			
Transfer of unrealized loss to realized (loss) upon reduction of net investment, net of nil taxes		(895)	–
Unrealized (loss) gain on translation of net investment, net of nil taxes		(376)	751
Unrealized gain (loss) on translation to presentation currency on foreign operations		2,224	(79)
Other comprehensive income		953	672
Total comprehensive income for the year		$ 32,416	$ 20,025

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

FOR THE YEARS ENDED DECEMBER 31,
(Expressed in thousands of US Dollars)

		Years ended December 31,	
	Notes	2012	2011
OPERATING ACTIVITIES			
Net income for the year		$ 31,463	$ 19,533
Items not involving cash			
Depletion and depreciation		21,372	9,421
Accretion of provisions		232	173
Income taxes		13,763	18,802
Share-based payments		1,703	3,682
Unrealized gain on commodity contracts		(17)	(116)
Write-off of mineral properties		3,887	–
Impairment of mineral properties, plant and equipment		–	1,894
Gain on disposal of mineral properties, plant and equipment		(50)	(59)
Accrued interest on long term loans receivable and payable		(25)	24
Other		20	–
		72,348	53,354
Changes in non-cash working capital items			
Accounts receivable and other assets		(6,971)	(3,292)
Prepaid expenses		(45)	(315)
Due from related parties		31	(35)
Inventories		(1,567)	(7,273)
Trade and other payables		718	6,829
Due to related parties		(155)	169
Provisions		(386)	(201)
Cash provided by operating activities before interest and income taxes		63,973	49,236
Income taxes paid		(10,703)	(15,007)
Interest expense paid		(31)	(80)
Interest income received		611	837
Net cash provided by operating activities		53,850	34,986
INVESTING ACTIVITIES			
Purchase of short term investments		(6,000)	(49,671)
Redemptions in short term investments		17,000	53,406
Expenditures on mineral properties, plant and equipment		(44,839)	(76,676)
Advances of deposits on long term assets		(9,752)	(31,859)
Receipts of deposits on long term assets		10,429	35,424
Proceeds on disposal of mineral properties, plant and equipment		116	41
Net cash used in investing activities		(33,046)	(69,335)
FINANCING ACTIVITIES			
Proceeds from long term debt		-	18
Repayment of long term debt		(800)	(18)
Net proceeds on issuance of common shares		738	3,656
Repayment of finance lease obligations		(844)	(1,178)
Net cash (used in) provided by financing activities		(906)	2,478
Effect of exchange rate changes on cash and cash equivalents		92	303
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		19,898	(31,871)
Cash and cash equivalents - beginning of year	3	38,730	70,298
CASH AND CASH EQUIVALENTS - END OF YEAR	3	$ 58,720	$ 38,730
Supplemental cash flow information	16		

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Financial Position

(Expressed in thousands of US Dollars)

	Notes	Years ended December 31, 2012	2011
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	3	$ 58,720	$ 38,730
Short term investments	4	6,019	17,000
Derivative assets	5	–	70
Accounts receivable and other assets	6	27,032	19,167
Prepaid expenses		1,268	1,218
Due from related parties	11 c)	5	36
Inventories	7	12,858	11,291
Assets held for sale	8, 19	51	–
Total current assets		105,953	87,512
NON-CURRENT ASSETS			
Deposits on long term assets	6	2,694	2,260
Deferred income tax assets	14	113	36
Mineral properties, plant and equipment	9	207,503	181,833
Total assets		$ 316,263	$ 271,641
LIABILITIES AND EQUITY			
CURRENT LIABILITIES			
Trade and other payables	10	$ 17,348	$ 17,155
Due to related parties	11 c)	54	205
Derivative liabilities	5	–	87
Provisions	13	457	727
Income tax payable	14	200	3,923
Current portion of leases and long term liabilities	12	449	1,512
Total current liabilities		18,508	23,609
NON-CURRENT LIABILITIES			
Leases and long term liabilities	12	2,250	2,764
Provisions	13	9,970	4,247
Deferred income tax liabilities	14	21,042	12,710
Non-controlling interest		–	–
Total liabilities		51,770	43,330
EQUITY			
Share capital		187,807	186,540
Share option and warrant reserve		12,994	10,495
Retained earnings		59,344	27,881
Accumulated other comprehensive income		4,348	3,395
Total equity		264,493	228,311
Total liabilities and equity		$ 316,263	$ 271,641
Contingencies and capital commitments	24		
Subsequent events	25		

APPROVED BY THE DIRECTORS:

"Jorge Ganoza Durant", Director — Jorge Ganoza Durant

"Robert R. Gilmore", Director — Robert R. Gilmore

The accompanying notes are an integral part of these consolidated financial statements.

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Consolidated Statements of Changes in Equity

FOR THE YEARS ENDED DECEMBER 31,

(Expressed in thousands of US Dollars, except for share amounts)

		Attributable to Equity Holders of the Company					
		Share Capital					
	Notes	Shares	Amount	Share Option and Warrant Reserve	Retained Earnings	Accumulated Other Compre-hensive Income ("AOCI")	Total Equity
Balance - December 31, 2011		124,945,921	$ 186,540	$ 10,495	$ 27,881	$ 3,395	$ 228,311
Exercise of options		314,225	738	–	–	–	738
Issuance of shares for property	**15 a)**	8,605	51	–	–	–	51
Transfer of share option and warrant reserve on exercise of options		–	478	(478)	–	–	–
Share-based payments expense		–	–	2,977	–	–	2,977
Net income for the year		–	–	–	31,463	–	31,463
Transfer of unrealized loss to realized loss upon reduction of net investment, net of taxes		–	–	–	–	(895)	(895)
Unrealized loss on translation of net investment		–	–	–	–	(376)	(376)
Unrealized gain on translation to presentation currency on foreign operations		–	–	–	–	2,224	2,224
Total comprehensive income for the year					31,463	953	32,416
Balance – December 31, 2012		**125,268,751**	**$ 187,807**	**$ 12,994**	**$ 59,344**	**$ 4,348**	**$ 264,493**
Balance – December 31, 2010		122,497,465	$ 180,403	$ 11,116	$ 8,348	$ 2,723	$ 202,590
Issuance of shares under bought deal financing, net of issuance costs		–	(95)	–	–	–	(95)
Exercise of options		2,441,700	3,751	–	–	–	3,751
Issuance of shares for property	**15 a)**	6,756	30	–	–	–	30
Transfer of share option and warrant reserve on exercise of options		–	2,451	(2,451)	–	–	–
Share-based payments expense		–	–	1,830	–	–	1,830
Net income for the year		–	–	–	19,533	–	19,533
Unrealized gain on translation of net investment		–	–	–	–	751	751
Unrealized loss on translation to presentation currency on foreign operations		–	–	–	–	(79)	(79)
Total comprehensive income for the year					19,533	672	20,205
Balance - December 31, 2011		124,945,921	$ 186,540	$ 10,495	$ 27,881	$ 3,395	$ 228,311

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(All amounts in US$'000's unless otherwise stated)

1. Corporate Information

Fortuna Silver Mines Inc. ("Fortuna" or the "Company") is engaged in silver mining and related activities, in Latin America, including exploration, extraction, and processing. The Company operates the Caylloma silver/lead/zinc mine in southern Peru and the San Jose silver/gold mine in Mexico.

Fortuna is a publicly traded company incorporated and domiciled in Canada. Its common shares are listed on the New York Stock Exchange under the trading ticker symbol FSM, on the Toronto Stock Exchange and Lima Stock Exchange, both under the trading ticker symbol FVI, and on the Frankfurt Stock Exchange under the trading symbol F4S.F.

The Company's registered office is located at Suite 650, 200 Burrard Street, Vancouver, British Columbia, Canada, V6C 3L6.

2. Basis of Consolidation and Summary of Significant Accounting Policies

a) Statement of Compliance

These consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The policies applied in these consolidated financial statements are based on IFRS issued and effective as at December 31, 2012. The Board of Directors approved these financial statements for issue on March 19, 2013.

b) Basis of Consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries: Minera Bateas S.A.C. ("Bateas"); Fortuna Silver (Barbados) Inc. ("Barbados"); Compania Minera Cuzcatlan SA ("Cuzcatlan"); Continuum Resources Ltd. ("Continuum"); Fortuna Silver Mines Peru S.A.C. ("FSM Peru"); and Fortuna Silver Mexico, S.A. de CV. ("FS Mexico").

All significant inter-company transactions, balances, revenues, and expenses have been eliminated upon consolidation.

c) Revenue Recognition

Revenue arising from the sale of metal concentrates is recognized when title or the significant risks and rewards of ownership of the concentrates have been transferred to the buyer. The passing of title to the customer is based on the terms of the sales contract. Final commodity prices are set in a period subsequent to the date of sale based on a specified quotational period, either one, two, or three months after delivery. The Company's metal concentrates are provisionally priced at the time of sale based on the prevailing market price.

Variations between the price recorded at the delivery date and the final price set under the sales contracts are caused by changes in market prices, and result in an embedded derivative in accounts receivable. The embedded derivative is recorded at fair value each period until final settlement occurs, with changes in fair value classified as provisional price adjustments and included in sales in the consolidated statement of income. Sales of metal concentrates are net of refining and treatment charges.

Revenues from metal concentrate sales are subject to adjustment upon final settlement of metals prices, weights, and assays as of a date that is typically one, two, or three months after the delivery date. Typically, the adjustment is based on an inspection of the concentrate by the customer and in certain cases an inspection by a third party. The Company records adjustments to revenues monthly based on quoted spot prices for the expected settlement period. Adjustments for weights and assays are recorded when results are determinable or on final settlement.

d) Cash and Cash Equivalents

Cash and cash equivalents are designated as fair value through profit or loss ("FVTPL"). Cash and cash equivalents include cash on hand, demand deposits, and money market instruments, with maturities from the date of acquisition of 90 days or less, which are readily convertible to known amounts of cash and are subject to insignificant changes in value. Transaction costs are expensed when incurred through profit or loss.

e) Mineral Properties, Plant and Equipment

Costs directly related to construction projects are capitalized to work-in-progress until the asset is available for use in the manner intended by management. Completed property, plant and equipment are recorded at cost, net of accumulated depreciation and accumulated impairments. Assets, other than capital work in progress, will be depreciated to their residual values over their estimated useful lives as follows:

Land and buildings		
Land	Not depreciated	
Mineral properties	Units of production	
Buildings	6 – 20 years	Straight line
Leasehold improvements	7 – 8 years	Straight line
Plant and equipment		
Machinery and equipment	3 – 8 years	Straight line
Furniture and other equipment	3 – 13 years	Straight line
Transport units	4 – 5 years	Straight line
Capital work in progress	Not depreciated	

Equipment under finance lease is initially recorded at the present value of minimum lease payments at the inception of the lease and depreciated as above. Spare parts and components included in machinery and equipment, depending on the replacement period of the initial component, are depreciated over 8 to 18 months.

Borrowing costs attributed to the construction of qualifying assets are capitalized to mineral properties, plant and equipment and included in the carrying amounts of related assets until the asset is available for use in the manner intended by management.

Costs associated with commissioning activities on constructed plants are deferred from the date of mechanical completion of the facilities until the date the assets are ready for use in the manner intended by management.

On an annual basis, the depreciation method, useful economic life and the residual value of each component asset is reviewed, with any changes recognized prospectively over its remaining useful economic life.

i. Exploration and Evaluation Assets

Significant payments related to the acquisition of land and mineral rights are capitalized as incurred. Prior to acquiring such land or mineral rights, the Company makes a preliminary evaluation to determine that the property has significant potential to develop an economic ore body. The time between initial acquisition and full evaluation of a property's potential is dependent on many factors including: location relative to existing infrastructure, the property's stage of development, geological controls and metal prices.

The Company defers the cost of acquiring, maintaining its interest, exploring and developing mineral properties as exploration and evaluation assets when future inflow of economic benefits from the properties is probable and until such time as the properties are placed into development, abandoned, sold or considered to be impaired in value.

