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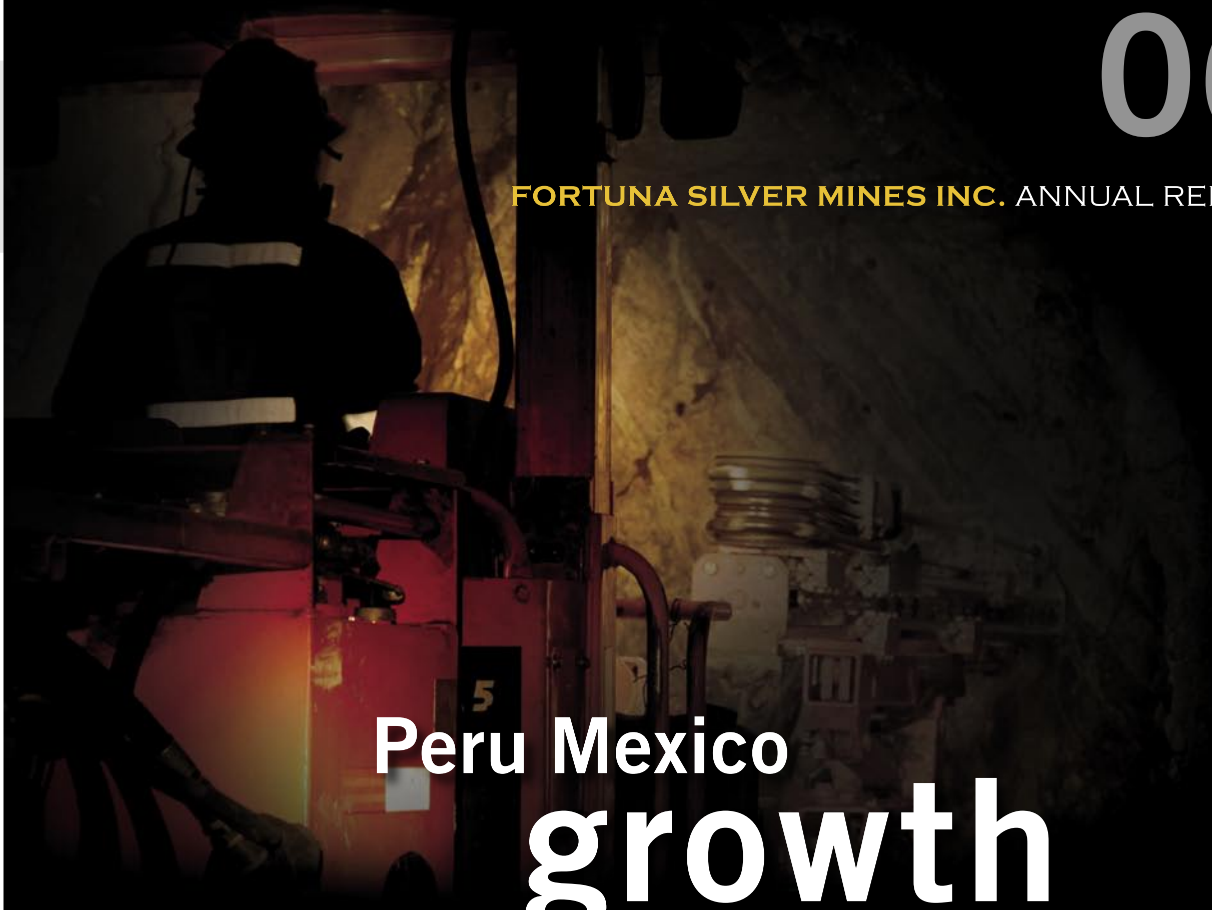
FORTUNA SILVER MINES INC. ANNUAL REPORT



Peru Mexico
growth

Table of Contents

PERU MEXICO GROWTH

This annual report, and the information presented in it, contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We have tried, whenever possible, to identify these forward-looking statements using words such as "anticipates", "believes", "expects", "plans", "intends", "potential", and similar expressions. These statements reflect our current belief and are based on currently available information. Accordingly, such forward-looking statements involve known and unknown risks, uncertainties and other factors which could cause the Company's actual results, performance or achievements to differ materially from those expressed or implied by such statements. We undertake no obligation to update or advise in the event of any change, addition, or alteration to information presented in this annual report including such forward-looking statements.

Today and Tomorrow

Fortuna Silver Mines is moving quickly toward the ranks of mid-tier silver producers. The company's Caylloma silver-zinc-lead mine opened in 2006 and achieved profitability within one quarter. At the 76%-owned San Jose project, outstanding drill results have fast-tracked underground development and the engineering and design of a 1500 to 2000 tpd processing plant.

Fortuna has established an aggressive, three-year mandate for rapid growth in **Peru**, **Mexico** and all of **Latin America**. Management's extensive experience in Latin American mining, exploration and business development provides a key element in achieving this goal.

What We Accomplished

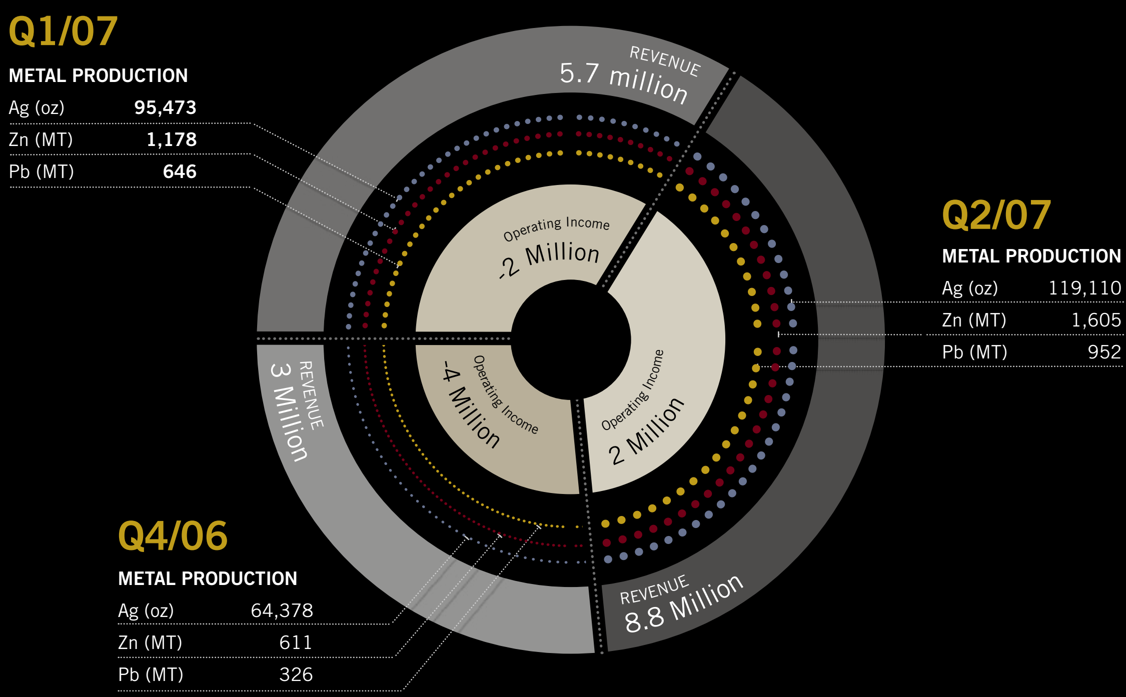
- Raised CAD$53 million
- Invested CAD$9.3 million bringing the Caylloma Mine back into operation as of October 2006
- Achieved profitability at the Caylloma Mine in its first quarter, generating revenues of CAD$3.37 million
- Expanded the inferred resources at San Jose project five-fold
- Purchased 76% direct interest in San Jose project for US$9 million
- Built outstanding technical teams at both the Caylloma Mine and the San Jose project

Looking Ahead

- Targeting an increase in production at Caylloma Mine to 1100 tpd in late 2008
- Additional 25,000 meters of drilling at San Jose project in 2007
- San Jose project pre-feasibility work
- Continue building technical and operational teams
- San Jose project underground development and engineering

Operating Highlights

To bring you up to date at our Caylloma Mine in Peru, we want to emphasize a few of the quarterly operating highlights from the start up of production at Caylloma in the fourth quarter of 2006, to the end of June 2007. The figures demonstrate how growth truly is the Fortuna theme.



