FORTUNA
SILVER MINES INC.

CORPORATE OFFICE:
Suite 840 - 355 Burrard St.
Vancouver, BC Canada, V6C 2G8
Tel: 604.484.4085
Fax: 604.484.4029

PERU OFFICE:
Piso 17 Av. Pardo y Aliaga 640
San Isidro, Lima - Peru
Tel: 511.616.6060

TRADING SYMBOL:
TSXV: FVI
Lima Exchange: FVI
info@fortunasilver.com
WWW.FORTUNASILVER.COM

# MANAGEMENT'S DISCUSSION AND ANALYSIS

# FOR THE

# THIRD QUARTER ENDED SEPTEMBER 30, 2009

***(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. For a comprehensive understanding of Fortuna's financial condition and results of operations, this MD&A should be read in conjunction with the Company's unaudited consolidated financial statements for the nine months ended September 30, 2009 and the related notes contained therein. The Company reports its financial position, results of operations and cash flows in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). In addition, the following should be read in conjunction with the Consolidated Financial Statements of the Company for the year ended December 31, 2008, the related MD&A, and Fortuna's Annual Information Form (available on SEDAR at www.sedar.com). This MD&A refers to various non-GAAP measures, such as cash cost per tonne of processed ore, cash cost per ounce of payable silver, and adjusted net income (loss) 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. Non-GAAP measures do not have standardized meaning. Accordingly, non-GAAP measures should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP. To facilitate a better understanding of these measures as calculated by the Company, we have provided detailed descriptions and reconciliations where applicable.*

***This MD&A is prepared as of November 5, 2009.***

## Forward Looking Information

Certain statements contained in this MD&A and elsewhere constitute forward-looking statements. Such forward-looking statements involve a number of known and unknown risks, uncertainties and other factors which may cause the actual results, and performance of achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, changes in project parameters to deal with unanticipated economic factors, risks related to technological and operational nature of the Company's business, the speculative nature of exploration and development, and changes in local and national government legislation.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statements were made, and readers are advised to consider such forward-looking statements in light of the risks set forth in the section Risks and Uncertainties.

This MD&A also contains references to estimates of mineral reserves and mineral resources. The estimation of reserves and resources is inherently uncertain and involves subjective judgments about many relevant factors. The accuracy of any such estimates is a function of the quantity and quality of available data, and of the assumptions made and judgments used in engineering and geological interpretation, which may prove to be unreliable. There can be no assurance that these estimates will be accurate or that such mineral reserves and mineral resources can be mined or processed profitably. Mineral resources that are not mineral reserves do not have demonstrated economic viability. 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.

In particular, forward-looking information and statements include:
- The copper circuit is now scheduled to be commissioned in December 2009 (page 6);
- "Management plans to have all the engineering and permits required to initiate construction at San Jose concluded by year end." (page 7);

- "The Company´s engineering staff is currently conducting an internal review of the various engineering projects and continues to work towards the delivery of the final study for December 2009." (page 9);
- "Management believes that the Company's cash position as well as its ongoing operation in Caylloma is sufficient to support the Company's operating and capital requirements on an ongoing basis." (page 11).

## Business of the Company

Fortuna Silver Mines Inc. (the "Company") is a mining company focused on producing silver and developing silver projects in Latin America. The Company's principal assets are the Caylloma polymetallic Mine in southern Peru and the San Jose Silver-Gold Project in southern Mexico.

## Recent Developments and Highlights

### Financial and Operating Results

During the third quarter of 2009, the Company generated record quarterly sales of $13.23 million compared to $7.49 million in the same period of 2008. This represents an increase of 77%.

The loss in the current quarter of $0.57 million was due primarily to negative mark-to-market movements on our commodity hedge book. The Company's base metal price protection program generated a loss on commodity contracts of $3.47 million during the third quarter of 2009 compared to a gain of $0.69 million for the same period of the prior year.

Adjusting for the mark-to-market effect on derivatives, the third quarter of 2009 resulted in adjusted net income of $1.22 million compared to $0.23 million for the same period of 2008. The increase of $0.99 million is primarily a result of record mine operating income of $7.07 million compared to $1.73 million in the same period of 2008.

| | Expressed in '000's | | | |
|---|---|---|---|---|
| | Three months ended September 30, | | Nine months ended September 30, | |
| | **2009** | 2008 | **2009** | 2008 |
| **NET (LOSS) INCOME FOR THE PERIOD** | **$ (556)** | $ (297) | **$ (414)** | $ 1,558 |
| Items of note: | | | | |
| **Mark-to-Market effect on derivatives** | **1,780** | 528 | **2,263** | (1,860) |
| **ADJUSTED NET INCOME (LOSS) FOR THE PERIOD (1)** | **$ 1,224** | $ 231 | **$ 1,849** | $ (302) |

Cash generated by operating activities before changes in working capital for the period was $2.66 million compared to $2.58 million in the same period of 2008.

In the third quarter of 2009, silver production amounted to 438,186 ounces with a negative cash cost per ounce of payable silver of $5.34. The Company's Caylloma mine growth trend in metal production that had been showing for the prior 12 consecutive quarters has marginally declined this quarter. In the third quarter, 105,241 tonnes of ore were treated compared to 89,827 tonnes in the same period of 2008 and the cash cost per tonne of treated ore was $45.09 (Cash cost is a non-GAAP measure. See page 10 for reconciliation of cash cost to the cost of sales in the consolidated statement of operations).

**(Dollar amounts expressed in US dollars, unless otherwise indicated)**

## New Reserves Estimate at Caylloma

On July 16, 2009, the Company released an updated NI 43-101 resource estimation for Caylloma, with the full NI 43-101 released on August 27, 2009, as follows:

- Proven and Probable Mineral Reserves are estimated at 4.03 million tonnes averaging 156 g/t Ag, 0.55 g/t Au, 1.70% Pb and 2.58% Zn;
- Contained silver is estimated at 20.3 million ounces, representing a 304% increase in silver ounces in the Proven and Probable reserve categories over the previous resource and reserve estimate (NI 43-101 Technical Report published October 3, 2006);
- Inferred Mineral Resources are estimated at 1.3 million tonnes averaging 187 g/t Ag, 0.29 g/t Au, 1.92% Pb and 3.25% Zn;
- Contained silver in the Inferred Resource category is estimated at 7.7 million ounces.