If a mineable ore body is discovered, exploration and evaluation costs are reclassified to mining properties. If no mineable ore body is discovered, such costs are expensed in the period in which it is determined the property has no future economic value.

Proceeds received from the sale of interests in evaluation and exploration assets are credited to the carrying value of the mineral properties, with any excess included in income as gain or loss on disposal of mineral properties, plant and equipment.

Write-downs due to impairment in value are charged to income. The cash-generating unit for assessing impairment is a geographic region and shall be no larger than the operating segment.

Exploration costs that do not relate to any specific property are expensed as incurred.

ii. Operational Mining Properties and Mine Development

For operating mines, all exploration within the mineral deposit is capitalized and amortized on a unit-of-production basis over proven and probable reserves and the portion of resources expected to be extracted economically as part of the production cost.

Costs of producing properties are amortized on a unit-of-production basis over proven and probable reserves and the portion of resources expected to be extracted economically, and costs of abandoned properties are written-off.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011
(All amounts in US$'000's unless otherwise stated)

The company has made a change in estimate and commencing in the fourth quarter of 2012, the amortization on a unit-of-production basis will be over the portion of resources, in addition to the proven and probable reserves, expected to be extracted economically. The change in estimate is applied prospectively and impacts the depletion of the mineral deposit for the current and future periods.

iii. Commercial Production

Capital work in progress consists of expenditures for the construction of future mines and includes pre-production revenues and expenses prior to achieving commercial production. Commercial production is a convention for determining the point in time in which a mine and plant has completed the operational commissioning and has operational results that are expected to remain at a sustainable commercial level over a period of time, after which production costs are no longer capitalized and are reported as operating costs. The determination of when commercial production commences is based on several qualitative and quantitative factors including but not limited to the following:

- all major capital expenditures to bring the mine to the condition necessary for it to be capable of operating in the manner intended by management have been completed;
- the mine or mill is operating within eighty percent of design capacity;
- metallurgical recoveries are achieved within eighty percent of projections; and,
- the ability to sustain ongoing production of ore at a steady or increasing level.

On the commencement of commercial production, depletion of each mining property will be provided on a unit-of-production basis. Any costs incurred after the commencement of production are capitalized to the extent they give rise to a future economic benefit.

f) Asset Impairment

Assets are reviewed and tested for impairment when an indicator of impairment is considered to exist. An assessment of impairment indicators is performed at each reporting period or whenever indicators arise. Even with no indicators present, the Company will test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment at least once annually. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less cost to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash inflows or cash generating units. These are typically individual mines or development projects. Brownfields exploration projects, located close to existing mine infrastructure, are assessed for impairment as part of the associated mine cash generating unit.

When the recoverable amount is assessed using pre-tax discounted cash flow techniques, the resulting estimates are based on detailed mine and/or production plans. For value in use, recent cost levels are considered, together with expected changes in costs that are compatible with the current condition of the business. The cash flow forecasts are based on best estimates of expected future revenues and costs, including the future cash costs of production, capital expenditure and reclamation and closures costs.

Where a fair value less cost to sell model is used the cash flow forecast includes net cash flows expected to be realized from extraction, processing and sale of mineral resources that do not currently qualify for inclusion in proven or probable reserves and the portion of resources expected to be extracted economically.

Where an impairment loss subsequently reverses, the carrying amount of the asset or cash-generating unit is increased to the revised estimate of recoverable amount, but not beyond the carrying amount that would have been determined had no impairment loss been recognized for the asset or cash-generating unit in prior years. A reversal of an impairment loss is recognized into earnings immediately.

g) Provisions

i. Decommissioning and restoration provisions

Future obligations to retire an asset, including dismantling, remediation and ongoing treatment and monitoring of the site related to normal operations are initially recognized and recorded as a liability based on estimated future cash flows discounted at the risk-free rate.

The decommissioning and restoration provision ("DRP") is adjusted at each reporting period for changes to factors including the expected amount of cash flows required to discharge the liability, the timing of such cash flows and the risk-free discount rate.

The liability is accreted to full value over time through periodic charges to income. This accretion of provisions is charged to finance costs in the consolidated statements of income.

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The amount of the DRP initially recognized is capitalized as part of the related asset's carrying value and amortized to income. The method of amortization follows that of the underlying asset. The costs related to a DRP are only capitalized to the extent that the amount meets the definition of an asset and can bring about future economic benefit. For a closed site or where the asset which generated a DRP no longer exists, there is no longer future benefit related to the costs and as such, the amounts are expensed. For operating sites, a revision in estimates or a new disturbance will result in an adjustment to the liability with an offsetting adjustment to the capitalized retirement cost. For closed sites, adjustments to the DRP that are required as a result of changes in estimates are charged to income in the period in which the adjustment is identified.

ii. Environmental disturbance restoration provisions

During the operating life of an asset, events such as infractions of environmental laws or regulations may occur. These events are not related to the normal operation of the asset and are referred to as environmental disturbance restoration provisions ("EDRP"). The costs associated with an EDRP are accrued and charged to earnings in the period in which the event giving rise to the liability occurs. Any subsequent adjustments to an EDRP due to changes in estimates are also charged to earnings in the period of adjustment. These costs are not capitalized as part of the long-lived asset's carrying value.

iii. Other provisions

Provisions are recognized when a present legal or constructive obligation exists, as a result of past events, and it is probable that an outflow of resources that can be reliably estimated will be required to settle the obligation. Where the effect is material, the provision is discounted using an appropriate current market-based pre-tax discount rate.

h) Inventories

Inventories include metals contained in concentrates, stockpiled ore, materials, and supplies. The classification of metals inventory is determined by the stage in the production process. Product inventories are sampled for metal content and are valued based on the lower of actual production costs incurred or estimated net realizable value based upon the period ending prices of contained metal.

Ore stockpile and finished goods inventories are valued at the lower of production cost and net realizable value. Materials and supplies are valued at the lower of average cost and net realizable value. Production costs include all mine site costs.

i) Assets Held for Sale

A non-current asset is classified as held for sale when it meets the following criteria:

- the non-current asset is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets; and,
- the sale of the non-current asset is highly probable. For the sale to be highly probable:
  - the appropriate level of management must be committed to a plan to sell the asset;
  - an active program to locate a buyer and complete the plan must have been initiated;
  - the non-current asset or disposal group must be actively marketed for sale at a price that is reasonable in relation to its current fair value;
  - the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification as held for sale (with certain exceptions); and,
  - actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Assets held for sale are not depreciated. When the sale of assets held for sale is expect to occur beyond one year, the assets are measured at the lower of its carrying amount and fair value less costs to sell. Any gain or loss from initial measurement and subsequent measurement are recorded in other comprehensive income but not in excess of cumulative impairment losses.

j) Income Taxes

Income tax expense consists of current and deferred tax expense. Income tax is recognized in the consolidated statement of income.

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at period end, adjusted for amendments to tax payable with regards to previous years.

Deferred tax assets and liabilities are recognized for deferred tax consequences attributable to unused tax loss carry forwards, unused tax credits and differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted or substantially enacted tax rates expected to apply when the asset is realized or the liability settled.

The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income or loss in the period that substantive enactment occurs.

A deferred tax asset is recognized to the extent that it is probable that future taxable income will be available against which the asset can be utilized. To the extent that the Company does not consider it probable that deferred tax asset will be recovered, the deferred tax asset is reduced.

The following temporary differences do not result in deferred tax assets or liabilities:

- the initial recognition of assets or liabilities, not arising in a business combination, that does not affect accounting or taxable income;
- goodwill; and,
- investments in subsidiaries, associates and jointly controlled entities where the timing of reversal of the temporary differences can be controlled and reversal in the foreseeable future is not probable.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to the offset current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

k) Share-Based Payments

The fair value method of accounting is used for share-based payment transactions. Under this method, the cost of share options and other equity-settled share-based payment arrangements are recorded based on the estimated fair value at the grant date and charged to earnings over the vesting period. Where awards are forfeited because non-market based vesting conditions are not satisfied, the expense previously recognized is proportionately reversed in the period the forfeiture occurs.

Share-based payment expense relating to cash-settled awards, including deferred and restricted share units is accrued over the vesting period of the units based on the quoted market value of Company's common shares. As these awards will be settled in cash, the expense and liability are adjusted each reporting period for changes in the underlying share price.

i. Stock Option Plan

The Company applies the fair value method of accounting for all stock option awards. Under this method, the Company recognizes a compensation expense for all stock options awarded to employees, based on the fair value of the options on the date of grant which is determined by using the Black-Scholes option pricing model. The fair value of the options is expensed over the graded vesting period of the options.

ii. Deferred Share Unit ("DSU") Plan

The Company's DSU compensation liability is accounted for based on the number of units outstanding and the quoted market value of the Company's common shares at the financial position date. The year-over-year change in the deferred share unit compensation liability is recognized in income.

iii. Restricted Share Unit ("RSU") Plan

The Company's RSU compensation liability is accounted for based on the number of units outstanding and the quoted market value of the Company's common shares at the financial position date. The Company recognizes a compensation cost in operating income on a graded vesting basis for each RSU granted equal to the quoted market value of the Company's common shares at the date of which RSUs are awarded to each participant prorated over the performance period and adjusts for changes in the fair value until the end of the performance date. The cumulative effect of the change in fair value is recognized in income in the period of change.

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l) Earnings per Share

Basic earnings per share is computed by dividing net income for the year by the weighted average number of common shares outstanding during the year.

The diluted earnings per share calculation is based on the weighted average number of common shares outstanding during the year, plus the effects of dilutive common share equivalents. This method requires that the dilutive effect of outstanding options issued should be calculated using the treasury stock method. This method assumes that all common share equivalents have been exercised at the beginning of the year (or at the time of issuance, if later), and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of the common shares during the year, but only if dilutive.

m) Foreign Currency Translation

The presentation currency of the Company is the United States Dollar ("US$").

The functional currency of each of the entities in the group is the US$, with the exception of the parent entity and certain holding companies which have a Canadian dollar functional currency.

Transactions in foreign currencies are initially recorded in the functional currency at the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange at each financial position date. Foreign exchange gains or losses on translation to the functional currency of an entity are recorded in income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction.

For entities with a functional currency different from the presentation currency of the Company, translation to the presentation currency is required. Assets and liabilities are translated at the rate of exchange at the financial position date. Revenue and expenses are translated at the average rate for the period. All resulting exchange differences are recognized in other comprehensive income.

n) Financial Instruments

i. Financial Assets

The Company classifies all financial assets as either fair value through profit or loss ("FVTPL"), held-to-maturity ("HTM"), loans and receivables, or available-for-sale "(AFS"). The classification is determined at initial recognition and depends on the nature and purpose of the financial asset.

a) Financial Assets at Fair Value Through Profit or Loss

Financial assets are classified as FVTPL when the financial asset is held-for-trading or it is a designated FVTPL on initial recognition. A financial asset is classified in this category if acquired principally for the purpose of selling in the short-term.

Financial assets classified as FVTPL are stated at fair value with any resulting gain or loss recognized in income or loss in the period in which they arise. Transaction costs related to financial assets classified as FVTPL are recognized immediately in net income (loss).

Derivatives are not being accounted for as hedges and are categorized as held-for-trading. Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. Fair value of the Company's recognized commodity-based derivatives are based on the forward prices of the associated market index. Gains or losses are recorded in the consolidated statement of income.

b) Held-to-Maturity ("HTM")

HTM investments are recognized on a trade-date basis and are initially measured at fair value, including transaction costs. The Company does not have any assets classified as HTM investments.

c) Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are initially measured at fair value, net of transaction costs and are classified as current or non-current assets based on their maturity date. They are carried at amortized cost less any impairment. The impairment loss of receivables is based on a review of all outstanding amounts at period end. Interest income is recognized by applying the effective interest rate, except for short term receivables when the recognition of interest would not be significant.

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(All amounts in US$'000's unless otherwise stated)

d) Available-For-Sale ("AFS") Assets
AFS financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories.