Fortuna's Fast Track

A quick look at the market capitalization table below signals just how fast things have changed. The Company's market capitalization and share price have trended upwards for the past four quarters as we've delivered solid operating figures, strong production growth from Caylloma and excellent exploration results from San Jose.

Fortuna's Fully Diluted Market Capitalization

	March 31, 2006	June 30, 2006	Sept 30, 2006	Dec 31, 2006	March 31, 2007	June 30, 2007
ISSUED SHARES	42,024,404	44,160,930	44,935,297	46,587,728	67,833,545	71,045,866
FULLY DILUTED SHARES	68,559,663	68,839,663	70,544,663	70,918,913	101,415,938	101,580,938
SHARE PRICE	$ 2.20	$ 1.67	$ 1.57	$ 1.96	$ 3.00	$ 3.22
MARKET CAP	$ 92,453,689	$ 73,748,753	$ 70,548,416	$ 91,311,947	$203,500,635	$228,767,689
FULLY DILUTED MARKET CAP	$150,831,259	$114,962,237	$110,755,121	$139,001,069	$304,247,814	$327,090,620

We wanted to create a silver producer, we wanted rapid growth, and we wanted people with the regional expertise and experience to make it happen.

Chairman's Letter:

TO OUR SHAREHOLDERS

As Fortuna completes its first quarter of production at Caylloma, I believe a quick summary of what the Company has accomplished within the short period under present management will help our shareholders better understand the potential going forward. I'm extremely proud of Fortuna's rapid growth and record of success to date, and I take great pleasure in recapping these highlights.

Less than three years ago, with the price of silver yet to begin its historic climb, we set out to build an enterprise that would capitalize on two major dynamics:

- Sustained silver supply/demand gap
- Latin America's growing dominance in world silver production

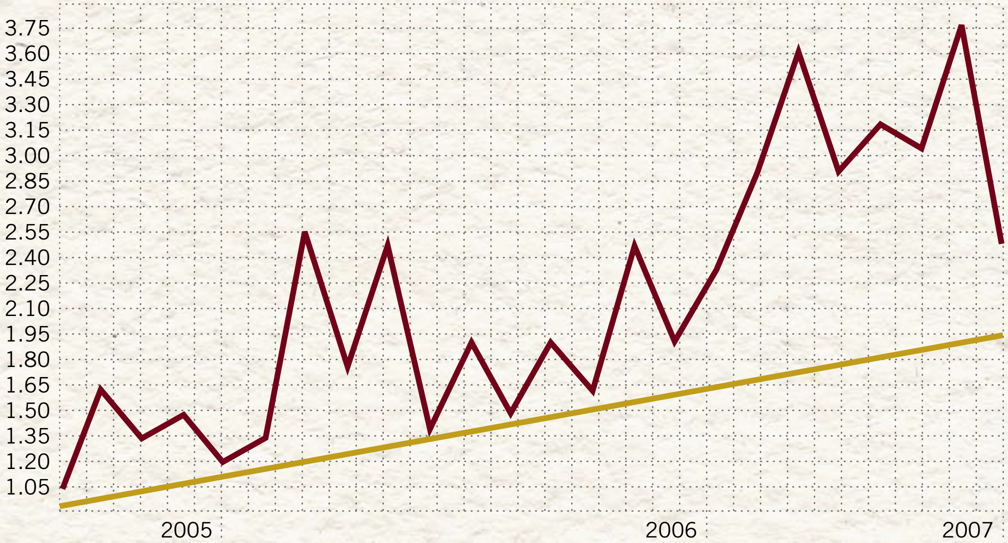
We wanted to create a silver producer, we wanted rapid growth, and we wanted people with the regional expertise and experience to make it happen.

We signed an agreement to acquire the Caylloma Mine—a silver mine with a history of more than 500 years of operation—in June 2005. By October 2006, we had located significant new resources and re-opened the mine at 500 tonnes per day. By year end, we had increased production to 700 tpd and reported our first profit from Caylloma.

Just one month after closing the acquisition of the Caylloma Mine, in November 2005, we signed an agreement with Continuum Resources that granted us the right to earn an interest in the San Jose project in Mexico. We had done our homework on San Jose and felt that this project had the potential to become one of Mexico's stellar silver-gold producers. In January 2007, following an aggressive drilling program that tested that potential and returned some excellent drill results, we announced the acquisition of a 76% controlling interest in the property. A few months later following a new resource calculation we announced a huge increase in the silver equivalent resources at San Jose.

While these achievements make for a very impressive and dynamic phase, we believe Fortuna's greatest growth lies ahead. Drilling at Caylloma continues to encounter new mineralization and at San Jose, the recent high-grade drill results point to a deposit that will hopefully be a Mexican classic, world-class in size.

HISTORIC CHART FOR CDN: FVI



Perhaps most important, however, is the stellar team we have assembled in both Peru and Mexico. Great projects don't go very far without the right people to develop them. We are extremely fortunate to have in place the management and technical staff that have the expertise and vision to build on the assets we have acquired.

This fine team will allow us not only to maximize the potential of both Caylloma and San Jose, but also to acquire new projects in Mexico and Peru that will drive Fortuna's growth for decades to come. I believe we have the right people in the right place at the right time, exploring for and developing the right metal – SILVER.

In closing, I want to express my sincere gratitude for the way everyone at Fortuna has come together in support of the company's long-term goals and vision. I believe our accomplishments to date have laid the groundwork for a spectacular future.

Simon T. Ridgway,
Chairman & Director

President's Letter:

TO OUR VALUED SHAREHOLDERS

With an outstanding year behind us and an even better year underway, I take great pleasure in presenting Fortuna Silver Mines' annual report for fiscal 2006. Our mandate has been—and continues to be—rapid growth and profitability in Latin American silver.

Betting on Metals, Peru and Mexico

Sustained high prices for silver, along with corresponding strength in gold, zinc and lead, continue to drive our growth strategy. We believe the brightest future for mining these metals lies in Latin America. We also believe our experience and expertise in the mineral-rich countries of Peru and Mexico, combined with the outstanding assets we've acquired to date, will deliver the results needed to meet our ambitious goals.

Caylloma Mine Opens

The most important milestone of the past year was opening the Caylloma Mine, in southern Peru. Through its start-up, commissioning and balancing, and on into expansion, the mine has been profitable. In the three months ending December 31, 2006, the mine processed 33,973 tonnes of ore, recovering 58,844 ounces silver, 611 tonnes zinc and 326 tonnes lead. Production has steadily increased in 2007 with a target of 1100 tonnes per day in late 2008. Cash production costs for the fourth quarter of 2006 were calculated at US$39.96 per tonne.