## New Resource Estimate at San Jose

On October 26, 2009, the Company released an updated NI 43-101 resource estimation for San Jose, with the full NI 43-101 to be released within 45 days of the release. Highlights are as follows:

Indicated Resources have increased 83% to 2.69 million tonnes with contained silver equivalent ounces increasing 112% to 37.6 million Ag Equivalent[1] ounces. Silver and gold grades in the Indicated Resource category have increased by 12% to 295 g/t and 4% to 2.27 g/t, respectively. The new resource estimate will serve as the basis for pre-feasibility level engineering studies projected for completion by year end.

At a cut-off grade of 150 g/t Ag Equivalent, the Indicated and Inferred Mineral Resources for the Trinidad Zone at San Jose are estimated at:

| | |
|---|---|
| Indicated Mineral Resource: | 2.69 million tonnes grading 295 g/t Ag and 2.27 g/t Au containing 37.6 million Ag Equivalent[1] ounces |
| Inferred Mineral Resource: | 2.41 million tonnes grading 262 g/t Ag and 2.11 g/t Au containing 30.4 million Ag Equivalent[1] ounces. |

[1]*Silver equivalency estimates were derived using metal prices of US$13.75/oz for silver and US$856.16/oz for gold (36-month average + 24 month future metal prices as of July 31, 2009). Metallurgical recoveries were estimated at 92.5% for silver and 91.5% for gold based on metallurgical testing completed by Metcon Research of Tucson, Arizona.*

## Approval of Environmental Impact Study for San Jose

On October 23rd, 2009, the "Secretaria de Medio Ambiente y Recursos Naturales" (Mexican Environmental Agency) delivered the authorization of the Environmental Impact Study for full mine and mill construction and operation at the San Jose silver-gold project, located in the southern State of Oaxaca, Mexico.

The Environmental Impact Study authorizes the construction and future operation of the San Jose Mine, including the underground workings, processing plant, tailings facility and other surface infrastructure for a 1,500 tonne per day operation within an area of ninety-two hectares.

The permit contemplates a processing plant that will use conventional flotation for production of high grade silver- and gold- bearing concentrates. Test work indicates this metallurgical process allows for recoveries of 88% for both metals (see Fortuna release dated January 15, 2009) without the use of cyanide. The primary source of industrial water for the project will be from a gray-water treatment facility located thirteen kilometers from the mine site.

## Quarterly Information

The following table provides information for the eight fiscal quarters ended September 30, 2009:

**Expressed in $000's, except per share data**

| | Quarters Ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 30-Sep-09 | 30-Jun-09 | 31-Mar-09 | 31-Dec-08 | 30-Sep-08 | 30-Jun-08 | 31-Mar-08 | 31-Dec-07 |
| Revenues | 13,230 | 12,862 | 8,980 | 2,795 | 7,492 | 7,772 | 6,808 | 8,097 |
| Mine operating income (loss) * | 7,074 | 6,792 | 3,487 | (2,986) | 1,734 | 2,848 | 2,303 | 3,469 |
| Net (loss) income | (556) | 1,196 | (1,054) | (2,468) | (297) | 2,493 | (638) | 1,440 |
| Net (loss) Income per share - basic | (0.01) | 0.01 | (0.02) | (0.03) | 0.00 | 0.03 | (0.01) | 0.02 |
| - diluted | (0.01) | 0.01 | (0.02) | (0.03) | 0.00 | 0.03 | (0.01) | 0.02 |

* Mine operating income (loss) is a non-GAAP measure used by the Company as a measure of operating performance

## Financial Results

During the third quarter of 2009, the Company generated record quarterly sales of $13.23 million compared to $7.49 million in the same period of 2008. This represents an increase of 77%. When broken down by type of concentrate: silver-lead concentrate sales increased in tonnage by 36%, and the unit value of concentrate increased by 15%. The latter increase is the combined result of an increase in lead price of 1% offset by a decrease in silver price of 2%, and lower smelter treatment charges of $165 per ton of concentrate. Zinc concentrate sales increased in tonnage by 15% and the unit value of concentrate increased by 21%. The latter increase is a result of a decrease in the metal price of 1% and lower smelter treatment charges of $124 per ton of concentrate. The quarterly sales also includes copper concentrates of 85 tonnes compared to nil in the same period of 2008.

The significant increase in concentrate sold is the result of the Company's continuous investments over the last two years in mine development, processing plant expansion, and infrastructure.

During the third quarter of 2009 mine operating income was $7.07 million, 308% above the $1.73 million achieved in the same period of 2008. This improvement is a reflection of improved head grades, higher throughput, and better commercial terms. Contributing to the loss for the third quarter of $0.56 million is primarily the non-operating loss in commodity contracts of $3.47 million.

Mark-to-Market effect: Included in the $3.47 million loss recorded on commodity contracts, is a mark-to market effect of $2.26 million related to open contracts as at the end of September 2009 expiring between the months of October 2009 and June 2010.

Total **cost of sales** for the third quarter of 2009 was $6.16 million compared to $5.76 million for the same period of 2008. While tonnage of concentrate sold in the third quarter of 2009 increased 24% with respect to the corresponding quarter in 2008, cost of sales increased only by 7% due to an increase in lead head grade offset by an increase of 1% in unit cash costs per ton. Other things being equal, an increase in head grades will deliver higher concentrate production for equal or similar production costs.

**Selling and administrative expenses** for the third quarter of 2009 totalled $2.56 million compared to $2.09 million for the same period of 2008. The increase is due mainly to higher selling expenses associated with higher tonnage of concentrate sold. Corporate general and administrative expenses increased by $0.35 million to $1.78 million; selling and administrative expenses increased by $0.07 million to $0.66 million; and government royalty paid by Minera Bateas increased by $0.06 million to $0.12 million.

**Stock based compensation** charge totalled $0.12 million for the third quarter of 2009, compared to $0.03 million for the same period of 2008.

**Interest and other income and expenses** in the third quarter of 2009 amounted to net income of $0.19 million compared to net income of $0.38 million for the same period of 2008. The decrease is attributable to the Company holding a comparatively smaller average cash balance as well as reduced interest rates.

**Interest and finance expenses** for the third quarter 2009 were $0.05 million compared to $0.03 million for the same period of 2008. Interest expenses relate primarily to capital lease operations at our operating subsidiary.