AFS financial assets are measured at fair value, determined by published market prices in an active market, except for investments in equity instruments that do not have quoted market prices in an active market which are measured at cost. Changes in fair value are recorded in other comprehensive income (loss) until realized through disposal or impairment. Investments classified as available-for-sale are written down to fair value through income whenever it is necessary to reflect prolonged or significant decline in the value of the assets. Realized gains and losses on the disposal of available-for-sale securities are recognized in the consolidated statement of income.

The Company does not have any assets classified as AFS.

e) Impairment of Financial Assets
Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each period end. Financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

Objective evidence of impairment could include the following:
- significant financial difficulty of the issuer or counterparty;
- default or delinquency in interest or principal payments; or
- it has become probable that the borrower will enter bankruptcy or financial reorganization.

For financial assets carried at amortized cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of the estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of all financial assets at amortized cost, excluding trade receivables, is directly reduced by the impairment loss. The carrying amount of trade receivables is reduced through the use of an allowance account. When a trade receivable is considered uncollectable, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in income or loss.

With the exception of AFS equity instruments, if in a subsequent period, the amount of the impairment loss decreases and the decrease relates to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through income or loss. On the date of impairment reversal, the carrying amount of the financial asset cannot exceed its amortized cost had an impairment not been recognized.

g) Derecognition of Financial Assets
A financial asset is derecognized when:
- the contractual right of the asset's cash flows expire; or
- if the Company transfers the financial asset and substantially all risks and reward of ownership to another entity.

ii. Financial Liabilities
Derivatives are categorized as held-for-trading. Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. Fair value of the Company's recognized commodity-based derivatives are based on the forward prices of the associated market index. Gains or losses are recorded in the consolidated statement of income.

Long term debt and other financial liabilities are recognized initially at the fair value, net of transaction costs incurred, and are subsequently stated at amortized cost. Any difference between the amounts originally received (net of transaction costs) and the redemption value is recognized in the consolidated statement of income over the period to maturity using the effective interest method.

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iii. Classification and Subsequent Measurements

The Company has designated each of its significant categories of financial instruments as follows:

Financial Instrument	Classification	Measurement
Cash and Cash Equivalents	FVTPL	Fair value
Short Term Investments	FVTPL	Fair value
Derivative Assets	FVTPL	Fair value
Trade Receivable from Concentrate Sales	FVTPL	Fair value
Other Accounts Receivables	Loans and receivables	Amortized cost
Due from Related Parties	Loans and receivables	Amortized cost
Long Term Receivables	Loans and receivables	Amortized cost
Trade and Other Payables	Other liabilities	Amortized cost
Due to Related Parties	Other liabilities	Amortized cost
Derivative Liabilities	FVTPL	Fair value
Income Tax Payable	Other liabilities	Amortized cost
Long Term Liabilities	Other liabilities	Amortized cost

iv Effective Interest Method

The effective interest method calculates the amortized cost of a financial instrument and allocates interest income or expense over the corresponding period. The effective interest rate is the rate that discounts estimated future cash receipts or payments over the expected life of the financial instrument, or where appropriate, a shorter period, to the net carrying amount on initial recognition. Income or expense is recognized on an effective interest basis for instruments other than those financial instruments classified as FVTPL.

o) Segment Reporting

A geographical segment is a distinguishable component of the entity that is engaged in providing products or services within a particular economic environment and is subject to risks and returns that are different than those of segments operating in other economic environments.

The business operations comprise the mining and processing of silver-lead, zinc, and silver-gold and the sale of these products.

p) Leases

A lease is a finance lease when substantially all of the risks and rewards incidental to ownership of the leased asset are transferred from the lessor to the lessee by the agreement. The leased assets are initially recorded at the lower of the fair value and the present value of the minimum lease payments and are depreciated over the shorter of the asset's useful lives and the term of the lease. Interest on the lease instalments is recognized as interest expense over the lease term using the effective interest method. Leases for land and buildings are recorded separately if the lease payments can be allocated accordingly.

Leases that do not transfer all the risks and rewards of ownership are classified as operating leases. Payments are recorded in the income statement using the straight line method over their estimated useful lives.

q) Share Capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of shares are shown in equity as a deduction from the proceeds. Share-based payments including stock option plan, deferred share unit plan, and restricted share unit plan are discussed in Note 2. j).

r) Related Party Transactions

Parties are considered to be related if one party has the ability directly, or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control, related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties.

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s) Significant Accounting Judgments and Estimates

The preparation of consolidated financial statements requires management to make judgments and estimates that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these judgments and estimates. The consolidated financial statements include judgments and estimates which, by their nature, are uncertain. The impacts of such judgments and estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and the revision affects both current and future periods.

Significant assumptions about the future and other sources of judgments and estimates that management has made at the statement of financial position date, that could result in a material adjustment to the carrying amounts of assets and liabilities, in the event that actual results differ from assumptions made, relate to, but are not limited to, the following:

i. Critical Judgments

- The analysis of the functional currency for each entity of the Company. In concluding that the United States dollar functional currency for its Peruvian and Mexican entities and the Canadian and Barbados entities have a Canadian dollar functional currency, management considered the currency that mainly influences the cost of providing goods and services in each jurisdiction in which the Company operates. As no single currency was clearly dominant the Company also considered secondary indicators including the currency in which funds from financing activities are denominated and the currency in which funds are retained.
- In concluding when commercial production has been achieved, the Company considered the following factors:
  - all major capital expenditures to bring the mine to the condition necessary for it to be capable of operating in the manner intended by management have been completed;
  - the mine or mill is operating as per design capacity and metallurgical recoveries were achieved; and,
  - the ability to sustain ongoing production of ore at a steady or increasing level.
- The identification of reportable segments, basis for measurement and disclosure of the segmented information.
- The determination of estimated useful lives and residual values of tangible and long-lived assets and the measurement of depreciation expense.
- The identification of impairment indicators, cash generating units and determination of value in use and the write down of tangible and long lived assets.
- Measurement of financial instruments involve significant judgments related to interpretation of the terms of the instrument, identification, classification, impairment and the overall measurement to approximate fair values.

ii. Estimates

- the recoverability of amounts receivable which are included in the consolidated statements of financial position;
- the estimation of assay grades of metal concentrates sold in the determination of the carrying value of accounts receivable which are included in the consolidated statements of financial position and included as sales in the consolidated statements of income;
- the carrying value of the short term investments and the recoverability of the carrying value which are included in the consolidated statements of financial position;
- the determination of net realizable value of inventories on the consolidated statements of financial position;
- the estimated useful lives of property, plant and equipment which are included in the consolidated statements of financial position and the related depreciation included in the consolidated statements of income;
- the determination of mineral reserves, carrying amount of mineral properties, and depletion of mineral properties included in the consolidated statements of financial position and the related depletion included in the consolidated statements of income;
- review of tangible and intangible assets carrying value, the determination of whether these assets are impaired and the measurement of impairment charges or reversals which are included in the consolidated statements of income;
- the determination of the fair value of financial instruments and derivatives included in the consolidated statements of financial position;

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- the fair value estimation of share-based awards included in the consolidated statements of financial position and the inputs used in accounting for share-based compensation expense in the consolidated statements of income;
- the provision for income taxes which is included in the consolidated statements of income and composition of deferred income tax asset and liabilities included in the consolidated statement of financial position;
- the recognition of deferred income tax assets, amounts recorded for uncertain tax positions, the measurement of income tax expense and indirect taxes included in the consolidated statement of financial position;
- the inputs used in determining the net present value of the liability for provisions related to decommissioning and restoration included in the consolidated statements of financial position;
- the inputs used in determining the various commitments and contingencies accrued in the consolidated statements of financial position; and,
- the assessment of indications of impairment of each mineral properties and related determination of the net realizable value and write-down of those properties where applicable.

t) Significant Changes in Accounting Policies including Initial Adoption

IFRS 7 *Financial Instruments: Disclosures* (Amendment)
The amendment, effective for annual periods beginning on or after July 1, 2011, with early application permitted, requires additional quantitative and qualitative disclosures relating to transfers of financial assets, where: financial assets are derecognized in their entirety, but where the entity has a continuing involvement in them; financial assets that are not derecognized in their entirety. The Company has adopted the amendment to IFRS 7 and the amendment did not have a material impact on the Company's consolidated financial statements.

IAS 12 *Income Taxes* (Amendment)
IAS 12 *Income Taxes,* amendments regarding Deferred Tax: Recovery of Underlying Assets introduces an exception to the existing principle for the measurement of deferred tax assets and liabilities arising on investment property measured at fair value, and the requirement that deferred tax on non-depreciable assets measured using the revaluation model in IAS 16 should always be measured on a sale basis. The amendment is effective for annual periods beginning on or after January 1, 2012. The Company has adopted the amendment to IAS 12 and the amendment did not have a material impact on the Company's consolidated financial statements.

u) New Accounting Standards

i) New Accounting Standards Impacting on or after July 1, 2012

IAS 1 *Presentation of Financial Statements* (Amendment)
The amendments to IAS 1 *Presentation of Financial Statements* retain the 'one or two statement' approach at the option of the entity and only revise the way other comprehensive income ("OCI") is presented: requiring separate subtotals for those elements which may be 'recycled' (e.g. cash-flow hedging, foreign currency translation), and those elements that will not (e.g. fair value through OCI items under IFRS 9) to the statement of income. In addition, the tax associated with items presented before tax to be shown separately for each of the two groups of OCI items (without changing the option to present items of OCI either before tax or net of tax).

ii) New Accounting Standards Impacting on or after January 1, 2013

On May 17, 2012, the IASB issued Annual Improvements to IFRSs: 2009-2011 Cycle, incorporating amendments to five IFRSs; ***IFRS 1 First-time Adoption of International Reporting Standards, IAS 1 Presentation of Financial Statements, IAS 16 Property, Plant and Equipment, IAS 32 Financial Statements: Presentation, IAS 34 Interim Financial Reporting.*** The amendments are effective for annual periods beginning on or after January 1, 2013, with early application permitted, and must be applied retrospectively.

IFRS 1 *First-time Adoption of International Financial Reporting Standards* (Amendment)
IFRS 1 is amended to clarify the repeated application of IFRS 1 and the treatment of borrowing costs incurred on or after the date of transition to IFRSs. This is not applicable as the company has already transitioned to IFRS.

IAS 1 *Presentation of Financial Statements* (Amendment)
IAS 1 is amended to clarify that only one comparative period - which is the preceding period - is required for a complete set of financial statements.

IAS 16 ***Property, Plant, and Equipment*** (Amendment)
IAS 16 is amended to clarify the classification of servicing equipment. Spare parts, stand-by equipment and servicing equipment should be classified as property, plant, and equipment when they meet the definition of property, plant, and equipment in IAS 16 and otherwise as inventory using IAS 2 *Inventories.*

IAS 32 ***Financial Instruments: Presentation*** (Amendment)
IAS 32 is amended to clarify that IAS 12 *Income Taxes* applies to the account for income taxes relating to distributions to holders of equity instruments and transaction costs of equity transactions.

IAS 34 ***Interim Financial Reporting*** (Amendment)
IAS 34 is amended to clarify that the total assets and total liabilities for a particular reportable segment would be separately disclosed in interim financial reporting only when the amounts are regularly provided to the chief operating decision maker and there has been a material change from the amounts disclosed in the last annual financial statements for the reportable segment.

The Company does not anticipate these amendments to have a significant impact on its consolidated financial statements.

IFRS 7 ***Financial Instruments: Disclosures in Respect of Offsetting (Amendment)***
At its meeting on December 13-15, 2011, the IASB approved amendments to IFRS 7, *Financial Instruments: Disclosures*, with respect to offsetting financial assets and financial liabilities. The common disclosure requirements issued by the IASB and the FASB in December 2011 are intended to help investors and other users to better assess the effect or potential effect of offsetting arrangements on a company's financial position. Companies and other entities are required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The required disclosures should be provided retrospectively. The Company does not anticipate this amendment to have a significant impact on its consolidated financial statements.

