MANAGEMENT'S DISCUSSION AND ANALYSIS
Third Quarter Report – June 30, 2006

General

This Management's Discussion and Analysis ("MD&A") supplements the unaudited financial statements of Fortuna Silver Mines Inc. (the "Company") for the nine months ended June 30, 2006. The following information, prepared as of August 21, 2006, should be read in conjunction with the June 30, 2006 financial statements, which have been prepared in accordance with Canadian generally accepted accounting principles. All amounts are expressed in Canadian dollars unless otherwise indicated. The June 30, 2006 financial statements have not been reviewed by the Company's auditors.

Business of the Company

The Company is an emerging silver-gold and base metal producer focused on Latin America., with its principal assets being the Caylloma Silver Mine in southern Peru and the San Jose Silver-Gold Project in Oaxaca, Mexico.

Peru – Caylloma Silver Mine

Fortuna continues with the implementation of modifications and upgrades to the processing plant. The flotation cells, thickeners and filters for the silver-lead and zinc circuits have been installed. The overhaul of the grinding circuit composed of four ball mills has been concluded. The primary crusher has been installed and the secondary and tertiary crushers are expected on site for the last week of August. Management expects the plant to be operational at 700 tonnes per day capacity by the end of September, 2006. The plant will be ready to accommodate a throughput increase up to the permitted 1,100 tonnes per day.

Mining of four stopes on the Animas vein is already taking place. Preparation of additional stopes continues at an accelerated pace to meet plant capacity by year end. A 4x4 m cross-cut ramp on intermediate level eight on the Animas vein intersected the structure in August. This new heading will assist in giving more speed to stope preparation on Animas.

A new mine resource estimate for Caylloma has been published on August 21st. A fifty percent increase in measured and indicated resources for the Animas vein has been obtained by remodeling the structure to include Ag-Pb-Zn zones. Management expects to report a significant portion of these resources as reserves before year end. Stope preparation and mining of some of these resource blocks is already taking place.

Table 1. Silver Veins Proven & Probable Reserves

Vein	Tonnes	Ag gpt	Au gpt	Pb %	Zn %	Contained Ag oz
PROVEN						
San Cristóbal	145,851	422	0.3	0.0	0.0	1,980,562
San Pedro	52,102	407	1.0	0.0	0.0	682,646
San Carlos	5,392	622	0.2	0.3	0.7	107,751
La Plata	8,537	478	2.1	0.2	0.1	131,184
Cimoide (La Plata)	30,269	575	3.4	0.0	0.1	560,075
Paralela	11,200	592	0.1	0.0	0.0	213,294
Proven Reserves	**253,351**	**451**	**0.9**	**0.0**	**0.0**	**3,675,513**
PROBABLE						
San Cristóbal	35,989	507	0.4	0.2	0.3	586,410
San Pedro	33,650	340	0.9	0.0	0.1	368,157
San Carlos	7,921	656	0.1	0.3	0.7	167,020
La Plata	1,954	720	4.1	0.1	0.1	45,213
Cimoide (La Plata)	5,691	414	3.0	0.0	0.1	75,814
Paralela	4,491	688	0.0	0.1	0.2	99,339
Probable Reserves	**89,695**	465	**0.8**	**0.1**	**0.2**	**1,341,953**
Proven + Probable	**343,046**	**454**	**0.8**	**0.1**	**0.1**	**5,017,466**

Table 2. Animas Vein Measured and Indicated Resources

Vein	Tonnes	Ag gpt	Au gpt	Pb %	Zn %	Contained Ag oz
Measured	484,540	152	0.8	2.3	4.2	2,388,782
Indicated	688,786	137	0.5	2.3	4.2	3,037,544
Measured+Ind.	**1,173,326**	**143**	**0.7**	**2.3**	**4.2**	**5,426,326**

Table 3. Inferred Resources

Vein	Tonnes	Ag gpt	Au gpt	Pb %	Zn %	Contained Ag oz
San Cristóbal	135,513	407	0.2	0.3	0.4	1,771,635
San Pedro	92,896	369	0.2	0.7	1.4	1,100,831
San Carlos	16,626	766	0.2	0.5	1.2	409,654
La Plata	40,540	663	2.5	0.2	0.7	863,893
Cimoide (La Plata)	7,326	231	2.0	0.0	0.1	54,330
Paralela	52,473	563	0.0	0.2	0.3	950,452
Ramal paralela	90,094	362	0.1	0.3	0.7	1,049,011
Animas	*980,032*	*243*	*0.5*	*2.7*	*4.2*	*7,626,114*
Inferred	**1,415,499**	**305**	**0.4**	**2.0**	**3.1**	**13,825,919**

Tables 1 through 3 may not check exactly due to rounding.