**Net loss on commodity contract** for the third quarter of 2009 was $3.47 million compared to a net gain of $0.69 million for the same period of 2008. This amount reflects the change in fair value of derivative contracts between the opening of the reporting period and either the expiry of the contracts or the closing of the period, whichever happened first. Included in the $3.47 million loss recorded on commodity contracts, is a mark-to market effect of $2.26 million related to open contracts as at the end of September 2009 expiring between the months of October 2009 and June 2010. The Company has entered into short term commodity forward contracts to secure a minimum price level on part of Caylloma's zinc and lead metal production, and enters regularly into forward lead and zinc contracts with banks 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 Company does not use hedge accounting.

The $1.31 million **Income tax provision** recorded in the third quarter of 2009 (2008: $0.85 million) consisted of current and future income tax expense. Current income tax for the period, including the worker profit sharing plan regulated by Peruvian law was $1.39 million (2008: $0.02 million). Future income tax recoverable, amounting to $0.08 million (2008: expense $0.83 million) is mainly related to temporary differences arising on amounts of mineral properties at Peruvian operations where exploration and development are expensed for tax purposes.

**(Dollar amounts expressed in US dollars, unless otherwise indicated)**

## Results of Operations

Peru - Caylloma Ag-Pb-Zn Mine

| **Caylloma Mine** | **Quarters ended** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **30-Sep-09** | **30-Jun-09** | **31-Mar-09** | **31-Dec-08** | **30-Sep-08** | **30-Jun-08** | **31-Mar-08** | **31-Dec-07** |
| **Tonnes milled** | 105,241 | 100,881 | 91,449 | 91,025 | 89,827 | 80,121 | 70,408 | 68,615 |
| **Average tons milled per day** | 1,182 | 1,146 | 1,051 | 1,023 | 1,009 | 910 | 800 | 754 |
| **Head Grade** | | | | | | | | |
| Silver (g/t) | 146.54 | 160.42 | 147.81 | 114.83 | 97.73 | 85.49 | 74.73 | 75.58 |
| Lead (%) | 2.95 | 3.20 | 3.11 | 2.97 | 2.58 | 2.29 | 1.94 | 1.87 |
| Zinc (%) | 3.58 | 3.82 | 3.83 | 3.75 | 3.64 | 3.75 | 3.42 | 3.09 |
| Copper (%) | 0.26 | 0.26 | - | - | - | - | - | - |
| **Recoveries** | | | | | | | | |
| Silver (%)* | 84.20 | 86.48 | 84.58 | 82.43 | 80.07 | 78.12 | 76.42 | 77.74 |
| Lead (%) | 93.23 | 92.56 | 92.97 | 93.41 | 92.19 | 88.94 | 87.26 | 87.51 |
| Zinc (%) | 88.58 | 88.60 | 90.02 | 87.25 | 88.11 | 87.58 | 86.45 | 85.09 |
| Copper (%) | 7.29 | 8.60 | - | - | - | - | - | - |
| **Production (metal contained)** | | | | | | | | |
| Silver (oz)** | 438,186 | 468,822 | 384,339 | 291,381 | 243,280 | 186,276 | 140,239 | 139,433 |
| Lead (lbs) | 6,391,201 | 6,587,412 | 5,831,227 | 5,564,467 | 4,715,688 | 3,600,149 | 2,621,296 | 2,478,107 |
| Zinc (lbs) | 7,365,644 | 7,526,582 | 6,948,970 | 6,560,957 | 6,342,699 | 5,795,953 | 4,583,410 | 3,979,686 |
| Copper (lbs) | 44,092 | 50,706 | - | - | - | - | - | - |
| **Unit cash cost and Net smelter return** | | | | | | | | |
| Unit cash cost (US$/oz ag) | (5.34) | (2.98) | 0.10 | - | - | - | - | - |
| Unit cash cost (US$/tonne) | 45.09 | 43.39 | 44.37 | 44.60 | 44.43 | 46.92 | 49.97 | 52.41 |
| Unit Net Smelter Return (US$/tonne) | 121.00 | 114.00 | 91.00 | 60.00 | 80.40 | 97.79 | 97.70 | 118.41 |

*** Silver recovery in lead and copper concentrates**
**** Total silver production**

In the third quarter of 2009, metal output at the Caylloma mine increased significantly with respect to the corresponding quarter of 2008 but decreased marginally with respect to the previous quarter. This slight decrease in metal production was contemplated in the annual mine plan. The mine continues to be on target to achieve its silver production forecast of 1.6 million ounces for 2009. Silver production reached 438,186 ounces; 7% decrease over the second quarter of 2009 and 80% increase over the third quarter of 2008. Lead production reached 2,899 tonnes; 3% decrease over the second quarter of 2009 and 36% increase over the third quarter of 2008. Zinc production reached 3,341 tonnes; 2% decrease over the second quarter of 2009 and 16% increase over the third quarter of 2008.

Increments against the third quarter of 2008 were achieved through a combination of higher grades, improved metallurgical recoveries, and a higher throughput which reached an average of 1,182 tpd for the third quarter of 2009, 17% above the average throughput rate for the corresponding quarter of 2008.

The copper circuit is now scheduled to be commissioned in December 2009.

Cash cost per ounce of payable silver net of by-product credits at Caylloma was negative $5.34 for the third quarter of 2009 compared to negative $2.98 for second quarter of 2009. This reduction in cash cost is due to higher credits from by-products. Cash cost per tonne of treated ore for the third quarter of 2009 was $45.09

**(Dollar amounts expressed in US dollars, unless otherwise indicated)**

compared to $44.43 for the corresponding quarter of 2008. (See page 10 for reconciliation of cash production cost to the cost of sales in the consolidated statement of operations).

On July 16, 2009, the Company released an updated NI 43-101 resource estimation for Caylloma. The NI 43-101 Technical Report was filed on August 27, 2009. Highlights of the resource & reserve estimation include:

- Proven and Probable Mineral Reserves are estimated at 4.03 million tonnes averaging 156 g/t Ag, 0.55 g/t Au, 1.70% Pb and 2.58% Zn;
- Contained silver is estimated at 20.3 million ounces, representing a 304% increase in silver ounces in the Proven and Probable reserve categories over the previous resource and reserve estimate (NI 43-101 Technical Report published October 3, 2006);
- Inferred Mineral Resources are estimated at 1.3 million tonnes averaging 187 g/t Ag, 0.29 g/t Au, 1.92% Pb and 3.25% Zn;
- Contained silver in the Inferred Resource category is estimated at 7.7 million ounces.