IFRS 10 ***Consolidated Financial Statements***
IFRS 10 *Consolidated Financial Statements* replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements, and SIC12 *Consolidation - Special Purpose Entities.* IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. This standard (i) requires a parent entity (an entity that controls one or more other entities) to present consolidated financial statements; (ii) defines the principle of control, and establishes control as a basis for consolidation; (iii) sets out how to apply the principle of control whether an investor controls an investee and therefore must consolidate the investee; and (iv) sets out the accounting requirements for the preparation of consolidated financial statements. IFRS 10 is effective for annual periods beginning on or after January 1, 2013. The Company does not anticipate the application of IFRS 10 to have a significant impact on its consolidated financial statements.

IFRS 11 ***Joint Arrangements***
IFRS 11 replaces IAS 31 *Interest in Joint Ventures* and SIC-13 *Jointly-Controlled Entities-Non-Monetary Contributions by Venturers.* This standard establishes the core principle that a party to a joint arrangement determines the type of joint arrangement in which it is involved by assessing its rights and obligations and accounts for those rights and obligations in accordance with that type of joint arrangement (joint operations or joint ventures). This standard is effective for annual periods on or after January 1, 2013.

IFRS 12 ***Disclosure of Interests in Other Entities***
IFRS 12 combines the disclosure requirements for an entity's interest in subsidiaries, joint arrangements, associates and structured entities into one comprehensive disclosure standard. This standard requires the disclosure of information that enable users of financial statements to evaluate the nature of, and risks associated with, its interest in other entities and the effects of those interests on its financial position, financial performance and cash flows. This standard is effective for annual periods beginning on or after January 1, 2013.

The Company does not anticipate these amendments to have a significant impact on its consolidated financial statements.

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IFRS *13 Fair Value Measurement*
IFRS 13 *Fair Value Measurement* provides guidance on how to measure fair value, but does not change when fair value is required or permitted under IFRS. IFRS 13 defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 applies when another IFRS requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except for: share-based payment transactions within the scope of IFRS 2 *Share-based Payment;* leasing transactions with the scope of IAS 17 *Leases*; measurements that have some similarities to fair value that are not fair value, such as net realizable value in IAS 2 *Inventories*; or value in use IAS 36 *Impairment of Assets.* This standard is effective for annual periods beginning on or after January 1, 2013. The Company does not anticipate the application of IFRS 13 to have a significant impact on its consolidated financial statements.

IFRS 10 *Consolidated Financial Statements,* IFRS 11 *Joint Arrangements, and* IFRS 12 *Disclosure of Interests in Other Entities: Transition Guidance*
The amendments provide additional transition relief, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. For disclosures related to unconsolidated structured entities, the amendments will remove the requirement to present comparative information for periods before IFRS 12 is first applied. The effective date of the amendments is annual periods beginning on or after January 1, 2013, which is aligned with the effective date of IFRS 10, IFRS 11, and IFRS 12. The Company does not anticipate these amendments to have a significant impact on its consolidated financial statements.

IAS 19 Employee Benefits
On June 16, 2011, the IASB issued amendments to IAS 19, *Employee Benefits*, in order to improve the accounting for employment benefits.

The amendments make important improvements by:
- eliminating the option to defer the recognition of gains and losses, known as the 'corridor method' or the "deferral and amortization approach";
- streamlining the presentation of changes in assets and liabilities arising from defined benefit plans, including requiring re-measurements to be presented in OCI, thereby separating those changes from changes that many perceive to be the result of an entity's day-to-day operations;
- enhancing the disclosure requirements for defined benefit plans, providing better information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in those plans.

The amendments are effective for financial years beginning on or after January 1, 2013. The Company does not anticipate the application of IFRS 13 to have a significant impact on its consolidated financial statements

IAS 27 *Separate Financial Statements*
IAS 27 has the objective of setting standards to be applied in accounting for investments in subsidiaries, jointly controlled entities, and associates when an entity elects, or is required by local regulations, to present separate (non-consolidated) financial statements. This standard is effective for annual periods beginning on or after January 1, 2013. This standard will not have an impact on the consolidated financial statements.

IAS 28 Investments in Associates and Joint Ventures
IAS 28 prescribes the accounting for investments in associates and to set the requirements for the application of the equity method when accounting for investments in associates and joint ventures. This standard is effective for annual periods beginning on or after January 1, 2013. This standard will not have an impact on the consolidated financial statements.

iii) New Accounting Standards Impacting on or after January 1, 2014

IAS 32 *Financial Instruments - Presentation in Respect of Offsetting* (Amendment)
The amendments to IAS 32 address inconsistencies in current practice when applying the requirements with regards to the offsetting of financial assets and financial liabilities. The amendments are effective for annual periods beginning on or after January 1, 2014 and are required to be applied retrospectively.

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iv) New Accounting Standards Impacting on or after January 1, 2015

IFRS 9 *Financial Instruments - Classification and Measurement*
IFRS 9, *Financial Instruments:* IFRS 9 introduces the new requirements for the classification, measurement and de-recognition of financial assets and financial liabilities. The amendments are effective for annual periods beginning on or after January 1, 2015, with earlier application permitted.

t) Comparative figures
Certain comparative figures have been reclassified to conform to the presentation adopted for the current period. In particular: prepaid expenses are now reported separate from accounts receivable and other assets as prepaid expenses are not a financial instrument under IFRS 7; due from related parties are included separate from due to related parties as offsetting is not permitted under IAS 1; and, GST/HST and value added tax receivable are included with accounts receivable and other assets as permitted under IAS 1.

	Accounts receivable and other assets	GST/HST and value added tax receivable	Prepaid expenses	Due from related parties	Due to related parties
December 31, 2011	$ 15,608	$ 4,777	$ –	$ –	$ 169
Reclassifications	3,559	(4,777)	1,218	36	36
Adjusted December 31, 2011	**$ 19,167**	**$ –**	**$ 1,218**	**$ 36**	**$ 205**

3. Cash and Cash Equivalents

	December 31, 2012	December 31, 2011
Cash	$ 18,038	$ 25,652
Cash equivalents	40,682	13,078
	$ 58,720	$ 38,730

Cash and cash equivalents include cash on hand, demand deposits, and money market instruments, with maturities from the date of acquisition of 90 days or less.

4. Short Term Investments

	December 31, 2012	December 31, 2011
Held for trading short term investments	$ 6,019	$ 17,000

Short term investments include deposits with maturities from the date of acquisition of more than 90 days.

5. Derivative Assets and Derivative Liabilities

	December 31, 2012		December 31, 2011	
	Assets	Liabilities	Assets	Liabilities
Lead forward contracts	$ –	$ –	–	$ 53
Zinc forward contracts	–	–	$ 70	–
Silver forward contracts	–	–	–	34
Total	$ –	$ –	$ 70	$ 87

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The Company occasionally enters into forward commodity contracts as well as put and call option commodity arrangements to secure a minimum price level on part of its zinc and lead metal production. As at December 31, 2012, no such contracts are outstanding.

In 2011, the Company entered into short term forward and option contracts to fix the final settlement price of metal delivered in concentrates, where the final settlement price is yet to be set at a future quotational period according to contract terms. The forward sale and option contracts were settled against the arithmetic average of metal spot prices over the month in which the contract matures. No initial premium associated with these trades had been paid.

6. Accounts Receivable and Other Assets and Deposits on Long Term Assets

The current accounts receivables and other assets are comprised of the following:

	December 31, 2012	December 31, 2011
Current		
Trade receivables from concentrate sales	$ 15,158	$ 11,287
Current portion of long term receivables	832	891
Advances and other receivables	3,637	2,213
GST/HST and value added tax receivable	7,405	4,776
Accounts receivable and other assets	$ 27,032	$ 19,167

Deposits on long term assets include the non-current accounts receivable and other assets are comprised of the following:

	December 31, 2012	December 31, 2011
Non-current		
Long term receivables	$ 1,557	$ 1,415
Less: current portion of long term receivables	(832)	(891)
Non-current portion of long term receivables	725	524
Deposits on equipment	1,086	1,167
Deposits paid to contractors	744	448
Other	139	121
Deposits on long term assets	$ 2,694	$ 2,260

As at December 31, 2012, the Company had $1,178 trade receivables (2011: $100) which were past due with no impairment. The Company's allowance for doubtful accounts is $nil for all reporting periods.

The aging analysis of these trade receivables from concentrate sales is as follows:

	December 31, 2012	December 31, 2011
0-30 days	$ 13,725	$ 9,518
31-60 days	255	911
61-90 days	–	758
over 90 days	1,178	100
	$ 15,158	$ 11,287

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7. Inventories

	December 31, 2012	December 31, 2011
Concentrate stock piles	$ 2,918	$ 2,488
Ore stock piles	3,391	4,008
Materials and supplies	6,549	4,795
Total inventories	$ 12,858	$ 11,291

For the years ended December 31, 2012, $59,077 (2011: $31,655) of inventory was expensed in cost of sales and there has been no impairment during 2012 (2011: $nil).

8. Assets Held for Sale

Balance, December 31, 2011	$ –
Additions	63
Disposals	(12)
Total assets held for sale – December 31, 2012	**$ 51**
Less current portion	**(51)**
Non current assets held for sale – December 31, 2012	**$ –**

As at December 31, 2012, the Company has $51 (2011: $nil) of equipment held for sale. Included in assets held for sale are a scoop and a front loader as the machinery is not being used in the mine operations and are expected to be sold within one year.

9. Mineral Properties, Plant and Equipment

	Mineral Properties Non-Depletable (Mario, Don Mario, Tlacolula)	Mineral Properties Depletable (Caylloma, San Jose, Taviche)	Machinery and Equipment	Land Buildings, and Leasehold Improvements	Furniture and Other Equipment	Transport Units	Equipment under Finance Lease	Capital Work in Progress	Total
Year ended December 31, 2012									
Opening carrying amount	$ 7,311	$ 105,668	$ 17,316	$ 37,452	$ 3,185	$ 135	$ 2,520	$ 8,246	$ 181,833
Additions	2,566	24,849	5,384	138	1,462	129	653	15,778	50,959
Disposals	–	–	(1,097)	–	(22)	(5)	–	(50)	(1,174)
Write–off of mineral properties	(3,887)	–	–	–	–	–	–	–	(3,887)
Depletion and depreciation	–	(12,327)	(3,000)	(4,449)	(629)	(73)	(705)	–	(21,183)
Reclassification	(5,030)	5,030	444	2,653	(12)	–	–	(3,085)	–
Adjustment on currency translation	–	953	–	2	–		–	–	955
Closing carrying amount	**$ 960**	**$ 124,173**	**$ 19,047**	**$ 35,796**	**$ 3,984**	**$ 186**	**$ 2,468**	**$ 20,889**	**$ 207,503**
As at December 31, 2012									
Cost	$ 960	$ 157,054	$ 27,092	$ 44,004	$ 5,694	$ 539	$ 5,124	$ 20,889	$ 261,356
Accumulated depletion and depreciation	–	(32,881)	(8,045)	(8,208)	(1,710)	(353)	(2,656)	–	(53,853)
Closing carrying amount	**$ 960**	**$ 124,173**	**$ 19,047**	**$ 35,796**	**$ 3,984**	**$ 186**	**$ 2,468**	**$ 20,889**	**$ 207,503**

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	Mineral Properties Non-Depletable (Mario, Don Mario, Taviche,Tlacolula)	Mineral Properties Depletable (Caylloma, San Jose*)	Machinery and Equipment	Land Buildings, and Leasehold Improvements	Furniture and Other Equipment	Transport Units	Equipment under Finance Lease	Capital Work in Progress	Total
Year ended December 31, 2011									
Opening carrying amount	$ 49,129	$ 33,608	$ 6,897	$ 7,013	$ 3,177	$ 112	$ 2,893	$ 14,534	$ 117,363
Additions	6,258	30,091	5,429	729	2,032	131	500	33,837	79,007
Disposals	–	–	(1,532)	–	(33)	–	–	–	(1,565)
Depletion and depreciation	–	(6,107)	(1,847)	(1,820)	(334)	(97)	(873)	–	(11,078)
Impairment charge	–	–	(1,688)	(195)	–	(11)	–	–	(1,894)
Reclassification	(48,076)	48,076	10,057	31,725	(1,657)	–	–	(40,125)	–
Closing carrying amount	$ 7,311	$ 105,668	$ 17,316	$ 37,452	$ 3,185	$ 135	$ 2,520	$ 8,246	$ 181,833
As at December 31, 2011									
Cost	$ 7,311	$ 125,667	$ 22,870	$ 41,212	$ 4,296	$ 520	$ 4,674	$ 8,246	$ 214,796
Accumulated depletion and depreciation	–	(19,999)	(5,554)	(3,760)	(1,111)	(385)	(2,154)	–	(32,963)
Closing carrying amount	$ 7,311	$ 105,668	$ 17,316	$ 37,452	$ 3,185	$ 135	$ 2,520	$ 8,246	$ 181,833

**Commercial production began on September 1, 2011 for San Jose.*

As at December 31, 2012, the non-depletable mineral properties includes the Tlacolula property (2011: Mario, Don Mario, Tlacolula, and Taviche) as the Mario and Don Mario properties were abandoned and written off in 2012.