Caylloma Resources—a 50% Increase

We acquired Caylloma in June 2005. A long-time producer with a 500-year history, Caylloma had operated until 2003 when the previous owners closed it due to low silver prices and depletion of accessible reserves. We modified and upgraded the processing plant in early 2006, then began mining from the Animas Vein. Drilling during 2006 increased resources by 50%. Exploration and development continue, and Caylloma has excellent potential for discovery of additional reserves through exploration on extensions of known mineralized structures on the property.

San Jose—a Five-fold Increase

At our San Jose project in the Oaxaca state, southern Mexico, a large-scale drill program produced outstanding results. Drilling to date has focused on the Trinidad mineralized shoot, with multiple additional targets yet to be tested. Resources expanded dramatically in 2006. Present Indicated Resources total 17.7 million ounces of silver equivalent, with 49 million ounces inferred, representing a five-fold increase over the previous calculations. A further 25,000 meters of drilling are underway at San Jose, including infill drilling at Trinidad, testing Trinidad's open extents, and testing a number of unexplored new targets.

Taking us to the Mid Tier

We believe San Jose will launch Fortuna into the ranks of mid-tier silver producers. That's why we renegotiated the original option agreement with our joint venture partner Continuum Resources Ltd. and purchased a direct 76% interest for US$9 million.

What's Next for San Jose

We see tremendous opportunity for continued growth from San Jose. During the current year, we have fully committed to advance the project with further surface land acquisitions, environmental impact studies, community relations programs and ongoing engineering. We will also conduct further studies of metallurgy, geomechanics and mine modeling.

Equity Funding—CAD$53 Million

Our ambitious growth plans require adequate funding, of course, and during the year we raised over CAD$53 million by way of two equity financings. We are now sufficiently funded to carry out our current expansion programs at both Caylloma and San Jose. These funds also allow us to aggressively seek new acquisitions in Latin America, focusing on Peru and Mexico where we have established a solid base of operations.

Securing Top Talent

One of the major challenges presently faced by all mining companies is securing good talent. I'm happy to report we have successfully staffed our critical positions with top-caliber personnel who have ample experience in Latin American mining, exploration and business development.

The Metals Boom Continues

At the time of this report, metals prices were sustaining historically high levels. With silver holding well above US$12.00 per ounce, gold above US$650 per ounce and both lead and zinc trading at over US$1.25 per pound, both Caylloma and San Jose hold extremely favorable cost/revenue dynamics. The fundamentals that have driven the long-term metals bull market—spectacular Asian growth, a weakening U.S. dollar, threats of inflation, and the ongoing silver supply demand—look like they will remain for some time to come. These macro factors, combined with the regional and operational advantages previously discussed, drive our strategy to invest in Latin American mining and exploration. Our board and management remain firmly convinced that dramatic increases in shareholder value will be the result.

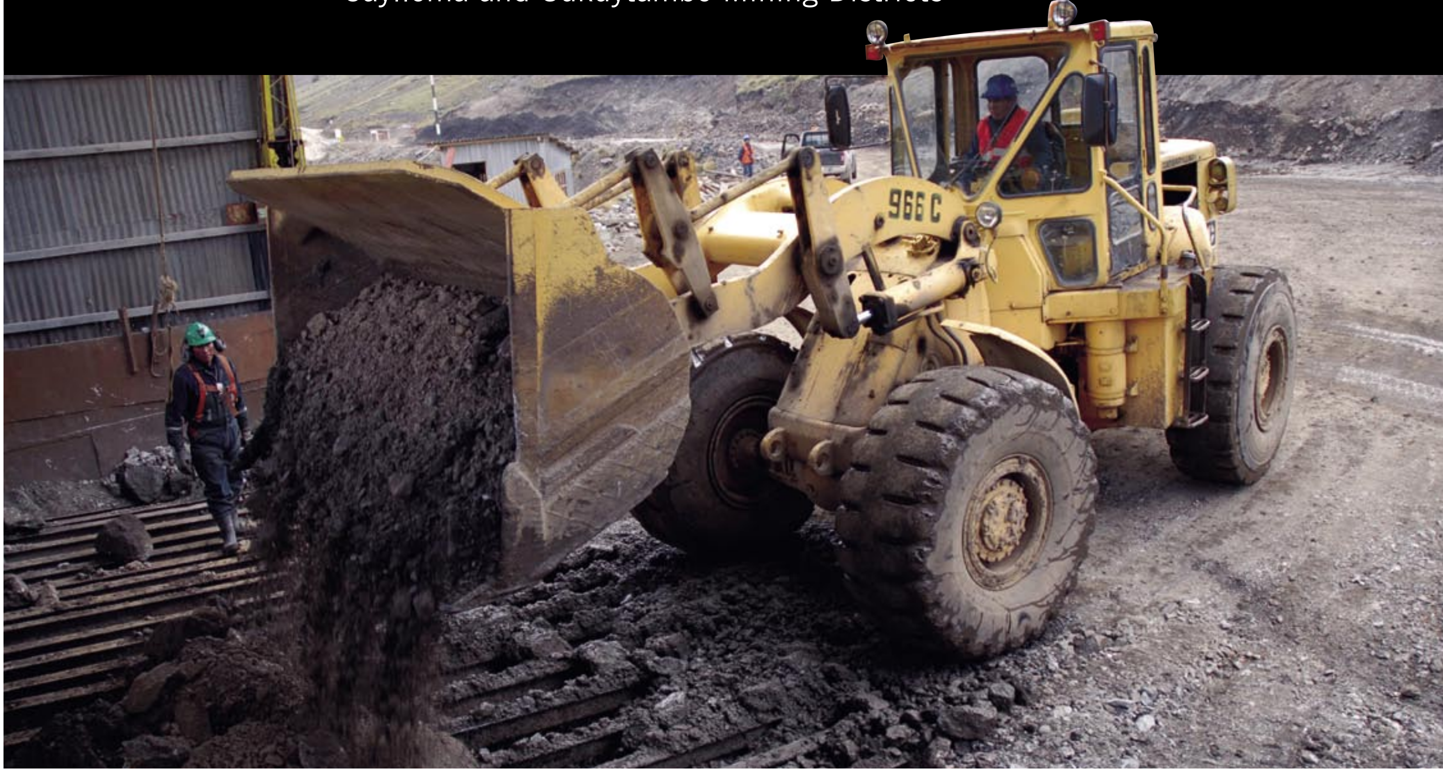
Fortuna's rapid growth has presented numerous challenges to our board, management, staff and field personnel. I am most grateful for the way the team has responded to these demands with dedication, enthusiasm and plain old hard work. At this time, I would also like to extend a warm welcome to the many new and talented personnel who joined the Fortuna team during the year. I look forward to sharing many successful months and years ahead with everyone.

Jorge A. Ganoza Durant,
President

Caylloma Mine

MINE SNAPSHOT

COMMODITIES	Zinc, Lead, Silver & Gold
LOCATION	Arequipa, Peru (Latitude: 15° 13” S, Longitude: 71° 49” W)
DEPOSIT TYPE	Intermediate-sulfidation epithermal deposit
STATUS	Mine and processing plant in operation at 720 tpd level with expansion to 1100 tpd in planning stage; actively exploring for new discoveries in Caylloma and Sukuytambo Mining Districts



OVERVIEW: The silver and base metal-rich epithermal deposits of the Caylloma Mining District of southern Peru have been worked intermittently since the start of the Spanish colonial period. Located within one of the more important metallogenic provinces of the Andes, past production is estimated at over 200 million ounces of silver. Fortuna Silver, through its wholly owned Peruvian subsidiary, Minera Bateas S.A.C., controls over 12,000 hectares encompassing the Caylloma Mining District and the nearby Sukuytambo District.