*Price protection program*

In January 2009, the Company entered into commodity forward contracts to secure a minimum price level on a portion of Caylloma's zinc and lead metal production throughout the period February 2009 to July 2009. The decision to hedge was aimed at securing our minimum cash flow requirements during the construction phase of the plant expansion and copper circuit projects. Subsequently the Company has been gradually extending its hedging programme for the remainder of 2009 and into the first half of 2010 with the objective of securing short term capital requirements for project development.

The contracts are spread evenly over the periods shown below with settlement occurring on a monthly basis:

settlements throughout February 2009 to July 2009:

| | |
|---|---|
| Lead forward contracts: | $1,109/t, for the total of 3,150 tons |
| Zinc forward contracts: | $1,240/t, for the total of 3,850 tons |

settlements throughout August 2009 to December 2009:

| | |
|---|---|
| Lead forward contracts: | $1,645/t, for the total of 2,675 tons |
| Zinc forward contracts: | $1,561/t, for the total of 3,000 tons |

settlements throughout January 2010 to June 2010:

| | |
|---|---|
| Lead forward contracts: | $1,910/t, for the total of 1,800 tons |
| Zinc forward contracts: | $1,787/t, for the total of 1,050 tons |

Mexico – San Jose Silver-Gold Project

Management plans to have all the engineering and permits required to initiate construction at San Jose concluded by year end. Project staffing for the construction phase is being conducted and the Company has initiated selective searches for long lead equipment.

**(Dollar amounts expressed in US dollars, unless otherwise indicated)**

*Trinidad Resource Estimation*

On October 26, 2009, the Company released an updated NI 43-101 resource estimation for San Jose, with the full NI 43-101 to be released within 45 days of the release. Highlights are as follows:

Indicated Resources have increased 83% to 2.69 million tonnes with contained silver equivalent ounces increasing 112% to 37.6 million Ag Equivalent[1] ounces. Silver and gold grades in the Indicated Resource category have increased by 12% to 295 g/t and 4% to 2.27 g/t, respectively. The new resource estimate will serve as the basis for pre-feasibility level engineering studies projected for completion by year end.

At a cut-off grade of 150 g/t Ag Equivalent, the Indicated and Inferred Mineral Resources for the Trinidad Zone at San Jose are estimated at:

| | |
|---|---|
| Indicated Mineral Resource: | 2.69 million tonnes grading 295 g/t Ag and 2.27 g/t Au containing 37.6 million Ag Equivalent[1] ounces |
| Inferred Mineral Resource: | 2.41 million tonnes grading 262 g/t Ag and 2.11 g/t Au containing 30.4 million Ag Equivalent[1] ounces. |

*[1]Silver equivalency estimates were derived using metal prices of US$13.75/oz for silver and US$856.16/oz for gold (36-month average + 24 month future metal prices as of July 31, 2009). Metallurgical recoveries were estimated at 92.5% for silver and 91.5% for gold based on metallurgical testing completed by Metcon Research of Tucson, Arizona.*

The resource estimate incorporates data from 196 core drill holes totaling 64,204 meters and 908 underground channel samples. Previously reported NI 43-101 compliant resources for San Jose were estimated at 1.47 million tonnes grading 263 g/t Ag and 2.19 g/t Au in the Indicated category and 3.9 million tonnes grading 261 g/t Ag and 2.57 g/t Au in the Inferred category (see March 31, 2007 Technical Report available on the company website (www.fortunasilver.com ) and on SEDAR).

*Approval of Environmental Impact Study*

On October 23rd, 2009, the "Secretaria de Medio Ambiente y Recursos Naturales" (Mexican Environmental Agency) delivered the authorization of the Environmental Impact Study for full mine and mill construction and operation at the San Jose silver-gold project, located in the southern State of Oaxaca, Mexico.

The Environmental Impact Study authorizes the construction and future operation of the San Jose Mine, including the underground workings, processing plant, tailings facility and other surface infrastructure for a 1,500 tonne per day operation within an area of ninety-two hectares.

The permit contemplates a processing plant that will use conventional flotation for production of high grade silver- and gold- bearing concentrates. Test work indicates this metallurgical process allows for recoveries of 88% for both metals (see Fortuna release dated January 15, 2009) without the use of cyanide. The primary source of industrial water for the project will be from a gray-water treatment facility located thirteen kilometers from the mine site.

*Other permits*

Management now looks forward to the approval of the "Estudio Técnico Justificativo" (change of land use) in the coming days; this permit will allow the commencement of construction activities.

On April 28, 2009, the "Comision Federal de Electricidad" (Mexican Federal Energy Commission) issued the permit to connect to the national power grid for up to five megawatts; sufficient power to cover the requirements of a 1,500 tonnes per day mine operation. The future transformer sub-station site will be located within five hundred meters of the main high voltage power line which runs through the Company´s property.

*Project Engineering*

The Company has received from its consultants all the engineering components that make up the San Jose Pre-Feasibility Study which include the processing plant, tailings facility, power project, water project, surface infrastructure, mine design, and other matters. The Company´s engineering staff is currently conducting an internal review of the various engineering projects and continues to work towards the delivery of the final study for December 2009.

The Company has engaged North American engineering firm CAM to provide Qualified Person supervision for the project engineering and to author required Technical Reports.

<u>Mexico - Tlacolula Silver Project</u>

In September 2009, the Company was granted an option to acquire a 60% interest in the Tlacolula silver project located in the State of Oaxaca, Mexico from Radius Gold Inc. ("Radius") (a related party by way of directors in common with the Company). The Company can earn the interest by spending $2 million, which includes a commitment to drill 1,500 meters within three years, and making staged annual payments of $0.25 million cash and $0.25 million in common stock 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 the first year anniversary;
- $0.05 million cash and $0.05 million cash equivalent in shares by the second year anniversary;
- $0.05 million cash and $0.05 million cash equivalent in shares by the third year anniversary; and,
- $0.10 million cash and $0.10 million cash equivalent in shares by the fourth year anniversary.