Mineral properties includes bonuses paid of $nil (2011: $1,350) which were paid upon commissioning of the San Jose mine. The bonus paid in 2011 comprises of $1,113 paid to key management and $237 paid to a company controlled by a director.

a) Mario Property

In May 2011, the Company entered into an agreement to acquire a 100% interest in the Mario Property, located in the Department of Junin in central Peru. Under the terms of the agreement, the Company is granted the exclusive right and option to purchase an undivided 100% interest in the Mario Property subject to the following payments:

1. $500 on signing of agreement;
2. $500 on or before six months from the signing of the agreement;
3. $500 on or before 12 months from the signing of the agreement; and,
4. $2,500 on or before 24 months from the signing of the agreement.

The transfer of the property to the Company is subject to a 1% net smelter return ("NSR") royalty on production from the property payable to Crocodile Gold ("Crocodile"). The Company shall have the right to purchase the NSR royalty from Crocodile at any time during the five-year period following the final option payment for the sum of $3,000. The property is also subject to a 2% NSR royalty on production payable to Teck Cominco and a 0.5% NSR royalty on production payable to Socrate Capital Inc., with each royalty in turn subject to certain buy-back provisions. As at May 14, 2012, $1,000 had been paid under the agreement.

During the second quarter of 2012, upon completion of a 7,000 meter Phase I drill program at the Mario and Don Mario Properties ("Mario project"), the Company determined the program was not successful in demonstrating the potential to meet the minimum target size established for the project and the Company abandoned its interest in the Mario property resulting in a write-off of $3,627.

b) Don Mario Property

The Company entered into an option agreement, effective July 20, 2011, to acquire 100% interest in the Don Mario property, with Consorcio Empresarial Agmin S.A.C.("AGMIN"). Under the terms of the mining assignment and option to purchase mineral rights agreement ("agreement"), the Company is required to make the following payments:

1. $200 on signing the agreement;
2. $300 after 12 months from signing the agreement;
3. $500 after 24 months from signing the agreement; and,
4. $2,000 after 36 months from signing the agreement.

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Under the terms of the agreement, once the option is exercised and the technical report is prepared under National Instrument 43-101 and published, if the pre-feasibility study indicates that the property contains more than five million silver equivalent ounces, the Company would further pay AGMIN, one dollar for each additional resource and reserves indicated in the pre-feasibility report. The Company has the option to buy-out the additional pay-out for a further $3,000, subject to certain conditions.

As at May 14, 2012, $200 had been paid under the agreement. The Don Mario property is part of the overall Mario project and as the Phase 1 drill program at the Mario Property was not successful, the Company abandoned its interest in the Don Mario Property resulting in a write-off of $260.

c) Tlacolula Property

Pursuant to an agreement dated September 14, 2009, as amended December 18, 2012, the Company, through its wholly owned subsidiary, Cuzcatlan, was granted an option (the "Option") to acquire a 60% interest (the "Interest") in the Tlacolula silver project ("property") located in the State of Oaxaca, Mexico from Radius Gold Inc.'s wholly owned subsidiary, Radius (Cayman) Inc. ("Radius") (a related party by way of directors in common with the Company described further in Note 11).

The Company can earn the Interest by spending $2,000, which includes a commitment to drill 1,500 meters within 12 months after Cuzcatlan has received a permit to drill the property and making staged annual payments totalling $250 cash and providing $250 in common shares of the Company to Radius according to the following schedule:

- $20 cash and $20 cash equivalent in shares upon stock exchange approval;
- $30 cash and $30 cash equivalent in shares by January 15, 2011;
- $50 cash and $50 cash equivalent in shares by January 15, 2012;
- $50 cash and $50 cash equivalent in shares by the January 15, 2013; and,
- $100 cash and $100 cash equivalent in shares within 90 days after Cuzcatlan has completed the first 1,500 meters of drilling on the property.

Upon completion of the cash payments and share issuances, and incurring the exploration expenditures as set forth above, the Company will be deemed to have exercised the Option and acquired a 60% interest in the property, whereupon a joint venture will be formed to further develop the property on the basis of the Company owning 60% and Radius 40%.

On January 15, 2010, the transaction was approved by the TSX Venture Exchange, The Company has issued 7,813 common shares at a fair market value of $2.56 per share and paid $20 cash according to the terms of the option agreement.

On January 14, 2011, the Company issued 6,756 common shares of the Company, at a fair market value of $4.44 per share and paid $30 cash according to the terms of the option agreement.

On January 13, 2012, the Company issued 8,605 common shares of the Company, at a fair market value of $5.81 per share and paid $50 cash according to the terms of the option agreement.

As at December 31, 2012, the Company had issued a total of 23,174 common shares of the Company, with a fair market value of $100 and paid $100 cash according to the terms of the option agreement.

Subsequent to December 31, 2012, on January 15, 2013, the Company issued 11,415 common shares of the Company, at a fair market value of $4.38 per share and on January 14, 2013 paid $50 cash according to the terms of the option agreement.

d) Taviche Property

In 2010, the Company included the idle plant in Taviche as part of the San Jose mine plant as it was more likely than not that the idle plant could be used to treat excess ore from San Jose or from surrounding areas where the company was conducting exploration. On September 1, 2011, the San Jose mine plant commenced commercial production and in the fourth quarter of 2011, achieved an average of 955 tonnes milled per day with the San Jose plant having sufficient capacity for the production. In the fourth quarter of 2011, management reassessed the usability of the idle plant and in conjunction, obtained an independent third party appraisal of various assets acquired under an asset purchase agreement dated 2007 related to the Taviche property.

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Management used the fair value less cost to sell method to determine the recoverable amount of the idle plant. Based upon an independent appraisal of the assets, which is in accordance with fair value less cost to sell, the Company took an impairment charge, in 2011, of $1.89 million that comprised of the following impairments: $1.08 million on the tailing dam, $0.14 million on the mine infrastructure, and $0.67 million on equipment, machinery, and buildings. As at December 31, 2011, the net book value of assets related to the Taviche property for machinery and equipment amounted to $0.36 million.

e) Taviche Oeste Concessions

Subsequent to December 31, 2012, on February 4, 2013, the Company, through its wholly owned subsidiary, Cuzcatlan, acquired, through an option agreement (the "Option") with Plata Pan American S.A. de C.V. ("Plata") (a wholly owned subsidiary of Pan American Silver Corp.), a 55% undivided interest in 6,254 hectare Taviche Oeste Concessions ("concessions") immediately surrounding the San Jose Mine in Oaxaca, Mexico. The Company made a cash payment of $4.0 million. Once a production decision is made to develop ore from the concessions, the Company, through its wholly owned subsidiary, Cuzcatlan, will purchase the remaining 45% undivided interest in the property for $6.0 million. Plata will retain a 2.5% net smelter royalty on ore production from this property.

f) San Luisito Concessions

Subsequent to December 31, 2012, in February 2013, the Company through its wholly owned subsidiary, Cuzcatlan, acquired, was granted an option (the "Option"), with a third party, on concessions in the San Luisito Project, Sonora, Mexico and made a cash payment of $50. Further payments due are as follows : August 26, 2013 $150, February 24, 2014 $400, February 24, 2015 $1,000, February 26, 2016 $1,400, and February 26, 2017 $12,000. The third party will retain a 2% net smelter royalty on ore produced from this property.

10. Trade and Other Payables

	December 31, 2012	December 31, 2011
Trade accounts payable	$ 11,114	$ 8,799
Payroll payable	4,238	5,809
Restricted share unit payable	648	1,204
Other payables	1,348	1,343
	$ 17,348	$ 17,155

11. Related Party Transactions

a) Purchase of Goods and Services

The Company entered into the following related party transactions:

	Years ended December 31,	
Transaction with related parties	**2012**	**2011**
Salaries and wages [1, 2]	$ 135	$ 173
Other general and administrative expenses [2]	308	292
Leasehold improvements [2]	23	93
	$ 466	$ 558

1 *Salaries and wages includes employees' salaries and benefits charged to the Company based on a percentage of the estimated hours worked for the Company.*

2 *Radius Gold Inc. ("Radius") has directors in common with the Company and shares office space, and is reimbursed for salaries, wages, general administration costs, and leasehold improvements incurred on behalf of the Company to June 30, 2012. Gold Group Management Inc. ("Gold Group"), which is owned by a director in common with the Company, provides various administrative, management, and other related services effective July 1, 2012.*

In January 2012, the Company issued 8,605 (2011: 6,756) common shares, at a fair market value of $5.81 (2011: $4.44) per share and paid $50 (2011: $30) cash to Radius, under the option to acquire a 60% interest in Tlacolula silver project located in the State of Oaxaca, Mexico.

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In October 2012, the Company entered into a services agreement, effective July 1, 2012, with Gold Group Management Inc. ("Gold Group"), which is owned by a director in common with the Company. The services agreement provides that Gold Group provides various administrative, management and other related services.

Subsequent to December 31, 2012 to March 19, 2013 the Company issued 11,415 common shares of the Company, at a fair market value of $4.38 per share and paid $50 cash to Radius, under the option to acquire a 60% interest in the Tlacolula silver project located in the State of Oaxaca, Mexico.

b) Key Management Compensation

Key management includes all persons named or performing the duties of Vice-President, Chief Financial Officer, President, Chief Executive Officer, and non-executive Directors of the Company. The compensation paid and payable to key management for services is shown below:

	Years ended December 31,	
	2012	2011
Salaries and other short term employee benefits	$ 2,789	$ 3,492
Directors fees	388	333
Consulting fees	180	416
Share-based payments	1,629	4,398
	$ 4,986	8,639

The share-based payments includes the change in the DSU and RSU fair value over each reporting period and payments made under the DSU and RSU plans and the non-cancellation of share options.

Consulting fees includes fees paid to two non-executive directors in both 2012 and 2011.

c) Year end Balances arising from Purchases of Goods/Services

Amounts due from related parties	December 31, 2012	December 31, 2011
Owing from a director and officer [3]	$ –	$ 36
Owing from a company with common director [3]	5	—
	$ 5	$ 36

[3] *Owing from a director includes non-interest bearing advances to a company controlled by a director of the Company at December 31, 2012 and to director and officers at December 31, 2011.*

Amounts due to related parties	December 31, 2012	December 31, 2011
Owing to company(ies) with common directors [4]	$ 54	$ 205

[4] *2012 Owing to Radius Gold Inc. ("Radius") and Gold Group Management Inc. ("Gold Group") whom have directors in common with the Company and 2011 to Radius.*

On October 10, 2012, the Company paid Gold Group Management Inc., which is owned by a director in common with the Company, a retainer of $61 representing three months deposit under a services agreement effective July 1, 2012.

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12. Leases and Long Term Liabilities

Leases and long term liabilities are comprised of the following:

	December 31, 2012	December 31, 2011
Obligations under finance lease (a)	$ 676	$ 866
Long term liability (b)	19	771
Deferred share units (Note 15 c))	2,004	2,639
	2,699	4,276
Less: current portion		
Obligations under finance lease	449	741
Long term liability	–	771
Current portion of leases and long term liabilities	449	1,512
Leases and long term liabilities, non-current	$ 2,250	$ 2,764

a) Obligations under Finance Lease

The following is a schedule of the Company's future minimum lease payments. These are related to the acquisition of mining equipment, and vehicles, and buildings.