Fortuna Silver purchased a 100% interest in the Caylloma Mine and related mining concessions in 2005 and returned the mine to production in October of 2006 following a significant upgrading and modernization of the ore processing plant. The mine and processing plant are currently operating at 720 tpd with expansion to 1100 tpd targeted for late 2008. Lead+silver and zinc concentrates are delivered on a weekly basis to port facilities in Callao for sale in the international markets. Production is currently sourced from the base metal-silver rich Animas and Santa Cata veins. Exploration of the Caylloma District is ongoing and upgrading and expansion of the existing reserve and resource base is anticipated.

Fortuna Silver is committed to the responsible development of the Caylloma Mine while working to assure the safeguarding of the environment, the safety and welfare of the work force and through fostering of sustainable development activities in nearby communities.

Caylloma Mine - CONTINUED

LOCATION

The Caylloma Mine is located 225 road kilometers or approximately 4 hours driving time northwest of Arequipa, Peru in mountainous highlands at an elevation of 4500 meters above sea level. The mine, processing plant and related infrastructure are located in the Caylloma Mining District, 14 kilometers northwest of the town of Caylloma. The mine is connected to the national power grid and water is locally available.

MINERAL RESERVE ESTIMATE

Silver Veins Proven & Probable Reserves

PROVEN

Vein	Tonnes	Ag gpt	Au gpt	Pb %	Zn %	Contained Ag oz.
San Cristobal	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
Total Proven Reserves	**253,351**	**451**	**0.9**	**0.0**	**0.0**	**3,675,513**

PROBABLE

Vein	Tonnes	Ag gpt	Au gpt	Pb %	Zn %	Contained Ag oz.
San Cristobal	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
Total Probable Reserves	**89,695**	**465**	**0.8**	**0.1**	**0.2**	**1,341,953**

TOTAL	**Tonnes**	**Ag gpt**	**Au gpt**	**Pb %**	**Zn %**	**Contained Ag oz.**
Proven + Probable	**343,046**	**454**	**0.8**	**0.1**	**0.1**	**5,017,466**

To estimate mining recovery, it has been assumed that a 3 meter high support sill occurs at every 50 meter level (± 6 % reduction in reserve tonnage).

MINERAL RESOURCE ESTIMATE

Animas Vein Measured and Indicated Resources

Classification	Tonnes	Ag g/t	Au g/t	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 + Indicated	**1,173,326**	**143**	**0.7**	**2.3**	**4.2**	**5,426,326**

INFERRED RESOURCES

Vein	Tonnes	Ag g/t	Au g/t	Pb %	Zn %	Contained Ag oz.
San Cristobal	135,513	407	0.2	0.3	0.4	1,771,635
San Pedro	92,896	369	0.2	0.7	1.4	1,100,000
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
Total Inferred	**1,415,499**	**305**	**0.4**	**2.0**	**3.1**	**13,825,919**

GEOLOGY AND MINERALIZATION

The silver-base metal rich epithermal vein deposits of the Caylloma Mining District are hosted by Tertiary calc-alkaline andesitic pyroclastic tuffs and tuff breccias, flows and laharic deposits that unconformably overlie a folded marine sequence of quartzite, shale and limestone of the Jurassic Yura Group. More than 15 major mineralized veins have been identified within the district with the veins typically trending northeasterly and dipping moderately to steeply to the southeast or northwest.

The veins range from 1 to 25 meters in width and range up to 4 kilometers in length. Ore grade shoots are generally subvertical in orientation within the plane of the vein, having lengths of tens to hundreds of meters and extending to more than 300 meters in a downdip direction. Principal ore minerals include sphalerite, galena, chalcopyrite and tetrahedrite with subordinate polybasite, stephanite, argentite, native silver, pyrargyrite, miargyrite, chalcocite, native gold, and other Pb and Ag sulfosalts. Principal gangue minerals are quartz, manganese-rich silicates (dominantly rhodonite), rhodocrosite, and calcite with variable quantities of adularia, illite and barite present locally (Echavarria et al, 2006).

San Jose Project

PROJECT SNAPSHOT

COMMODITIES	Silver-gold
LOCATION	Oaxaca, Mexico (Latitude: 16° 41” N, Longitude: 96° 42” W)
DEPOSIT TYPE	High-grade, low-sulfidation epithermal vein deposit
STATUS	Resource definition, engineering design, environmental permitting

OVERVIEW: San Jose is a high-grade, silver-and-gold-bearing epithermal vein system with outstanding expansion potential. Indicated Resources in the property's Trinidad vein system grade an average 262.6 g/t silver and 2.19 g/t gold. San Jose lies in a silver-gold vein district with a previously unrecognized potential.

Exploration at San Jose in 2006 increased inferred resources five-fold. As a result, management set a goal to fast track the development of the project into a mine targeting it for late 2009. Drilling continued throughout the first half of 2007, with 25,000 meters planned for the year. Fortuna is also conducting metallurgical, geomechanical and mine modeling studies as part of its pre-feasibility work. The start of a negative ramp is scheduled for 3rd quarter of 2007.

San Jose operates under a joint venture between Fortuna (76%) and Continuum Resources Ltd. (24%). Both parties contribute to costs in proportion to their respective ownership percentage.

San Jose Project - CONTINUED

LOCATION

San Jose is located approximately 47 road kilometers, or 1 hour driving time, south of the city of Oaxaca. Access to the property is excellent and local infrastructure is good.

RESOURCES

Mineral Resources as of March 31, 2007 are estimated as follows:

San Jose Mineral Resource- Cutoff Grade of 150 g/t silver equivalent:

Resources Classification	K tonnes	Eq Ag (g/t)	Silver (g/t)	Gold (g/t)	Silver (koz)	Gold (koz)
INDICATED MINERAL RESOURCES						
Trinidad Vein	824	322.8	232.2	1.78	6,151.6	47.2
Bonanza Vein	599	453.3	310.5	2.8	5,979.8	53.9
Paloma Vein	48	263.8	185.2	1.54	285.8	2.4
Total Indicated Resources	**1,471**	**374.0**	**262.6**	**2.19**	**12,417.2**	**103.5**
INFERRED MINERAL RESOURCES						
Trinidad Vein	1,687	376.7	268.0	2.13	14,536.1	115.5
Bonanza Vein	1,609	443.6	272.6	3.35	14,102.0	173.3
Bonanza Splay Vein	15	922.5	694.2	4.48	334.8	2.2
Paloma Vein	373	275.5	194.3	1.59	2,330.1	19.1
Stockwork Zone	214	281.6	196.6	1.67	1,352.7	11.5
Total Inferred Resources	**3,898**	**391.5**	**260.6**	**2.57**	**32,655.7**	**321.5**

Indicated Resources contain an estimated 17.7 million silver-equivalent ounces. Inferred Resources are estimated to contain 49.1 million silver-equivalent ounces. Silver equivalency estimates were derived using US$10.30/oz for silver and US$ 525/oz for gold. The resulting Ag: Au ratio is 51:1. Metallurgical recoveries and net smelter returns are assumed to be 100% for the purposes of estimating silver equivalency.

Michael G. Hester of Independent Mining Consultants, Inc. is the Qualified Person for the purposes of reporting the Mineral Resources as defined by the Canadian Securities Administrators' National Instrument 43-101.