As at September 30, 2009, the transaction is pending stock exchange approval and no payments have been made.

The 12,000 ha Tlacolula property is located 14km E-SE of the city of Oaxaca, 20km north of the Taviche District, where high-grade silver has been mined since Spanish colonial times, and is 30km northeast of the Company's 100% owned San Jose silver-gold development project.

**<u>Cash cost per silver ounce and cash cost per tonne (non-GAAP measures)</u>**

Cash cost per ounce and cash cost per tonne are key performance measures that management uses to monitor performance. These performance measures have no meaning within Canadian Generally Accepted Accounting

Principles ("Canadian GAAP"), and, therefore, amounts presented may not be comparable to similar data presented by other mining companies.

The following table presents 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 statement of operations:

| | **$'000's** |
|---|---|
| **Cost of sales** | **6,156** |
| **Add / (Subtract)** | |
| Change in inventory (ore and concentrate stock piles) | 102 |
| Depletion, depreciation, and accretion | (1,513) |
| **Cash cost** | **4,745** |
| **Total processed ore (tonnes)** | **105,241** |
| **Cash cost per tonne of processed ore ($/t)** | **45.09** |
| **Cash cost** | **4,745** |
| **Add / (Subtract)** | |
| By-product credits [1] | (7,179) |
| Refining charges | 354 |
| **Cash cost applicable per payable ounce** | **(2,080)** |
| **Payable silver ounces** | **389,836** |
| **Cash cost per ounce of payable silver ($/oz)** | **(5.34)** |

[1] **By-product credits are included in the provisional liquidation**

## Liquidity and Capital Resources

The Company's cash resources and liquid investments as at September 30, 2009 were $33.68 million compared to $29.45 million as at December 31, 2008.

During the third quarter of 2009, cash generated by operating activities before changes in working capital was $2.66 million. Further liquidity provided by changes in working capital amounted to $0.86 million, for total cash generated by operating activities of $3.51 million.

During the third quarter of 2009, the Company invested a total amount of $2.72 million in mineral properties and $0.99 million in plant and equipment. Additionally, the Company collected a net amount of value added tax refundable credit from the Mexican Government of $0.05 million. This is net of value added tax disbursements on local expenses during the period.

As at September 30, 2009, the Company had working capital of $34.86 million compared to working capital of $34.06 million at December 31, 2008.

Management believes the Company's cash position as well as its ongoing operation in Caylloma is sufficient to support the Company's operating and capital requirements on an ongoing basis. Actual funding requirements may vary from those planned due to further acquisition opportunities. Management believes it will be able to raise equity capital or access debt facilities as required in both the short and long term, but recognizes the uncertainty attached thereto.

## Guarantees and Indemnifications

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.

The Company acts as a guarantor to capital lease obligations held by two of its mining contractors. These capital lease contracts are related to the acquisition of mining equipment deployed at the Caylloma mine.

## 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 is 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)

The Company incurred charges from directors, officers, and companies having a common director or officer as follows:

| | Expressed in $'000's | | | |
|---|---|---|---|---|
| | Three months ended September 30, | | Nine months ended September 30, | |
| **Transactions with related parties** | **2009** | 2008 | **2009** | 2008 |
| Consulting fees [1] | **$ 38** | $ 27 | **$ 103** | $ 42 |
| Salaries and wages [2] | **28** | 45 | **88** | 58 |
| Other general and administrative expenses [3] | **36** | 39 | **102** | 39 |
| | **$ 102** | $ 111 | **$ 293** | $ 139 |

[1] Consulting fees includes fees paid to two directors, Simon Ridgway and Mario Szotlender.

[2, 3] Radius Gold Inc. ("Radius") has directors in common with the Company and shares office space, and is reimbursed for various general and administrative costs incurred on behalf of the Company.

[2] Salaries and wages includes employees' salaries and benefits charged to the Company based on an estimated percentage of the actual hours worked for the Company.

In September 2009, the Company was granted an option to acquire a 60% interest in the Tlacolula silver project located in the State of Oaxaca, Mexico from Radius. Refer to Notes to the Consolidated Financial Statements Note 9. d).

| | Expressed in $'000's | | | |
|---|---|---|---|---|
| **Amounts due to/(from) related parties** | **September 30, 2009** | | December 31, 2008 | |
| Owing to a director | **$** | **-** | $ | - |
| Owing to a company with common directors [3] | **$** | **23** | $ | 38 |
| | **$** | **23** | $ | 38 |

The transactions with related parties are measured at the exchange amount, which is the amount of consideration established and agreed upon by the parties. The balances with related parties are unsecured, non-interest bearing, and payable in the normal course of business.

## Critical Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. These estimates and assumptions are based on established industry standards, historical experience, and are reviewed on an ongoing basis to confirm their continued applicability.

*Amortization and Mineral Property Costs*

Mineral property costs are comprised of acquisition costs and capitalized exploration, construction and development costs. Upon initiating production, the asset is amortized over its estimated useful life on a units-of-production basis. The Company estimates reserves and resources and the economic life of its mines and utilizes this information to calculate depletion and amortization expense. Depreciation and depletion charges are adjusted prospectively based on periodic re-assessments of the Company's mineral reserves.

The estimate of mineral reserves is prepared by Qualified Persons in accordance with industry standards defined under NI 43-101 of the Canadian Securities regulatory authorities. Mineral reserve estimates can change over time as a result of numerous factors, including changes in metal prices, production costs, or the re-evaluation of geological, engineering and economic data of a deposit. A significant reduction in mineral reserves would have a negative impact on the calculation of the amortization of this asset.

*Asset Retirement Obligations*

Fortuna's determination for asset retirement obligations involves estimation of timing and amounts of future costs relating to ongoing environmental and mine closure activities required under applicable law or the Company's own remediation plans. These estimates are subject to significant uncertainties because many of these costs will not be incurred for a number of years, the nature of the reclamation activities might change and the assumptions regarding the rate of inflation and credit risk-adjusted interest rate used in the calculation may vary over time. Therefore, actual costs and their timing might differ from current estimates.