The Company continues to explore the northeast extension of the Animas vein as all the measured and indicated resources reported above are located along 1.5 km of the 3.8 km long vein. 3000 meters of drilling are planned, for completion by year end.

The Company is working to update the production and financial models provided in the April, 2005 Caylloma technical report, to reflect changes in production scenarios on the Animas vein and metal prices. The April, 2005 Caylloma technical report is available on SEDAR and on the Company's website at www.fortunasilver.com.

Capital Expenditures: The Company is accelerating the original capital expenditures budget of US$6.5 million over three years and it is expected that this amount will be invested in great part during the first year, giving more versatility to the mine in an environment of historically high commodity prices. The capital expenditures budget is part of the April, 2005 Caylloma technical report available on SEDAR and on the Company's website at www.fortunasilver.com.

Mexico – San Jose Silver-Gold Project

On June 12, 2006 Fortuna concluded the first phase drill program at San Jose, which begun on February, totalling 11,941meters in 37 core holes. The first group of assay results was made public in a news release dated May 15th. Initial results for nine holes on the Trinidad zone of the vein returned high grade silver and gold mineralization extending the zone 100 meters down dip and along strike to the south from previous drilling. A schematic long section showing the pierce points within the vein structure is available on our website at www.fortunasilver.com. Results have been slow to arrive. The Company still has pending assays for the main Trinidad zone. Management is evaluating the results on hand and as soon as pending assays arrive a comprehensive news release will be made.

In November 2005, the Company reached an agreement with Continuum Resources Ltd. (TSXV:CNU) in which the Company can earn a 70% interest in Continuum's 80% share of the San Jose silver-gold deposit located in Oaxaca, Mexico. The agreement calls for the Company to spend CAD$2 million in exploration by December 2007, primarily on diamond drilling, with a minimum of $1.0 million to be spent by August 1, 2006 (spent). At the termination of the drill program, and based on a NI 43-101 compliant resource calculation, the Company will be required to pay Continuum US$0.50 for each ounce of silver or silver equivalent in the Measured resource category, and US$0.35 for each ounce of silver or silver equivalent in the Indicated resource category corresponding to the interest of the Company in the ounces.

Acquisitions

Fortuna is constantly evaluating new opportunities in order to meet our corporate objective of building significant silver inventory and future cash flow, by acquiring advanced projects and near term producers accretive to shareholder value. Through this aggressive growth strategy, the Company has obtained interests in two significant projects in less than a year, with high expectations for additional success in the coming months. We look forward to continued growth through the advancement and development of our existing projects and future acquisitions.

Results of Operations

For the nine months ended June 30, 2006, the Company had a net loss of $2,624,147 ($0.08 per share) compared to a net loss of $403,466 ($0.06 per share) for the nine months ended June 30, 2005. Every category of corporate expenses in the current nine-month period, except accounting and legal and bank charges, have increased significantly compared to the 2005 period due to the overall increase in the Company's exploration and corporate activity. The most significant increases have occurred in the areas of consulting and management fees, public relations (printing and distributing marketing materials to at least 250,000 persons), regulatory fees, and travel. In addition, the 2006 net loss includes a $2,193,325 non-cash compensation charge. During the three months ended June 30, 2006, a significant credit was recorded for public relations as the marketing program was terminated prior to its completion and the Company was not required to make the additional payment instalment to the marketing services provider.

Quarterly Information

The following table provides information for the eight fiscal quarters ended June 30, 2006:

	Third Quarter ended June 30, 2006 ($) *	Second Quarter ended Mar. 31, 2006 ($)	First Quarter ended Dec. 31, 2005 ($)	Fourth Quarter ended Sept. 30, 2005 ($)	Third Quarter ended June 30, 2005 ($)	Second Quarter ended Mar. 31, 2005 ($)	First Quarter ended Dec. 31, 2004 ($)	Fourth Quarter ended Sept. 30, 2004 ($)
Total Income	126,394	45,813	18,464	279	-	-	-	-
Net Earnings (Loss)	362,879	(2,370,712)	(616,314)	(202,166)	(151,070)	(146,887)	(105,510)	(16,473)
Net Earnings (Loss) per share	0.01	(0.09)	(0.03)	(0.02)	(0.02)	(0.02)	(0.02)	(0.01)

*As the quarter ended June 30, 2006 resulted in a net gain, the net earnings per share is calculated on both a basic and diluted basis, and equals $0.01 per share in each case.

Mineral Property Expenditures

Guatemala - During the nine months ended June 30, 2006, $39,511 was spent on exploration of the Tambor Property in Guatemala. Of that amount, $36,237 was spent on property overhead. The total deferred exploration costs of $39,511 have been written off as the Company is not continuing with its option to earn an interest in this property.