GEOLOGY & MINERALIZATION

The San Jose deposit is a low-sulfidation, epithermal vein system characterized by mineralized multiphase quartz-carbonate-sulfide veins, hydrothermal breccias and stockwork veining. The mineralized system is hosted within a sequence of Tertiary andesitic volcanic and volcaniclastic rocks.

EXPLORATION & RESOURCE DEFINITION DRILLING

Exploration to-date has focused on the Trinidad zone and to a lesser extent on the San Ignacio zone, located approximately 800 meters to the south on the same vein system. In the Trinidad zone, high-grade silver/gold bearing mineralized shoots have been identified and defined in association with the Trinidad and Bonanza vein systems. Mineralization is present in high-grade shoots with estimated true widths ranging from less than 2 meters to greater than 20 meters. Locally, mineralized stockwork veining is present between the Trinidad and Bonanza veins, including continuously mineralized widths estimated at over 80 meters locally.

Highlights of the 2007 drill program include (cutoff grade of 100 g/t silver equivalent):

Drill Hole	From (m)	To (m)	Interval (m)	Au (g/t)	Ag (g/t)	Ag Eq (g/t)	Ag Eq (oz/T)	News Release
SJO-054	360.70	465.55	104.85	2.48	283	410	12.0	30-May-07
Including	360.70	367.00	6.30	7.00	510	867	25.3	
and	411.25	417.60	6.35	4.52	692	922	26.9	
and	425.30	438.10	12.80	4.58	633	867	25.3	
and	446.00	455.00	9.00	8.32	848	1272	37.1	
SJO-055	173.60	176.10	2.50	11.86	1151	1756	51.2	16-Jul-07
SJO-057	149.90	161.45	11.55	6.06	588	897	26.1	16-Jul-07
SJO-060	129.70	154.80	25.10	10.85	588	1141	33.3	16-Jul-07
including	129.70	135.05	5.35	32.49	2017	3674	107.2	
and	143.60	147.40	3.80	17.61	637	1535	44.8	
SJO-063	292.70	295.30	2.60	4.44	1224	1450	42.3	16-Jul-07
SJO-065	423.50	444.40	20.90	1.43	183	256	7.5	16-Jul-07

For the first time in history, the world's annual silver consumption is approaching

1 billion ounces.

While the metal's use in photography, jewelry and coins declines, more silver than ever is purchased for industrial fabrication

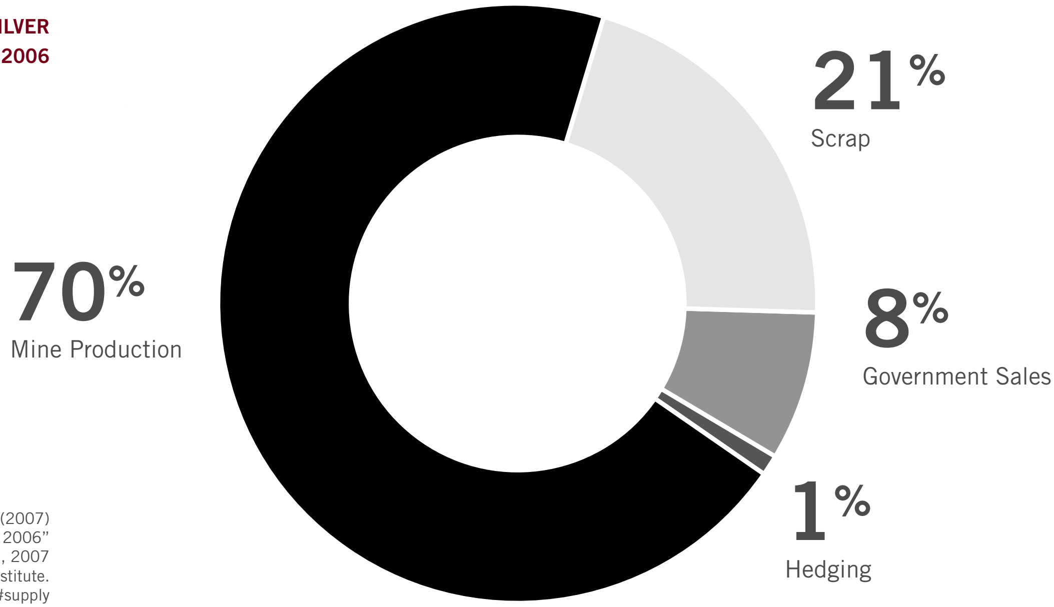
and investment.

Silver's Extraordinary Run

The price of silver has tripled since 2003. At the time of this report, the price remains close to US$12 per ounce, a level it has held since October 2006. Unprecedented demand from Asia, a weakening U.S. dollar and an accelerating list of new uses are the primary factors fueling this extraordinary silver bull market.

The investment demand for silver is emerging as a key growth component (9% of total demand in 2006). With the 2006 opening of silver exchange-traded funds (investing in certificates backed by silver, rather than purchasing physical silver)—or silver ETFs—further investment growth is likely.

ESTIMATED SILVER SUPPLY IN 2006

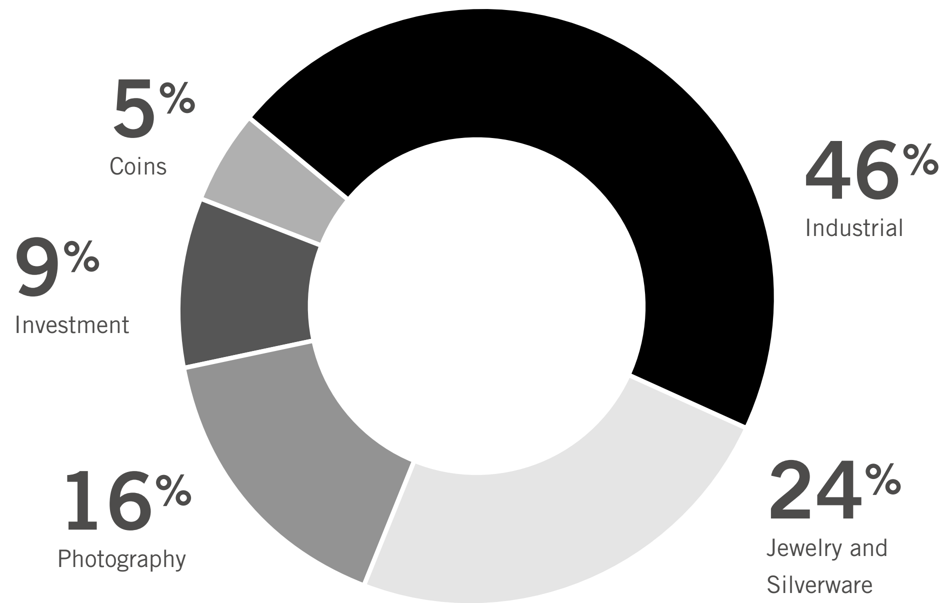


The Silver Institute (2007) "Demand and Supply in 2006" Retrieved on August 1, 2007 from http://www.silverinstitute.org/supply/index.php#supply

The supply of silver continues to lag behind demand. Although higher prices are beginning to bring more mine production on-stream, the increase has so far been minimal (0.6% in 2006). This slight increase came from mines where silver is a by-product (mostly lead-zinc, copper and gold mines). Production from primary silver mines fell by nearly 3%.

The outlook for this year and next shows little change in any of these trends, with the exception of mine production and silver investment. A number of new mines are in the pipeline and will almost certainly increase mining's contribution to world supply. And as world dynamics continue to favor upward pressure on nearly all metals, the purchase of both physical silver and ETFs for investment is likely to make up a growing percentage of overall silver demand. The net result should be continued strength in the silver market.