*Impairment of Long-lived Assets*

Management reviews and evaluates its long-lived assets for impairment when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Examples of such events or circumstances are changes in metal prices, sudden physical deterioration of the asset, legal circumstances or political risks in the countries Fortuna operates, or other external factors which could have a significant impact on the operations of the Company. Impairment is considered to exist if total estimated future cash flows or probability-weighted cash flows on an undiscounted basis are less than the carrying amount of the assets, including mineral property, plant and equipment and non-producing property. An impairment loss is measured and recorded based on discounted estimated future cash flows or the application of an expected present value technique to estimate fair value in the absence of a market price. Future cash flows include recoverable proven and probable reserves and a portion of recoverable resources, silver, zinc, copper, lead and gold prices (considering current and historical prices, price trends and related factors), production levels, capital and reclamation costs, all based on detailed engineering life-of-mine plans. Assumptions underlying future cash flow estimates are subject to risks and uncertainties. Any differences between significant assumptions and market conditions and/or the Company's performance could have a material effect on any impairment provision, and on the Company's financial position and results of operations.

*Income Taxes*

The estimation of the Company's future tax liabilities and assets involves significant judgment around a number of assumptions. Judgement must be used to determine the Company's future earning potential, and the expected timing of the reversal of future tax assets and liabilities. Further uncertainties are the result of interpretation of tax legislation in a number of jurisdictions which might differ from the ultimate assessment of the tax authorities. These differences may affect the final amount or the timing of the payment of taxes.

*Stock-based Compensation*

The determination of the value of stock-based compensation is estimated using the Black-Scholes option pricing model. Option pricing models require the input of highly subjective assumptions, particularly as to the expected price volatility of the stock. Other assumptions include the expected life of the options and the risk-free interest rate at the time of the grant. Changes in these assumptions can materially affect the fair value estimated.

## Financial Instruments

The carrying value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, due to related parties, net 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. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and, therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The Company enters into derivative contracts to manage its exposure to fluctuations in base metal prices. These contracts are marked-to-market at the end of each period, and the changes in estimated fair value are recorded as an unrealized gain (loss) on commodity contracts in the statement of operations. As at September 30, 2009 the Company estimated the fair value of the outstanding contracts to constitute a liability of $3.07 million, and recorded a loss in the consolidated statements of operations for the third quarter of 2009 of $3.47 million. The estimated fair value was determined based on using applicable valuation techniques for commodity options with reference to the published market prices for underlying commodities quoted at the London Metal Exchange.

The long term investments in marketable securities are classified as available-for-sale and are measured at fair value at the end of each period. Fair value of these investments is determined based on published market prices of underlying securities. Change in fair values of available-for-sale marketable securities is recognized in other comprehensive income. At December 31, 2008 the Company had an investment in 3,706,250 shares of Continuum. These shares were de-recognized upon the Company's acquisition of Continuum on March 6, 2009 and a loss of $0.46 million was recorded in the statement of operations to reflect the realization of the loss.

The Company's financial instruments are exposed to certain financial risks, including currency risk, credit risk, liquidity risk, interest risk, and price risk.

*(a) Currency risk*

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada, Peru, Mexico, and Barbados 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 results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

At September 30, 2009, 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 | | | | | |
|---|---|---|---|---|---|---|
| | **September 30, 2009** | | | December 31, 2008 | | |
| | **Canadian Dollars** | **Nuevo Soles** | **Mexican Pesos** | Canadian Dollars | Nuevo Soles | Mexican Pesos |
| Cash and cash equivalents | **$ 23,821** | **S/. 2,526** | **$ 4,610** | $29,748 | S/. 629 | $ 3,864 |
| Accounts receivable | **7** | **334** | **18,490** | 13 | 10,400 | 46,460 |
| Accounts payable and accrued liabilities | **(87)** | **(11,291)** | **(641)** | (172) | (5,281) | (10,259) |

Based on the above net exposure as at September 30, 2009, 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, expressed in US dollars, as follows:

| | | | |
|---|---|---|---|
| Impact to other comprehensive income (loss) | $ 2,429 | | |
| Impact to net income (loss) | | $ (325) | $ 200 |

*(b) 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 equivalents are held through large Canadian and international financial institutions. These investments mature at various dates over the current operating period. All of the

Company's trade accounts receivables are held with large international metals trading companies. As at September 30, 2009, the Company has a Mexican value added tax of $1.29 million and Peruvian value added tax of $0.15 million. The Company expects to recover the full amounts from the Mexican and Peruvian Governments.

*(c) 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 and cash equivalents, and its committed liabilities.

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

| | Expressed in '000's | | | | |
|---|---|---|---|---|---|
| | **Expected payments due by period as at September 30, 2009** | | | | |
| | Less than 1 year | 1 - 3 years | 4 - 5 years | After 5 years | Total |
| Accounts payable and accrued liabilities | $ 6,370 | $ - | $ - | $ - | $ 6,370 |
| Due to related parties, net | 23 | - | - | - | 23 |
| Derivatives | 3,065 | - | - | - | 3,065 |
| Capital lease obligations | 1,037 | 894 | - | - | 1,931 |
| Long term liability | - | 630 | - | - | 630 |
| Total [1] | $ 10,495 | $ 1,524 | $ - | $ - | $ 12,019 |

[1] Amounts above do not include payments related to the following: (i) the Company's anticipated asset retirement obligation of $1,887 associated with mine closure, land reclamation, and other environmental matters.

*(d) 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 of the amounts in investments with maturities of 90 days or less included in cash and cash equivalents is limited because these investments, although available for sale, are generally held to maturity.

*(e) Price risk*

The Company is exposed to metals price risk with respect to silver, gold, zinc, and lead 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 derivative instruments. As a matter of policy, the Company does not hedge its silver production.