Obligations under Finance Lease	December 31, 2012	December 31, 2011
Not later than 1 year	$ 469	$ 763
Less: future finance charges on finance lease	(20)	(22)
	449	741
Later than 1 year but less than 5 years	231	126
Less: future finance charges on finance lease	(4)	(1)
	227	125
Present value of finance lease payments	$ 676	$ 866

b) Long Term Liabilities

In May 2008, the Company acquired the Monte Alban II concession for which a payment of $800 was due May 2012. This liability is non-interest bearing and the principal was paid during the second quarter of 2012.

The Company's Mexican operation is required to provide a seniority premium to all employees as required under Mexican labor law. This liability is calculated using actuarial techniques and discounting the benefit using the Projected Unit Credit Method with the following assumptions: a discount rate of 7.50%, wages increases ranging from 4.5% to 5.0%, minimum wage increase of 4.0%, and a long term inflation rate of 4.0%. During the year ended December 31, 2012, $20 (2011: $nil) has been recognized as an expense, respectively.

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13. Provisions

A summary of the Company's provisions for other liabilities and charges is presented below:

	Decommissioning and Restoration Liability		
	Caylloma Mine	San Jose Mine	Total
Total provisions - December 31, 2010	$ 3,298	$ 1,583	$ 4,881
Increase to existing provisions	119	7	126
Accretion of provisions	138	35	173
Foreign exchange differences	142	(147)	(5)
Cash payments	(201)	–	(201)
Total provisions - December 31, 2011	$ 3,496	$ 1,478	$ 4,974
Less: current portion	(501)	(226)	(727)
Non current - December 31, 2011	$ 2,995	$ 1,252	$ 4,247
Total provisions – December 31, 2011	$ 3,496	$ 1,478	$ 4,974
Increase to existing provisions	3,954	1,680	5,634
Accretion of provisions	124	108	232
Foreign exchange differences	(129)	102	(27)
Cash payments	(386)	–	(386)
Total provisions - December 31, 2012	$ 7,059	$ 3,368	$ 10,427
Less: current portion	(111)	(346)	(457)
Non current - December 31, 2012	$ 6,948	$ 3,022	$ 9,970

In view of the uncertainties concerning environmental reclamation, the ultimate cost of reclamation activities could differ materially from the estimated amount recorded. The estimate of the Company's decommissioning and restoration liability relating to the Caylloma and San Jose mine is subject to change based on amendments to laws and regulations and as new information regarding the Company's operations becomes available.

Future changes, if any, to the estimated liability as a result of amended requirements, laws, regulations, operating assumptions, estimated timing and amount of obligations may be significant and would be recognized prospectively as a change in accounting estimate. Any such change would result in an increase or decrease to the liability and a corresponding increase or decrease to the mineral properties, plant and equipment balance.

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14. Income Tax

a) Income tax expense differs from the amount that would be computed by applying the Canadian statutory income tax rate of 25.00% (2011: 26.50%) to income before income taxes. The reasons for the differences are as follows:

	December 31, 2012	December 31, 2011
Income before tax	$ 45,226	$ 38,335
Statutory income tax rate	25.00%	26.50%
Expected income tax	$ 11,307	$ 10,159
Items non-deductible for income tax purposes	1,155	1,401
Difference between Canadian and foreign tax rates	2,354	1,376
Effect of change in tax rates	(796)	620
Impact of foreign exchange on tax assets and liabilities	(1,580)	3,271
Impact of Mexican inflation on tax values	(193)	(16)
Other items	(70)	704
Unused tax losses and tax offsets not recognized in tax asset	1,586	1,287
Total income taxes	$ 13,763	$ 18,802
Represented by:		
Current income tax	$ 5,508	$ 14,607
Deferred income tax	8,255	4,195
	$ 13,763	$ 18,802

The effective tax rate for the years ended December 31, 2012 and 2011 was 30.43% and 49.05%, respectively. The change in the effective tax rate was primarily attributable to the geographical mix of income, fluctuations in exchange rates for foreign currency, the impact of foreign exchange on the tax basis on non-monetary assets, and the non-recognition of tax benefits.

Effective January 1, 2012, the Canadian Federal corporate tax rate decreased from 16.5% to 15.0% and the British Columbia provincial tax remained the same at 10%. The overall reduction in tax rates has resulted in a decrease in the Company's statutory tax rate from 26.50% to 25.00%.

In 2009, the Mexican government approved tax reform that includes a 2% increase in the income tax rate in Mexico from 28% to 30% for a three-year period starting in 2010.

The Mexican corporate tax rate was scheduled to be reduced from 30% to 29% on January 1, 2013 and then to 28% on January 1, 2014. However, newly enacted legislation maintains the 2012 rate of 30% through the end of 2013, with a reduction to 29% on January 1, 2014 and an additional reduction to 28% on January 1, 2015.

Income taxes payable of $200 (December 31, 2011: $3,923) relates to current taxes.

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b) The tax effected items that give rise to significant portions of the deferred income tax assets and deferred income tax liabilities at December 31, 2012 and 2011 are presented below:

	December 31, 2012	December 31, 2011
Deferred income tax assets:		
Non-capital losses	$ 2,431	$ 12,544
Provisions and other	4,059	2,059
Other	78	5
Mineral properties, plant and equipment	–	296
Net deferred income tax assets	6,568	14,904
Deferred income tax liabilities:		
Mineral properties - Peru	$ (14,314)	$ (11,790)
Mineral properties - Mexico	(3,452)	(5,640)
Equipment	(9,731)	(10,148)
Total deferred income tax liabilities	$ (27,497)	$ (27,578)
Net deferred income tax liabilities	$ (20,929)	$ (12,674)
Classification		
Non-current assets	$ 113	$ 36
Non-current liabilities	(21,042)	(12,710)
Net deferred income tax liabilities	$ (20,929)	$ (12,674)

c) The Company recognizes tax benefits on losses or other deductible amounts generated in countries where the probable criteria for the recognition of deferred tax assets has been met. The Company's unrecognized deductible temporary differences and unused tax losses for which no deferred tax asset is recognized consist of the following amounts:

	December 31, 2012	December 31, 2011
Non-capital losses	$ 47,124	$ 38,503
Provisions and other	2,652	3,841
Share issue cost	1,947	2,913
Investments in subsidiaries	1,283	56
Mineral properties, plant and equipment	1,467	1,532
Unrecognized deductible temporary differences	$ 54,473	$ 46,845

The Company's unrecognized taxable temporary difference consists of the following amounts:

	December 31, 2012	December 31, 2011
Withholding tax	$ 505	$ 147
Unrecognized taxable temporary difference	$ 505	$ 147

The Company's tax losses have the following expiry dates:

		Expiry Date
Non-capital losses, expiring as follows:		
Canada	$ 43,906	2013 - 2032
Mexico	11,321	2016 - 2032
	$ 55,227	

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15. Share Capital

a) Unlimited Common Shares Without Par Value

During the year ended December 31, 2012, the Company issued 8,605 (2011: 6,756) common shares, at a fair market value of $5.81 (2011: $4.44) per share to Radius Gold, under the option to acquire a 60% interest in Tlacolula silver project located in the State of Oaxaca, Mexico. (Refer to Note 9. c)).

Subsequent to December 31, 2012 to March 19, 2013, the Company issued 11,415 common shares of the Company, at a fair market value of $4.38 per share and paid $50 cash to Radius, under the option to acquire a 60% interest in the Tlacolula silver project located in the State of Oaxaca, Mexico. (Refer to Note 9. c)).

b) Share Options

Shareholder approval of the Company's Stock Option Plan (the "Plan"), dated April 11, 2011, was obtained at the Company's annual general meeting held on May 26, 2011. The Plan provides that the number of common shares of the Company issuable under the Plan, together with all of the Company's other previously established or proposed share compensation arrangements, may not exceed 12,200,000 shares, which equals 9.92% of the current total number of issued and outstanding common shares of the Company, as at April 11, 2011.

Option pricing models require the input of highly subjective assumptions including the estimate of the share price volatility, risk-free interest rate and expected life of the options. Changes in the subjective input assumptions can materially affect the fair value estimate.

The following is a summary of share option transactions:

	December 31, 2012		December 31, 2011	
	Shares (in '000's)	Weighted average exercise price (CAD$)	Shares (in '000's)	Weighted average exercise Price (CAD$)
Outstanding at beginning of the year	3,876	$ 2.83	4,551	$ 1.51
Granted	2,613	4.18	1,792	4.46
Exercised	(314)	2.35	(2,442)	1.55
Forfeited	(50)	4.46	(25)	4.46
Expired	(8)	4.46	–	–
Outstanding at end of the year	6,117	$ 3.42	3,876	$ 2.83
Vested and exercisable at end of the year	3,081	$ 2.63	3,557	$ 1.99

During the year ended December 31, 2012, 2,612,459 share purchase options were granted with exercise prices ranging from CAD$3.79 to CAD$6.67 with terms ranging from three and five years, respectively. The vesting of 2,047,542 share purchase options are as follows: 50% after twelve months of grant date and a further 50% after twenty four months of grant date. The vesting of 184,138 share purchase options are as follows: 33.33% after twelve months of grant date, a further 33.33% after twenty four months of grant date, and a further 33.34% after thirty six months of grant date. The vesting of 380,779 share purchase options are as follows: 33.33% after twelve months of grant date, a further 33.33% after twenty-four months of grant date, and a further 33.34% after thirty-six months of grant date.

During the year ended December 31, 2012, 49,628 share purchase options were forfeited, 41,542 share purchase options were accelerated to expire March 30, 2012, and 8,271 share purchase options expired unexercised.

Subsequent to December 31, 2012, 25,000 share purchase options were accelerated to expire March 31, 2013 from January 11, 2017.

Subsequent to December 31, 2012 to March 19, 2013, 25,000 share purchase options were exercised at CAD$0.85 resulting in issued and outstanding shares of 125,305,166.

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The share-based payment charge of $2,977 (2011: $1,830) covering option grants, forfeitures, and accelerated vesting recognized for the year ended December 31, 2012 has been determined under the fair value method using the Black-Scholes option pricing model with the following assumptions:

	Years ended December 31,	
	2012	2011
Risk-free interest rate	1.00% to 1.62%	1.91%
Expected stock price volatility	55.93% to 58.36%	56.48%
Expected term in years	3	3
Expected dividend yield	0%	0%
Expected forfeiture rate	4.15%	1.38%

The expected volatility assumption is based on the historical volatility of the Company's Canadian dollar common share price on the Toronto Stock Exchange.

Exercise price in CAD$	Number of outstanding share purchase options (in '000's)	Weighted average remaining contractual life of outstanding share purchase options (years)	Weighted average exercise price on outstanding share purchase options CAD$	Exercisable share purchase options (in '000's)	Weighted average exercise price on exercisable share purchase options CAD$
$0.80 to $0.99	781	5.8	$ 0.84	781	$ 0.84
$1.00 to $1.99	660	4.4	1.53	660	1.53
$2.00 to $6.67	4,676	2.4	4.11	1,640	3.92
$0.80 to $6.67	6,117	3.0	$ 3.42	3,081	$ 2.63

The weighted average remaining life of vested share purchase options at December 31, 2012 was 3.3 years (2011: 4.9 years).

c) Deferred Share Units ("DSU") Cost

During 2010, the Company implemented a DSU plan which allows for up to 1% of the number of shares outstanding from time to time to be granted to eligible directors. All grants under the plan are fully vested upon credit to an eligible directors' account.

During the year ended December 31, 2011, the Company granted 48,824 DSU with a market value of CAD$232, at the date of grant, to a director, and 93,544 DSU with a market value of CAD$473, at the date of grant, to a director, with vesting subject to the commissioning of the San Jose mine, which occurred on September 1, 2011. During the year ended December 31, 2011, 70,000 DSU were settled in cash for $5.36 per unit for a total payment of $375.