ESTIMATED SILVER DEMAND IN 2006



The Silver Institute (2007) "Demand and Supply in 2006" Retrieved on August 1, 2007 from http://www.silverinstitute.org/supply/index.php#supply

Our team will allow us not only to **maximize the potential** of both Caylloma and San Jose, but also to acquire new projects in Mexico and Peru that will drive **Fortuna's growth for decades to come.**

Our team

Simon Ridgway

Mr. Simon Ridgway is an internationally known mining financier and has over 15 years' experience managing publicly-traded mineral exploration companies in North, Central and South America. Simon has been the Chairman of Fortuna Silver Mines Inc. since its reorganization in late 2004, early 2005. During 2006 he has been instrumental in raising close to CAD$53-million to fund the exploration and development programs for Fortuna's major assets, the Caylloma Mine in Peru and the San Jose project in Mexico. Simon is also the President of Radius Gold Inc., as well as a director of Northland Resources Inc.

SIMON RIDGWAY

CHAIRMAN & DIRECTOR

Jorge A. Ganoza Durant, Geol. Eng.

Mr. Jorge Ganoza Durant is a geological engineer with over 12 years experience in exploration, mining and business development throughout Latin America. Jorge graduated from the New Mexico Institute of Mining in 1994. He is a fourth generation miner from a Peruvian family that has owned and operated several underground gold, silver, and base metal mines. His professional experience is vast and varied- before Fortuna 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's experience extends through various countries including Panama, Guatemala, Nicaragua, Honduras, Mexico, Dominican Republic, Haiti, Peru, and Colombia.

Luis Ganoza Durant, B.Sc., MBA, M.Sc.

Mr. Luis Ganoza Durant has extensive experience in the financial management of mining companies, most recently as Controller 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, an MBA from ESAN, a Tier 1 Latin American Business School, and an M.Sc. in Accounting and Finance from The London School of Economics.

JORGE A. GANOZA DURANT
PRESIDENT & DIRECTOR

LUIS GANOZA DURANT
CHIEF FINANCIAL OFFICER

Our team - CONTINUED

Jorge R. Ganoza Aicardi, B.Sc. Eng.

Mr. Jorge Ganoza Aicardi is a mining engineer with 35 years experience in the mining industry. Jorge obtained a B.Sc. of Engineering in 1973 from the Universidad National La Molina in Peru, and also completed advanced finance studies at the Escuela Superior de Administration in 1983. He is a third generation miner from a Peruvian family that has owned and operated several underground gold, silver, and base metal mines. From 1997 to the present, Jorge has worked as a consultant in Panama and Peru, in the mining and aquaculture sectors.

Thomas I. Vehrs, Ph.D.

Over the past thirty years, Dr. 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, among others. He has lived in Latin America for 18 years managing multi-million dollar exploration budgets in Chile, Peru, Bolivia, Colombia, Argentina and Central America, specializing in epithermal and porphyry related precious and base metal exploration. Dr. Vehrs' appointment as Vice President of Exploration enhances the Company's ability to manage exploration and development programs at our various projects in Peru and Mexico as well as to identify new opportunities for acquisition and development by the Company.

JORGE R. GANOZA AICARDI

VICE PRESIDENT OPERATIONS

THOMAS I. VEHRS

VICE PRESIDENT EXPLORATION

06 Financial Statements

CHANGE IN FISCAL YEAR END

In August, 2006, Fortuna Silver Mines Inc. (the "Company") changed its fiscal year end from September 30th to December 31st. The Company's year end now matches that of its Peruvian subsidiary which owns the Caylloma Mine, resulting in an increase in the efficiency of the Company's accounting operations. A Notice of Change in Fiscal Year End has been filed on sedar.com.

For the current period, the old fiscal year ending September 30, 2006 has been changed to a transitional 15-month fiscal year ending December 31, 2006. Therefore, the accompanying financial statements are for an interim fifteen-month period ended December 31, 2006, with comparatives to the twelve-month period ended September 30, 2005.

GENERAL

This Management's Discussion and Analysis ("MD&A") supplements the audited financial statements of the Company for the fifteen months ended December 31, 2006. The following information, prepared as of April 20, 2006, should be read in conjunction with the December 31, 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.

BUSINESS OF THE COMPANY

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

RECENT DEVELOPMENTS AND 2006 HIGHLIGHTS

Fortuna achieved a significant milestone in 2006 with the commencement of production at its fully owned Caylloma silver/base metal mine in Southern Peru. Production was initiated in October 2006, with total revenue generated during the last quarter in an amount of $ 3.37 million. Commencement of production was achieved with no significant deviations from budget or schedule and throughput rate has been steadily increasing towards the full 700 tpd plant capacity, reaching an average of 700 tpd in June 2007.

Also during 2006 Fortuna achieved another significant corporate milestone with the addition of its second mining asset. In November, 2006 the Company completed an acquisition, jointly with Continuum Resources, of the San Jose property, a high-grade silver-gold deposit located in southern Mexico. A jointly owned Mexico subsidiary ("Cuzcatlan") was formed which is held 76% by Fortuna and 24% by Continuum. Total consideration paid was US$ 9 million of which Fortuna's contribution was US$ 8.76 million. Under the terms of the shareholders' agreement which governs Cuzcatlan, Fortuna has overall management responsibility for the project, including development, and eventually construction and operation.

On March 12, 2007 Fortuna published an updated resource estimate for San Jose based on an 11,000 meter drilling program conducted during the first half of 2006. The results significantly exceeded management's expectations, reporting:

INDICATED MINERAL RESOURCES: 1.47 million tonnes grading 262.6 g/t Ag and 2.19 g/t Au containing 17.7 million Ag equivalent ounces.

INFERRED MINERAL RESOURCES: 3.9 million tonnes grading 260.6 g/t Ag plus 2.57 g/t Au containing 49.1 million Ag equivalent ounces.

Silver equivalency estimates were derived using US$10.30/oz for silver and US$525/oz for gold yielding a Ag:Au ratio of 51:1. Metallurgical recoveries and net smelter returns are assumed to be 100%.

This represented nearly a five fold increase in the inferred resource and the addition of 17.7 million indicated Ag equivalent ounces. The deposit remains open at depth and along strike and an aggressive 25,000 meter drilling program for 2007 has already begun.

During 2006 total resources were also increased significantly at the Caylloma mine. Measured and indicated pure silver resources, inclusive of reserves, increased by 50% to 10.5 million ounces. Inferred resources total 13.8 million ounces.

The Company was successful in raising significant funding by way of two equity financings, as follows:

- In March 2006, the Company completed a brokered private placement of 12.7 million units at a price of $1.50 per unit, providing gross proceeds of $19.05 million. Each unit consists of one common share and one-half of a common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share of the Company for two years at a price of $1.85.

- In January 2007, the Company completed a brokered private placement of 18.0 million units at a price of $1.90 per unit, providing gross proceeds of $34.2 million. Each unit consists of one common share and one-half of a common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share of the Company for 18 months at a price of $2.30.