**(Dollar amounts expressed in US dollars, unless otherwise indicated)**

## 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.

## Share Position and Outstanding Warrants and Options

The Company's outstanding share position at November 5, 2009 is 94,863,684 common shares. In addition, a total of 8,894,000 share purchase warrants and incentive stock options are currently outstanding as follows:

| Type of Security | No. of Shares | Exercise Price CAD$ | Expiry Date |
|---|---|---|---|
| Director/Employee Stock Options: | 29,000 | $0.37 | December 2, 2009 |
| | 30,000 | $0.80 | July 24, 2010 |
| | 270,000 | $1.35 | February 5, 2016 |
| | 250,000 | $2.29 | March 30, 2016 |
| | 60,000 | $1.75 | May 8, 2016 |
| | 200,000 | $1.75 | May 22, 2016 |
| | 20,000 | $0.85 | July 5, 2016 |
| | 225,000 | $1.55 | July 5, 2016 |
| | 860,000 | $1.66 | July 10, 2016 |
| | 225,000 | $1.61 | September 13, 2016 |
| | 110,000 | $0.85 | January 11, 2017 |
| | 700,000 | $2.22 | January 11, 2017 |
| | 50,000 | $2.75 | February 6, 2017 |
| | 15,000 | $0.85 | April 22, 2017 |
| | 10,000 | $0.85 | May 31, 2017 |
| | 50,000 | $0.85 | June 27, 2017 |
| | 50,000 | $0.85 | July 2, 2017 |
| | 1,075,000 | $3.22 | July 2, 2017 |
| | 25,000 | $0.85 | October 24, 2017 |
| | 250,000 | $2.52 | February 5, 2018 |
| | 150,000 | $1.25 | August 25, 2018 |
| | 1,190,000 | $0.85 | October 5, 2018 |
| | 650,000 | $0.85 | November 5, 2018 |
| | 250,000 | $0.83 | July 6, 2019 |
| | 2,150,000 | $1.60 | October 27, 2019 |
| **TOTAL OUTSTANDING OPTIONS:** | **8,894,000** | | |

## Change in Accounting Policy

*Change in Reporting Currency*

Effective January 1, 2009, the Company changed its reporting currency to the US dollar. The change in reporting currency is to better reflect the Company's business activities and to improve investors' ability to compare the Company's financial results with other publicly traded businesses in the mining industry. Prior to January 1, 2009, the Company reported its annual and quarterly consolidated balance sheets and the related consolidated statements of operations and cash flows in Canadian dollar (CAD).

In making this change in reporting currency, the Company followed the recommendations of the Emerging Issues Committee (EIC) of the Canadian Institute of Chartered Accountants ("CICA"), set out in EIC-130, "Translation Method when the Reporting Currency Differs from the Measurement Currency or there is a Change in the Reporting Currency". In accordance with EIC-130, the financial statements for all years and periods presented have been translated in to the new reporting currency using the current rate method. Under this method, the statements of operations and cash flows statements items for each year and period have been translated into the reporting currency using the average exchange rates prevailing during each reporting period. All assets and liabilities have been translated using the exchange rate prevailing at the consolidated balance sheets dates. Shareholders' equity transactions since October 1, 1998 have been translated using the rates of exchange in effect as of the dates of the various capital transactions, while shareholders' equity balances on September 30, 1998 have been translated at the exchange rate on that date. All resulting exchange differences arising from the translation are included as a separate component of other comprehensive income. All comparative financial information has been restated to reflect the Company's results as if they had been historically reported in US dollars.

*Adoption of New Accounting Standards*

*Goodwill and Intangible Assets (Section 3064)*

In February 2008, the CICA issued the following Handbook Sections: Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Intangible Assets", Section 3450, "Research and Development Costs", and Section 1000, "Financial Statement Concepts". The standard intends to reduce the differences with International Financial Reporting Standards ("IFRS") in the accounting for intangible assets and results in closer alignment with U.S. GAAP. Under current Canadian standards, more items are recognized as assets than under IFRS or U.S. GAAP. The objectives of Section 3064 are to reinforce the principle-based approach to the recognition of assets only in accordance with the definition of an asset and the criteria for asset recognition; and clarify the application of the concept of matching revenues and expenses such that the current practice of recognizing assets that do not meet the definition and recognition criteria are eliminated. The standard will also provide guidance for the recognition of internally developed intangible assets (including research and development activities), ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. This standard will be effective for fiscal years beginning on or after October 1, 2008. The Company has evaluated the new section and determined that adoption of these new requirements will have no impact on the Company's consolidated financial statements.

*Credit risk and fair value of financial assets and financial liabilities*

In January 2009, the Emerging Issues Committee of the CICA issued EIC-173 "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". This guidance clarified that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments, for presentation and disclosure purposes.

The guidance should be applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after the date of issuance of this Abstract. Retrospective application with restatement of prior periods is permitted but not required. Early adoption is encouraged.

The Company has evaluated the new section and determined that adoption of these new requirements will have no impact on the Company's consolidated financial statements.

*Mining Exploration Costs*

On March 27, 2009, the Emerging Issues Committee of the CICA issued EIC-174 "Mining Exploration Costs" which applies to interim and annual financial statements for periods ending on or after January 20, 2009. This guidance clarified that an entity that has initially capitalized exploration costs has an obligation in the current and subsequent accounting periods to test such costs for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

This standard will be effective for the Company beginning on April 1, 2009. The Company has evaluated the new section and determined that adoption of these new requirements has no impact on the Company's consolidated financial statements.

*Foreign currency translation*

The Company's functional currency is the Canadian dollar. Effective January 1, 2009, the Company changed its reporting currency to the US dollar.

All subsidiaries, except its wholly owned subsidiary Minera Bateas S.A.C. ("Bateas"), are considered to be integrated foreign operations and their financial statements are translated to Canadian dollars under the temporal method. Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities at historical exchange rates. Revenues and expenses are translated at the average exchange rate in effect during the period. Realized and unrealized foreign exchange gains and losses are included in earnings.

Commencing January 1, 2009, Bateas was reclassified as a self-sustaining operation from an integrated foreign operation because of the significant changes in the economic facts and circumstances of Bateas. Bateas's commercial mine production and cash generated from sales is sufficient to cover further exploration expenditure and other operation costs. Therefore, its financial statements are translated using the current rate method. Assets and liabilities of Bateas, which are denominated in US dollars, are translated into Canadian dollars using the current rate method at period-end exchange rates and resulting translation adjustments are reflected in comprehensive income. Revenues and expenses of Bateas are translated at average exchange rates for the period.

## Recent released Canadian Accounting Standards

The Company has assessed new and revised accounting pronouncements that have been issued that are not yet effective and determined that the following may have an impact on the Company:

*Convergence with International Financial Reporting Standards ("IFRS")*

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canadian GAAP. This date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company will begin reporting its financial statements in accordance with IFRS on January 1, 2011, with comparative figures for 2010.

The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Company for its year ended December 31, 2010, and of the opening balance sheet as at January 1, 2010.