During the year ended December 31, 2012, there were no DSU grants or settlements in cash. As at December 31, 2012, there are 481,465 (2011: 481,465) DSU outstanding with a fair value of $2,004 (2011: $2,639).

d) Restricted Share Units ("RSU") Cost

During 2010, the Company implemented a RSU plan for certain employees or officers. The RSU entitle employees or officers to a cash payment after the end of a performance period of up to two years following the date of the award. The RSU payment will be an amount equal to the fair market value of the Company's common share on the five trading days immediately prior to the end of the performance period multiplied by the number of RSU held by the employee.

During the year ended December 31, 2011, the Company granted 155,674 RSU with a market value of CAD$788, at the date of grant, to a director, with vesting subject to the commissioning of the San Jose mine, which occurred on September 1, 2011.

During the year ended December 31, 2012, there were no RSU grants and the Company paid $583 (2011: $736) on 109,557 (2011: 109,557) RSU to directors and officers of the Company. As at December 31, 2012, there are 155,674 (2011: 265,231) RSU outstanding with a fair value of $648 (2011: $1,204). Refer to Note 10.

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e) Earnings per Share

i. Basic
Basic earnings per share is calculated by dividing the income for the year by the weighted average number of shares outstanding during the year.

The following table sets forth the computation of basic earnings per share:

	Years ended December 31,	
	2012	**2011**
Income available to equity owners	$ 31,463	$ 19,533
Weighted average number of shares (in '000's)	123,585	123,295
Earnings per share - basic	$ 0.25	$ 0.16

ii. Diluted
Diluted earnings per share is calculated by adjusting the weighted average number of shares outstanding to assume conversion of all potentially dilutive shares. The following table sets forth the computation of diluted earnings per share:

	Years ended December 31,	
	2012	**2011**
Income available to equity owners	$ 31,463	$ 19,533
Weighted average number of shares ('000's)	123,585	123,295
Incremental shares from share options	1,648	1,417
Weighted average diluted shares outstanding ('000's)	125,233	124,712
Earnings per share - diluted	$ 0.25	$ 0.16

For the year ended December 31, 2012, excluded from the calculation were 184,138 (2011: $nil) anti-dilutive options with an exercise price of CAD$6.67 (2011: $nil).

16. Supplemental Cash Flow Information

		Years ended December 31,	
	Note	**2012**	**2011**
Non-cash Investing and Financing Activities:			
Issuance of shares on purchase of mineral properties, property, plant and equipment	9 c)	$ 50	$ 30

17. Capital Disclosure

The Company's objectives when managing capital are to provide shareholder returns through maximization of the profitable growth of the business and to maintain a degree of financial flexibility relevant to the underlying operating and metal price risks while safeguarding the Company's ability to continue as a going concern.

The capital of the Company consists of equity and available credit facility, net of cash. The Board of Directors does not establish a quantitative return on capital criteria for management. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets.

The management of the Company believes that the capital resources of the Company as at December 31, 2012, are sufficient for its present needs for at least the next 12 months. The Company is not subject to externally imposed capital requirements.

The Company's overall strategy with respect to capital risk management remained unchanged during the year.

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18. Management of Financial Risk

The Company is exposed to certain financial risks, including currency risk, credit risk, liquidity risk, interest risk, and price risk. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework and reviews the Company's policies on an ongoing basis.

a) Fair Value of Financial Instruments

The carrying value of cash and cash equivalents, short term investments, derivative assets, trade receivable from concentrate sales, other accounts receivables, due from related parties, trade and other payables, due to related parties, and derivative liabilities approximate their fair value due to the relatively short periods to maturity and the terms of these financial instruments. Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument.

The amortized value of long term receivables approximates their fair value as these are measured at the amortized cost using the effective interest method. The fair value of the lease and long term liabilities is $2,723 as at December 31, 2012.

The analysis of financial instruments that are measured subsequent to initial recognition at fair value can be categorized into Levels 1 to 3 based upon the degree to which the fair value is observable.

- Level 1 - inputs to the valuation methodology are quoted (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - inputs to valuation methodology include quoted market prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The Company has classified the determination of fair value of trade receivable from concentrate sales, and derivatives as Level 2, as the valuation method used by the Company includes an assessment of assets in quoted markets with significant observable inputs.

	Financial assets (liabilities) at fair value as at December 31, 2012			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 58,720	$ –	$ –	$ 58,720
Short term investments	6,019	–	–	6,019
Trade receivable from concentrate sales	–	15,158	–	15,158
	$ 64,739	$ 15,158	$ –	$ 79,897

There were no changes in the levels during the year ended December 31, 2012.

	Financial assets (liabilities) at fair value as at December 31, 2011			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 38,730	$ –	$ –	$ 38,730
Short term investments	17,000	–	–	17,000
Trade receivable from concentrate sales	–	11,287	–	11,287
Derivatives assets	–	70	–	70
Derivatives liabilities	–	(87)	–	(87)
	$ 55,730	$ 11,270	$ –	$ 67,000

There were no changes in the levels during the year ended December 31, 2011.

Accounts receivable includes trade receivable from concentrate sales, provisional price adjustments, and final price adjustments. The fair value of accounts receivable resulting from provisional pricing reflect observable market commodity prices. Resulting fair value changes to accounts receivable are through sales. Transactions involving accounts receivable are with counterparties the Company believes are creditworthy. As such, these accounts receivable are classified within Level 2 of the fair value hierarchy.

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Derivatives are carried at their fair value, which is determined based on internal valuation models that reflect observable forward market commodity prices. Resulting fair value changes to derivatives are through net gain (loss) on commodity contracts. Transactions involving derivatives are with counterparties the Company believes to be creditworthy.

During the year ended December 31, 2012, there have been no changes in the classification of financial assets and liabilities in Levels 1, 2, and 3 of the hierarchy.

b) Currency Risk

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada, Peru and Mexico and a portion of its expenses are incurred in Canadian dollars, nuevo soles, and Mexican pesos. A significant change in the currency exchange rates between the United States dollar relative to the other currencies could have a material effect on the Company's income, financial position, or cash flows. The Company has not hedged its exposure to currency fluctuations.

As at December 31, 2012, the Company is exposed to currency risk through the following assets and liabilities denominated in Canadian dollars, nuevo soles and Mexican pesos (all amounts are expressed in thousands of Canadian dollars, thousands of nuevo soles or thousands of Mexican pesos):

	December 31, 2012			December 31, 2011		
	Canadian Dollars	Nuevo Soles	Mexican Pesos	Canadian Dollars	Nuevo Soles	Mexican Pesos
Cash and cash equivalents	$ 4,231	S/. 1,389	$ 6,136	$ 18,457	S/. 1,396	$ 1,758
Short term investments	6,000	–	–	–	–	–
Accounts receivable and other assets	77	3,097	98,147	42	5,657	58,939
Due from related parties	–	–	–	–	4,434	–
Trade and other payables	(1,225)	(12,300)	(49,779)	(1,580)	(17,993)	(24,310)
Due to related parties	(54)	–	–	(209)	–	–
Provisions, current	–	(284)	(4,502)	–	(1,351)	(3,163)
Income tax payable	–	(326)	–	–	(10,581)	–
Leases and long term liabilities	(1,998)	–	(245)	(2,691)	–	–
Provisions	–	(19,560)	(39,323)	–	(8,079)	(17,494)
Total	$ 7,031	S/. (27,984)	$ 10,434	$ 14,019	S/. (26,517)	$ 15,730
Total US$ equivalent	$ 7,053	$ (10,970)	$ 802	$ 13,745	$ (9,832)	$ 1,125

Based on the above net exposure as at December 31, 2012, and assuming that all other variables remain constant, a 10% depreciation or appreciation of the US dollar against the above currencies would result in an increase or decrease, as follows: impact to other comprehensive income of $784 (2011: $1,527) and a net loss of $1,130 (2011: net loss $967).

c) Credit Risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The Company's cash and cash equivalents and short term investments are held through large Canadian, international and foreign national financial institutions. These investments mature at various dates within one year. All of the Company's trade accounts receivables from concentrate sales are held with large international metals trading companies.

The Company holds derivative contracts with financial institutions and in this regard is exposed to counterparty risk. The Company mitigates this risk by transacting only with reputable financial institutions to minimize credit risk.

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(All amounts in US$'000's unless otherwise stated)

The Company's maximum exposure to credit risk as at December 31, 2012 is as follows:

	December 31, 2012	December 31, 2011
Cash and cash equivalents	$ 58,720	$ 38,730
Short term investments	6,019	17,000
Accounts receivable and other assets	27,032	19,167
Derivative assets	–	70
Due from related parties	5	36
	$ 91,776	$ 75,003

The carrying amount of financial assets recorded in the financial statements represents the Company's maximum exposure to credit risk. The Company believes it is not exposed to significant credit risk and overall, the Company's credit risk has not declined significantly from the prior year.

d) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages liquidity risk by continuing to monitor forecasted and actual cash flows. The Company has in place a planning and budgeting process to help determine the funds required to support the Company's normal operating requirements on an ongoing basis and its development plans. The Company strives to maintain sufficient liquidity to meet its short term business requirements, taking into account its anticipated cash flows from operations, its holdings of cash, short term investments, and its committed liabilities.

The Company expects the following maturities of its financial liabilities (including interest), finance leases, and other contractual commitments:

	Expected payments due by period as at December 31, 2012				
	Less than 1 year	1–3 years	4–5 years	After 5 years	Total
Trade and other payables	$ 17,348	$ –	$ –	$ –	$ 17,348
Due to related parties	54	–	–	–	54
Income tax payable	200	–	–	–	200
Long term liabilities	469	2,254	–	–	2,723
Operating leases	702	1,305	886	147	3,040
Provisions	528	519	459	11,333	12,839
	$ 19,301	$ 4,078	$ 1,345	$ 11,480	$ 36,204

Operating leases includes leases for office premises, computer and other equipment used in the normal course of business. Refer to Note 24 c) for details of operating leases.

In 2010, the Company entered into a credit agreement with the Bank of Nova Scotia for a $20 million senior secured revolving credit facility ("credit facility") to be refinanced or repaid on or within two and one-half years or before February 6, 2013. The credit facility is secured by a first ranking lien on Bateas and its assets and bears interest and fees at prevailing market rates. In the event that utilization under the credit facility is less than $10 million, a commitment fee of 1.50% per annum is payable quarterly on the unutilized portion of the available credit facility. No funds have been drawn from this credit facility.

Subsequent to December 31, 2012, in February 2013 the Bank of Nova Scotia extended the credit facility maturity date to February 6, 2013 and then to February 27, 2013. On March 15, 2013, the Bank of Nova Scotia extended the credit facility maturity date to March 28, 2013. No funds were drawn from this credit facility.

e) Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The risk that the Company will realize a loss as a result of a decline in the fair value is limited because the balances are generally held with major financial institutions in demand deposit accounts.

A 10% change in interest rates would cause a $nil change in income on an annualized basis.

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f) Metal Price Risk

The Company is exposed to metals price risk with respect to silver, gold, zinc, lead, and copper sold through its mineral concentrate products. The Company mitigates this risk by implementing price protection programs for some of its zinc and lead production through the use of derivative instruments. As a matter of policy, the Company does not hedge its silver production.

19. Segmented Information

All of the Company's operations are within the mining sector, conducted through operations in three countries. Due to geographic and political diversity, the Company's mining operations are decentralized whereby management are responsible for achieving specified business results within a framework of global policies and standards. Country corporate offices provide support infrastructure to the mine in addressing local and country issues including financial, human resources, and exploration support.

Products are silver, gold, lead, zinc and copper produced from mines in Peru and Mexico, as operated by Bateas and Cuzcatlan, respectively. Segments have been aggregated where operations in specific regions have similar products, production processes, types of customers and economic environment.