SELECTED ANNUAL INFORMATION

		Fifteen Month Period ended Dec. 2006	**Twelve Month period ended Sep. 2005**
Sales	$ 000	3,370	0
Loss before income taxes	$ 000	(3,854)	(606)
Net Loss	$ 000	(4,348)	(606)
per share, basic	$	(0.12)	(0.08)
per share, diluted	$		
Total assets	$ 000	59,208	24,141
Total long-term financial liabilities	$ 000	5,827	5,271

QUARTERLY INFORMATION

The following table provides information for the eight fiscal quarters ended December 31, 2006:

		Quarters Ended							
		31-Dec 2006	**30-Sep 2006**	**30-Jun 2006**	**31-Mar 2006**	**31-Dec 2005**	**30-Sep 2005**	**30-Jun 2005**	**31-Mar 2005**
Revenues	$ 000	3,370	0	0	0	0	0	0	0
Net Income (Loss)	$ 000	21	(1,745)	363	(2,371)	(616)	(202)	(151)	(147)
Net Income (Loss) per share, basic	$ 000	0.00	(0.04)	0.01	(0.09)	(0.03)	(0.02)	(0.02)	(0.02)
Net Income (Loss) per share, diluted	$ 000	0.00		0.01					

FINANCIAL RESULTS

During the last quarter of 2006 the Company generated the whole of its $3.37 million of sales reported for the 15 month period as production at its Caylloma mine began in October of 2006. Also for the period mine operating income was $1.2 million, and a net loss of $4.35 million was recorded compared to a net loss of $605,633 for the twelve months ended September 30, 2005.

For the last quarter of 2006 the Company recorded net income of $20,679 compared to a net loss of $616,314 in the corresponding quarter of 2005. Increment in the loss of the second and third quarter of 2006 was due to larger stock-based compensation charges recorded of $2.13 million and $1.81 million respectively.

Total cost of sales was $2.17 million, of which $918,617 was depletion, depreciation, and accretion. This corresponds entirely to production and sales from Caylloma in the last quarter of 2006.

Sales and administrative expenses for the period totalled $2.02 million compared to $0.65 million for the twelve months ended September 30, 2005. The increase is due to the impact of the beginning of operations in our Peruvian subsidiary, higher total corporate expenses associated to the growth of the company, and the 15 month transition year. The stock based compensation charge totalled $4.13 million for the 15 month period ended December 31, 2006, compared to $228,721 for the period ended September 2005.

Interest and other income and expenses were $470,002 compared to $279 for the twelve months ended September 30, 2005. This included $402,215 attributable to Interest generated by the Company's short term investments and cash deposits.

Foreign exchange gain recorded for the period was $673,031, compared to $454,276 for the twelve months ended September 30, 2005. This includes $200,700 of realized gains from US Dollar debt obligations undertaken in June of 2005 which were finally paid in June of 2006.

Write-off of deferred exploration costs was $40,218 compared to $182,657 for the twelve months ended September 30, 2005. This consisted mainly of $39,511 from El Tambor project in Guatemala.

The Company recognized a gain on disposal of investments of $25,875 in connection with 1,293,750 shares of Continuum Resources previously held by the Company which were delivered as part of the consideration paid in the San Jose property acquisition.

The $494,082 Income tax provision recorded for the period resulted from the taxable income generated in our Peruvian Subsidiary. Current income taxes for the period were actually nil and the recorded income tax provision results from the accounting for temporary differences in taxable income.

RESULTS OF OPERATIONS

Peru – Caylloma Silver Mine

The 100% owned Caylloma mine began commercial production of silver-lead and zinc concentrates in October 2006. Management expects all unit operations at the mine will be in an adjustment and balancing period for at least six to eight months from start up.

Total ore milled as of December 31, 2006 has been 33,973 tonnes. Average daily throughput for November and December was 453 tonnes per day and 503 tonnes per day respectively. A significant portion of processed ore during the period was provided by existing low grade stock piles from previous mining activity. This has been reversed by the end of the first quarter of 2007. Mill throughput for March 2007 was 642 tonnes per day; mine production accounted for seventy four percent of mill throughput, existing stock piles accounted for eleven percent, and material from underground development and preparation accounted for fifteen percent.

Mine production is presently taking place entirely on the polymetalic Animas vein. Silver veins on the northern portion of the deposit will be in preparation and development in 2007. Average grades of processed ore for the period were 78.39 gpt of silver, 2.33% of zinc, and 1.66% of lead. Management expects grade to increase and better reflect resource and reserve estimate grades as production from stopes is stabilized and mill feed becomes less dependant on existing low grade stock piles and development material.

The processing plant has performed well within expectations showing continued improvement during the first months of operations. Average metal recoveries for the period were as follows; silver 69.02%, zinc 77.04%, and lead 84.58%. Metal produced for the period was 58,844 ounces of silver, 611 tonnes of zinc, and 326 tonnes of lead. These production variables have seen sustained improvement in the first months of 2007. During March the plant achieved the following recoveries: silver 70%, zinc 85.6%, and lead 88.8%.

Cash production cost per tonne during the period was US$38.70 per tonne. This is expected to rise moderately over the following months as there will be greater emphasis on mine preparation during the first half of 2007 and as the impact of the full mining cycle is better reflected on unit costs.

RESULTS OF OPERATIONS (continued)

The processing plant is permitted and practically ready to accommodate production increments up to 1,100 tonnes per day. Management is accelerating the preparation of stopes on the Ag-Zn-Pb rich Animas vein as well as in the silver rich traditional vein system with the objective of achieving full throughput capacity by 2008.

Fortuna is currently selling its silver-lead and zinc concentrate production from Caylloma to Swiss company Glencore in Peru. Glencore is a leading global commodity trading firm with mines, smelters and offices in various parts of the world.

Exploration at Caylloma has begun for 2007. Multiple targets will be drill tested during the year. The first drill rig arrived in April and will be focusing on extending mineralization below current underground workings on the main ore shoot. A second drill rig is expected in May and will be drill testing new targets developed on the property during 2006.

Mexico – San Jose Silver-Gold Project

On March 12, 2007 the Company announced the latest resource estimate for the San Jose project, the details of which are noted above. In light of the significant increase in the size of the estimated resource at San Jose, management is re-assessing development plans to assure optimal sizing of the future operation relative to the resource base.

The Company expects to drill 25,000 meters during the course of the year. Three surface drill rigs are working on site. The program aims to:

- Expand the size of existing resource on the Trinidad zone, which remains open in two directions (press release dated March 12, 2007).
- In-fill drilling of the Trinidad zone to increase size of measured and indicated resource.
- Continue exploring and drill testing over two kilometers of vein structure along the longitudinal extent of the Trinidad zone.

In addition to the drill program field crews are already conducting mapping and geochemical sampling on the Monte Alban II concession which holds multiple untested exploration targets. Monte Alban II covers a large area around the San Jose claims that host the Trinidad zone and vein system.

Concurrent with the exploration programs the Company is advancing with mine contractor selection for the underground development that is scheduled to start in the third quarter of the year.

On February 5, 2007, as operator of the project, Cuzcatlan purchased 100% interest in a processing facility and mine equipment valued at US$2,250,000, to be paid in three instalments of US$750,000 over a twelve month period, with the first payment made on signing of the agreement. The transaction is subject to an additional 15% for value added tax.

The plant facility is located 10 kilometers from the San Jose project. This plant facility has been processing high grade ore being mined at a rate of 100 tonnes per day from San Jose up until November 2006. The plant has enough capacity to treat up to 350 tonnes per day with minor improvements. Management plans to launch production this year at rated capacity.

Acquisitions

Fortuna is constantly evaluating new mining opportunities in order to meet our corporate objective of building significant silver inventory and cash flow, by acquiring advanced projects or operating mines from private parties in Latin America.