The Company has begun planning its transition to IFRS but the impact on its consolidated financial position and results of operations has not yet been determined. The process will consist of three phases: Scoping and Diagnostics, Analysis and Development, and Implementation and Review. In the third quarter of 2009, the Company completed a high-level impact assessment to identify key areas that will be affected by the conversion. The detailed analysis of the IFRS - Canadian GAAP differences, and the selection of accounting policy choices under IFRS has commenced and is expected to be completed by the end of the fourth quarter 2009. The Company will continue to monitor changes in IFRS leading up to the changeover date, and will update its conversion plan as required.

*Business Combinations*

In January 2009, the CICA issued the following Handbook Sections: Section 1582, "Business Combinations", Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests". These new standards are harmonized with International Financial Reporting Standards (IFRS). Section 1582 specifies a number of changes, including: an expanded definition of a business, a requirement to measure all business acquisitions at fair value, a requirement to measure non-controlling interests at fair value, and a requirement to recognize acquisition-related costs as expenses. Section 1601 establishes the standards for preparing consolidated financial statements. Section 1602 specifies that non-controlling interests be treated as a separate component of equity, not as a liability or other item outside of equity. The new standards will become effective in 2011 but early adoption is permitted. The Company is evaluating the attributes of early adoption of this standard and its potential effects if events or transactions occurred that this standard applies to.

*Comprehensive revaluation of assets and liabilities and Equity*

In August 2009, the CICA amended Section 1625, "Comprehensive revaluation of assets and liabilities" as a result of issuing "Business Combinations, Section 1582, "Consolidated Financial Statements", Section 1601, and Non-Controlling Interests", Section 1602, in January 2009.

In August 2009, the CICA amended Section 3251, "Equity" as a result of issuing Section 1602, "Non-controlling Interests". These amendments only apply to entities that have adopted Section 1602.

These amendments apply prospectively to comprehensive revaluations of assets and liabilities occurring in fiscal years beginning on or after January 1, 2011, but early adoption is permitted. The Company is evaluating the attributes of early adoption of this standard and its potential effects if events or transactions occurred that this standard applies to.

*Financial Instruments and Impaired Loans*

In August 2009, the CICA issued amendments to Section 3855, "Financial Instruments: Recognition and Measurement". These amendments will permit (or require in certain circumstances) entities to reclassify certain investments in debt instruments, will amend the guidance regarding impairment measurement for Held to Maturity debt instruments and will require reversals of impairment losses for Available for Sale debt instruments when conditions have changed. These amendments apply only to investments in debt instruments and do not apply to investments in equity investments or to debt instruments that have been designated at orgination as Held for Trading.

In August 2009, the CICA amended Section 3025, "Impaired loans" to conform with the definition of a loan to that in amended Section 3855 and to include held-to-maturity investments within the scope of this Section.

These amendments are effective for annual financial statements relating to fiscal years beginning on or after November 1, 2008 with early adoption permitted for interim financial statements issued on or after August 20, 2009. The Company is evaluating the attributes of early adoption of this standard and its potential effects if events or transactions occurred that this standard applies to.

## Risks and Uncertainties

*Metal prices*

One of the most significant risks affecting the profitability and viability of the Company's mining operations is the fluctuation of metal prices. Volatility of metal prices is high by historic measures and strong downturns on these prices can have significant adverse effects on the continuity of the Company's operations. In order to mitigate this risk in the medium term, the Company put in place price protection strategies for approximately 60% of its zinc and lead metal production during the six month period between February 2009 and July 2009. Subsequently the Company extended the price protection for 58% of zinc and lead production between the months of August and June 2010.

*Credit risk*

The Company is subject to credit risk through its trade receivables. The Company enters into one year contracts to sell its concentrate products at Caylloma and transacts only with credit worthy costumers to minimize credit risk. The Company has awarded its full production of 2009 to large international metals trading companies, including Glencore International.

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 credit worthy costumers to minimize credit risk.

The Company currently holds derivatives contracts with Standard Bank PLC, Banco Bilbao Vizcaya Argentaria, S.A., Macquarie Bank Limited, and Goldman Sachs.

*Environmental risk*

The Company has recorded an asset retirement obligation of $1.89 million as of September 30, 2009 in relation to the cost of reclamation associated with the Caylloma property. This amount has been estimated by a third party in compliance of local regulations and is still in the process of being reviewed by the relevant authorities before definitive approval.

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 asset retirement obligation relating to the Caylloma mine is subject to change based on amendments to laws and regulations and as new information regarding the Company's operations becomes available.

*Exchange rate risk*

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada, Peru, Mexico, and Barbados 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 results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

*Exploration and development*

The business of mineral exploration and extraction involves a high degree of risk. Few properties that are in the exploration stage ultimately become producing mines. Major expenses may be required to establish reserves by drilling and to construct mining and processing facilities at a site. It is impossible to ensure that exploration and development programs carried out by the Company will result in profitable commercial mining operations.

*Resources and reserves*

There is a degree of uncertainty attributable to the estimation of resources and reserves and to expected mineral grades. Mineral Resources and Mineral Reserves may require revision based on actual production experience. Market fluctuations in the price of metals, as well as increased production costs and reduced recovery rates, may render certain mineral reserves uneconomic and may ultimately result in a restatement of resources and/or reserves. Short term operating factors relating to the mineral resources and reserves, such as the need for sequential development of ore bodies may adversely affect the Company's profitability in any accounting period.

*Political and country risk*

The Company's mineral properties are located in emerging nations and consequently may be subject to a higher level of risk compared to developed countries. Operations, the status of mineral property rights, title to the properties and the recoverability of amounts shown for mineral properties in emerging nations can be affected by changing economic, regulatory, and political situations.

The State of Oaxaca has a history of social conflicts and political agitation which can lead to public demonstrations and blockades that can from time to time affect the Company's operations.

## Internal Controls

The Company evaluated the effectiveness of the design and operation of the disclosure controls and procedures as of September 30, 2009 under the supervision of the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based on the results of this evaluation the CEO and the CFO have concluded that such disclosure controls are sufficiently effective to provide reasonable assurance that material information relating to the Company is made known to management and disclosed in accordance with the applicable securities laws.

Management is 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 Canadian generally accepted accounting principles. Management of the Company has evaluated the effectiveness of internal control over financial reporting as of September 30, 2009 and has concluded there are no material weaknesses. Management continues to review and refine its internal controls and procedures.