The Company's operating segments are based on the reports reviewed by the senior management group that are used to make strategic decisions. The Chief Executive Officer considers the business from a geographic perspective considering the performance of the Company's business units. The segment information for the reportable segments for the years ended December 31, 2012 and 2011 are as follows:

Reportable Segments	Corporate	Bateas	Cuzcatlan	Total
Year ended December 31, 2012				
Sales to external customers	$ –	$ 83,697	$ 77,323	$ 161,020
Silver-gold concentrates	–	–	77,323	77,323
Silver-lead concentrates	–	68,616	–	68,616
Zinc concentrates	–	15,081	–	15,081
Sales to internal customers	8,379	–	–	8,379
Cost of sales*	–	51,231	39,127	90,358
Depletion and depreciation**	284	8,961	12,127	21,372
Selling, general and administrative expenses*	13,594	3,337	3,610	20,541
Exploration and evaluation costs	777	–	–	777
Write-off of mineral properties	–	3,887	–	3,887
Other material non-cash items	2	(1)	(51)	(50)
Interest income	156	394	70	620
Interest expense	300	154	108	562
Income (loss) before tax	(14,514)	25,396	34,344	45,226
Income taxes	272	6,521	6,970	13,763
Income (loss) for the year	(14,786)	18,875	27,374	31,463
Capital expenditures	525	29,566	20,868	50,959

* *cost of sales and selling, general and administrative expenses includes depletion and depreciation*
** *included in cost of sales or selling, general and administrative expenses*

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Reportable Segments	Corporate	Bateas	Cuzcatlan	Total
Year ended December 31, 2011				
Sales to external customers	$ –	$ 97,740	$ 12,264	$ 110,004
Silver-gold concentrates	–	–	12,264	12,264
Silver-lead concentrates	–	80,689	–	80,689
Zinc concentrates	–	15,290	–	15,290
Copper concentrates	–	1,761	–	1,761
Sales to internal customers	5,961	–	–	5,961
Cost of sales*	–	42,236	6,794	49,030
Depletion and depreciation**	100	7,053	2,268	9,421
Selling, general and administrative expenses*	14,352	3,920	1,568	19,840
Exploration and evaluation costs	1,715	–	–	1,715
Other material non-cash items	1	10	(70)	(59)
Impairment of mineral properties, plant and equipment	–	–	1,894	1,894
Interest income	494	297	39	830
Interest expense	306	219	35	560
Income (loss) before tax	(15,881)	52,133	2,083	38,335
Income taxes $	183	15,804	2,815	18,802
Income (loss) for the year	(16,064)	36,329	(732)	19,533
Capital expenditures	814	25,066	53,127	79,007

* *cost of sales and selling, general and administrative expenses includes depletion and depreciation*
** *included in cost of sales or selling, general and administrative expenses*

Reportable Segments	Corporate	Bateas	Cuzcatlan	Total
As at December 31, 2012				
Assets held for sale	$ –	$ 51	$ –	$ 51
Total assets	19,412	127,778	169,073	316,263
Total liabilities	5,466	27,710	18,594	51,770
As at December 31, 2011				
Total assets	27,878	112,746	131,017	271,641
Total liabilities	5,729	29,793	7,808	43,330

The segment information by geographical region for the years ended December 31, 2012 and 2011 are as follows:

Reportable Segments	Canada	Peru	Mexico	Other	Total
Year ended December 31, 2012					
Sales to external customers	$ –	$ 83,697	$ 77,323	$ –	$ 161,020
Silver-gold concentrates	–	–	77,323	–	77,323
Silver-lead concentrates	–	68,616	–	–	68,616
Zinc concentrates	–	15,081	–	–	15,081
Year ended December 31, 2011					
Sales to external customers	–	97,740	12,264	–	110,004
Silver-gold concentrates	–	–	12,264	–	12,264
Silver-lead concentrates	–	80,689	–	–	80,689
Zinc concentrates	–	15,290	–	–	15,290
Copper concentrates	–	1,761	–	–	1,761

Reportable Segments	Canada	Peru	Mexico	Other	Total
As at December 31, 2012					
Non current assets	$ 3,132	$ 84,531	$ 122,647	$ –	$ 210,310
As at December 31, 2011					
Non current assets	3,004	68,105	113,020	-	184,129

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For the years ended December 31, 2012, six (2011: three) customers, respectively, represented 100% of total sales to external customers as follows:

External Sales by Customer and Region	Years ended December 31, 2012		2011	
Customer 1	$ 1,391	2%	$ 95,978	98%
Customer 2	75,136	89%	1,762	2%
Customer 3	6,675	8%	–	0%
Customer 4	495	1%	–	0%
Bateas/Peru	$ 83,697	100%	$ 97,740	100%
% of total sales	52%		89%	
Customer 1	$ 2,333	3%	$ 12,264	100%
Customer 2	74,990	97%	$ –	0%
Cuzcatlan/Mexico	$ 77,323	100%	$ 12,264	100%
% of total sales	48%		11%	
Consolidated	$ 161,020	100%	$ 110,004	100%
% of total sales	100%		100%	

20. Cost of Sales

The cost of sales for the years ended December 31, 2012 and 2011 are as follows:

	Years ended December 31, 2012			2011		
	Caylloma	San Jose	Total	Caylloma	San Jose	Total
Direct mining costs [1]	$ 40,879	$ 27,511	$ 68,390	$ 33,995	$ 4,654	$ 38,649
Depletion and depreciation	8,861	11,616	20,477	6,919	2,140	9,059
Royalty expenses	1,491	–	1,491	1,322	–	1,322
	$ 51,231	$ 39,127	$ 90,358	$ 42,236	$ 6,794	$ 49,030

[1] *Direct mining costs includes salaries and other short term benefits, contractor charges, energy, consumables and production related costs.*

21. Selling, General and Administrative Expenses

The selling, general and administrative expenses for the years ended December 31, 2012 and 2011 are as follows:

	Years ended December 31, 2012	2011
Salaries and benefits	$ 12,213	$ 12,168
Corporate administration	2,172	3,409
Audit, legal and professional fees	4,461	2,915
Filing and listing fees	236	467
Director's fees	564	519
Depreciation	895	362
	$ 20,541	$ 19,840

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(All amounts in US$'000's unless otherwise stated)

22. Exploration and Evaluation Costs

The exploration and evaluation costs for the years ended December 31, 2012 and 2011 are as follows:

	Years ended December 31,	
	2012	**2011**
Share-based payments	$ 52	$ –
Salaries, wages, and benefits	506	931
Direct costs	219	784
	$ 777	$ 1,715

23. Net Finance Income

The net finance income for the years ended December 31, 2012 and 2011 are as follows:

	Years ended December 31,	
	2012	**2011**
Finance income		
Interest income on FVTPL financial assets	$ 620	$ 830
Total finance income	620	830
Finance expenses		
Interest expense	30	81
Standby and commitment fees	300	306
Accretion of provisions (Note 13)	232	173
Total finance expense	562	560
Net finance income	$ 58	$ 270

24. Contingencies and Capital Commitments

a) Bank Letter of Guarantee

The Caylloma mine closure plan was approved in November 2009 with total closure costs of $3,587 of which $1,756 is subject to annual collateral in the form of a letter of guarantee, to be awarded each year in increments of $146 over 12 years based on the estimated life of the mine.

Scotiabank Peru, a third party, has established a bank letter of guarantee on behalf of Bateas in favor of the Peruvian mining regulatory agency in compliance with local regulation associated with the approved Bateas' mine closure plan, for the sum of $585. This bank letter of guarantee expires 360 days from December 2012.

Banco Bilbao Vizcaya Argentaria, S.A. had also established bank letters of guarantee totalling $54 to provide an annual guarantee associated with an office lease contract and truck rentals. These bank letters of guarantee were renewed in June 2011 with expiry 360 days to June 2012. This guarantee expired in June 2012.

b) Capital Commitments

As at December 31, 2012, $5,613 of capital commitments not disclosed elsewhere in the consolidated financial statements, and forecasted to be expended within one year, includes the following: $4,280 mine and tailing dam development at the San Jose property; and, $1,333 for the tailings dam transport system, concentrator plant, electrical infrastructure renewal, and camp infrastructure at Caylloma.

c) Other Commitments

The Company has a contract to guarantee power supply at its Caylloma mine. Under the contract, the seller is obligated to deliver a "maximum committed demand" (for the present term this stands at 3,500 Kw) and the Company is obligated

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to purchase subject to exemptions under provisions of "Force Majeure". The contract is automatically renewed every two years for a period of 10 years and expiring in 2017. Renewal can be avoided without penalties by notification 10 months in advance of renewal date.

Tariffs are established annually by the energy market regulator in accordance with applicable regulations in Peru.

The Company acts as guarantor to finance lease obligations held by two of its mining contractors. These finance lease contracts are related to the acquisition of mining equipment deployed at the Caylloma mine. As at December 31, 2012, these obligations amounted to $13 and mature in 2013.

On May 24, 2010, the Company entered into a seven year office premise lease located in Peru. The annual rent payable on 1,717 rentable square meters for office space, is as follows:

- year one $289;
- year two $297;
- year three $306; and,
- years four through seven the lease is subject a minimum annual increase of 3% or the Consumer Price Index published by Bureau of Labor Statistics of the United States Department of Labor, whichever is higher.

The lease also includes the use of additional space for mini-warehouse and parking spots, the obligation for which is $58 per annum for the first year and is subject to an annual increase of 3% as stated above until the end of the lease. During 2011, the Company provided a security deposit of $44.

On September 30, 2012, the Company entered into an one year office premise lease in Mexico effective September 30, 2012, with an annual lease obligation of $16.

The expected payments due by period as at December 31, 2012 are as follows:

	Expected payments due by period as at December 31, 2012				
	Less than 1 year	1–3 years	4–5 years	After 5 years	Total
Office premises – Canada	$ 148	$ 443	$ 306	$ 147	$ 1,044
Office premises – Peru	373	781	580	–	1,734
Office premises – Mexico	14	–	–	–	14
Total office premises	$ 535	$ 1,224	$ 886	$ 147	$ 2,792
Computer equipment – Peru	149	64	–	–	213
Computer equipment – Mexico	18	17	–	–	35
Total computer equipment	$ 167	$ 81	$ –	$ –	$ 248
Total operating leases	$ 702	$ 1,305	$ 886	$ 147	$ 3,040

d) Other Contingencies

The Company is subject to various investigations, claims and legal and tax proceedings covering matters that arise in the ordinary course of business activities. Each of these matters is subject to various uncertainties and it is possible that some of these matters may be resolved unfavorably to the Company. Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Company. In the opinion of management none of these matters are expected to have a material effect on the results of operations or financial conditions of the Company.

During the year ended December 31, 2012, the Ministry of Mining and Energy (MEM) in Peru made an update to the approved Mining Environmental Liabilities List. The Company is currently in the process of evaluating its mining concessions which are currently included on the list and as at the date of the issuance of the financial statements an estimate of liability cannot be determined.

25. Subsequent Events up to March 19, 2013

Subsequent to December 31, 2012, in February 2013 the Bank of Nova Scotia extended the credit facility maturity date to February 6, 2013 and then to February 27, 2013. On March 15, 2013, the Bank of Nova Scotia extended the credit facility maturity date to March 28, 2013. No funds were drawn from this credit facility.

FORTUNA
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Qualified Person

Dr. Thomas I. Vehrs, Ph.D., Vice President of Exploration, is the Qualified Person for Fortuna Silver Mines Inc. as defined by National Instrument 43-101. Dr. Vehrs is a Founding Registered Member of the Society for Mining, Metallurgy, and Exploration, Inc. (SME Registered Member Number 3323430RM) and is responsible for ensuring that the technical information contained in this annual report is an accurate summary of the original reports and data provided to or developed by Fortuna Silver Mines Inc.

Symbols

Ag	silver
Ag Eq	silver equivalent
Au	gold
Cu	copper
g/t	grams per metric tonne
m	meters
koz	1,000 ounces
M	million
Moz	1,000,000 ounces
oz	troy ounce. One troy ounce is equal to 31.1035 grams
Pb	lead
t	metric tonne
tpd	metric tonnes per day. One metric tonne equals 2,204.62 pounds
Zn	zinc

FORTUNA

SILVER MINES INC.

NYSE: **FSM** | TSX: **FVI** | BVL: **FVI** | Frankfurt: **F4S.F**

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