Mexico - During the nine months ended June 30, 2006, $1,826,466 was spent on exploration of mineral properties in Mexico. Of that amount, the major expenditure categories include $892,166 for drilling and assays, $113,767 for geological and other consulting, and $113,158 for property overhead.

Peru - During the nine months ended June 30, 2006, $3,087,769 was spent on mine construction at the Caylloma Mine, Peru. Of that amount, the major expenditure categories include $1,344,448 for mine camp and consulting, and $796,097 for drilling and assays.

Liquidity and Capital Resources

The Company's cash resources and liquid investments increased during the nine months ended June 30, 2006 by approximately $7.6 million. During the period, the Company received $3,888,565 from the exercise of warrants and stock options, and gross proceeds of $19,050,000 from a private placement financing. The Company invested $1.0 million by purchasing shares in Continuum Resources Ltd., the Company's joint venture partner in Mexico. Subsequent to June 30, 2006, certain stock options and warrants were exercised, providing the Company with additional cash proceeds of $20,367. Working capital increased from a deficiency of $218,826 at September 30, 2005 to positive working capital of $15,313,764 at June 30, 2006.

Management expects that the Company will have sufficient working capital to meet its corporate and exploration commitments over at least the next 12 months. Actual funding requirements may vary from those planned due to a number of factors, including the progress of exploration and development activity. Management believes it will be able to raise equity capital as required in both the short and long term, but recognizes the uncertainty attached thereto. The Company continues to use various strategies to minimize its dependence on equity capital, including the securing of joint venture partners where appropriate.

Other Data

Additional information related to the Company is available for viewing at www.sedar.com.

Share Position and Outstanding Warrants and Options

The Company's outstanding share position at August 21, 2006 is 44,187,597 common shares. In addition, a total of 22,657,066 share purchase warrants and incentive stock options are currently outstanding as follows:

Type of Security	Number	Exercise Price	Expiry Date
Warrants	50,000	$1.50	February 20, 2007
	952,275	$1.85	September 23, 2007
	272,785	$0.80	September 26, 2007
	8,970,000	$1.00 / $1.25	September 26, 2007
	189,056	$0.80	October 6, 2007
	3,017,465	$1.00 / $1.25	October 6, 2007
	6,730,130	$1.85	March 22, 2008
	862,117	$0.345	June 27, 2010
	1,613,238	$0.345	November 17, 2010
	22,657,066		
Options	125,000	$2.29	March 30, 2007
	167,500	$0.37	December 2, 2009
	72,500	$0.72	July 13, 2010
	50,000	$0.80	July 24, 2010
	75,000	$1.35	November 17, 2010
	675,000	$1.35	February 5, 2016
	500,000	$2.29	March 30, 2016
	130,000	$1.75	May 8, 2016
	200,000	$1.75	May 22, 2016
	485,000	$1.55	July 5, 2016
	995,000	$1.66	July 10, 2016
	3,475,000		

Related Party Transactions

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

	Nine Month Period Ending June 30,	
	2006	2005
Mineral property costs – geological fees	$ 90,180	$ 13,137
Consulting fees	$ 60,342	$ 18,522
Salaries and wages	$ 9,556	$ 58,000
Management fees	$ 61,321	$ -

These charges were measured by the exchange amount, which is the amount agreed upon by the transacting parties.

At June 30, 2006, accounts payable and accrued liabilities included $nil (Sept 2005: $181,036) to a company with a common director.

At June 30, 2006, due to related parties consists of an amount owing to an officer and to companies with a common director. These amounts were incurred as a result of shared administrative costs. These amounts are unsecured, non-interest bearing and payable in the normal course of business.

At June 30, 2006, due from related parties consists of amounts owed from companies with a common director which were incurred as a result of shared administrative costs. This amount is unsecured, non-interest bearing and will be collected in the normal course of business.

Financial Instruments

The carrying value of cash and cash equivalents, receivables, due from/to related parties and accounts payable and accrued liabilities approximate fair value because of the short-term maturity of those instruments. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments.

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, performance of achievements of the company to materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. 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 below.

Risks and Uncertainties

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. 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. Other risks facing the Company include competition, environmental and insurance risks, fluctuations in metal prices, share price volatility and uncertainty of additional financing.

Internal Disclosure Controls and Procedures

We have evaluated the effectiveness of our disclosure controls and procedures and have concluded that they are sufficiently effective to provide reasonable assurance that material information relating to the Company and its consolidated subsidiaries is made known to management and disclosed in accordance with applicable securities regulations.