Cash cost per tonne (Non-GAAP measures)

Cash cost per tonne is a key performance measure that management uses to monitor performance. These performance measures have no meaning within Canadian Generally Accepted Accounting Principles (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 production costs per tonne of processed ore to the cost of sales from the consolidated statement of operations:

	CAD$	US$ @ 0.8771
Cost of sales	2,174,488	1,907,243
Change in inventory (ore and concentrate stock piles)	243,215	213,324
Depletion, depreciation, and accretion	(918,617)	(805,719)
Total cash production cost	1,499,086	1,314,848
Total processed ore (tonnes)		33,973
Cash production cost per tonne of processed ore (US$)		38.70

LIQUIDITY AND CAPITAL RESOURCES

The Company's cash resources and liquid investments decreased during the fifteen months ended December 31, 2006 by $4.21 million to $1.64 million.

For the 15 month period operating activities consumed a net cash amount of $775,973.

During 2006 the Company invested a total amount of $25.32 million in its mineral properties and plant and equipment. This includes US$8.76 million of Fortuna's share of the acquisition cost for San Jose. Additionally, the investments in our mining properties and projects demanded total disbursements of $3.3 million of value added taxes that the company expects to recover in the short term.

LIQUIDITY AND CAPITAL RESOURCES (continued)

Management expects Caylloma to attend ongoing and expansion capital needs for 2007 from cash generated internally by the operation. With regards to San Jose management expects investments of up to US$14 million over the next 12 months for the advancement of development and further exploration of the project.

In net terms over the 15 month period our funding needs were met with the issuance of common shares for total net proceeds of $25.6 million. This was comprised of $423,775 from the exercise of stock options, $5.6 from the exercise of warrants, and $ 19.56 of net proceeds from the two private placements arranged during the 15 month period.

Also during 2006 the Company attended temporary liquidity needs by raising short term debt that has allowed it to arrange permanent funding sources at a suitable time with regards to market conditions and other relevant considerations.

As at December 31, 2006, the Company had working capital of $110,625 compared to a working capital deficit of $218,826 at September 30, 2005.

As at April 20, 2007 the Company has 8.65 million warrants outstanding with expiry dates in September and October 2007 and which are currently in-the-money. This could potentially bring in cash to the Company in the amount of $11 million.

With the successful completion of the equity financing of January 2007 described above, the Company raised $32.57 million net of issuance costs that will allow it to contribute to the advancement of the San Jose project through the development stage over the next 18 to 24 months. Part of these funds have been deployed to the repayment of short term debt associated with the acquisition of San Jose back in October of 2006.

Management believes the Company's financial position after the closing of its January financing as well as a result of its ongoing operation in Caylloma are 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 as required in both the short and long term, but recognizes the uncertainty attached thereto.

RELATED PARTY TRANSACTIONS

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

	15 months Ended Dec. 31, 2006	Year Ended Sep. 30, 2005
Mineral property costs – geological fees	$ 174,332	$ 115,468
Consulting fees	$ 75,342	$ 7,371
Salaries and wages	$ 16,384	$ 79,185
Management fees	$ 146,146	$ 2,629

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

At December 31, 2006, accounts payable and accrued liabilities included $395 (Sept 2005: $181,036) to an officer of the Company.

At December 31, 2006, due to related parties consists of $41,147 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 December 31, 2006, due from related parties consists of $13,869 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.

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 years. Significant items subject to such estimates and assumptions include the carrying amount of mineral property, plant and equipment, revenue recognition, inventories and future income taxes, provisions for asset retirement obligation and reclamation, and stock based compensation.

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.

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 April 20, 2007 is 70,322,132 common shares. In addition, a total of 31,093,806 share purchase warrants and incentive stock options are currently outstanding as follows:

Type of Security	Number	Exercise Price	Expiry Date
Warrants	593,356	$1.85	September 23, 2007
	6,570,000	$1.25	September 26, 2007
	270,085	$0.80	September 26, 2007
	1,146,833	$1.25	October 6, 2007
	72,056	$0.80	October 6, 2007
	4,896,396	$1.85	March 23, 2008
	10,559,725	$2.30	July 11, 2008
	862,117	$0.345	June 27, 2010
	1,613,238	$0.345	November 17, 2010
	26,583,806		
Options	39,000	$0.37	December 2, 2009
	30,000	$0.80	July 24, 2010
	511,000	$1.35	February 5, 2016
	451,000	$2.29	March 30, 2016
	130,000	$1.75	May 8, 2016
	200,000	$1.75	May 22, 2016
	390,000	$1.55	July 5, 2016
	874,000	$1.66	July 10, 2016
	225,000	$1.61	September 13, 2016
	50,000	$1.90	November 20, 2016
	50,000	$1.96	November 23, 2016
	1,480,000	$2.22	January 11, 2017
	80,000	$2.75	February 6, 2017
	4,510,000		

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.

The most significant risk affecting the profitability and viability of the Company's mining operations is the fluctuation of metal prices, as the Company's earnings and cash flow are highly sensitive to changes in these metal prices. Low metal prices will affect the Company's liquidity, and if they persist for an extended period of time, the Company may have to look for other sources of cash flow to maintain liquidity until metal prices recover. Volatility in the metal prices is influenced by factors such as exchange rates, inflation, political circumstances and the world's supply and demand fundamentals, which are beyond the control of the Company.

Other risks facing the Company include environmental risks, 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 assessed the design of internal control of financial reporting as of December 31, 2006 pursuant to the requirements of Multilateral Instrument 52-109.

Management determined that the Company's ability to account for income taxes and acquisitions represented a weakness in the design of internal control over financial reporting. Management will address this by ensuring appropriate accounting advice is available on the recording of complex transactions and will also review its finance team capabilities.

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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheet of Fortuna Silver Mines Inc. as at December 31, 2006 and the consolidated statements of earnings, deficit and cash flows for the fifteen month period then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and the results of its operations and its cash flows for the fifteen month period then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at September 31, 2005 and for the year then ended were audited by other auditors, who expressed an opinion without reservation on those statements in their report, dated January 20, 2006.

KPMG LLP

Chartered Accountants
Vancouver, Canada
April 17, 2007

KPMG LLP, a Canadian limited liability partnership is the Canadian member firm of KPMG International, a Swiss cooperative.

FORTUNA SILVER MINES INC.

(Formerly Fortuna Ventures Inc.)

AS AT DECEMBER 31, 2006 AND SEPTEMBER 30, 2005

Expressed in Canadian Dollars

CONSOLIDATED BALANCE SHEETS

	Dec. 31, 2006	Sep. 30, 2005
ASSETS		
CURRENT		
Cash and cash equivalents (Note 3)	$ 1,641,264	$ 5,850,257
Accounts receivable and prepaid expenses (Note 13)	5,638,611	81,355
Inventories (Note 8)	826,165	-
Due from related parties (Note 6)	13,869	-
	8,119,909	5,931,612
LONG-TERM INVESTMENTS (Note 4)	741,250	-
PROPERTY, PLANT & EQUIPMENT (Note 7)	9,160,546	3,160,874
MINERAL PROPERTIES (Note 7)	41,186,418	15,048,653
	$ 59,208,123	$ 24,141,139
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities (Note 6)	$ 2,238,031	$ 870,663
Due to related parties (Note 6)	41,147	8,925
Loans (Note 5)	5,730,105	5,270,850
	8,009,283	6,150,438
Obligation under capital lease (Note 5)	97,100	-
As set retirement obligations (Note 14)	1,757,970	1,578,441
Future income tax liability (Note 10)	4,910,377	1,207,149
Non-controlling interest	3,226,631	-
	18,001,361	8,936,028
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 9)	43,341,404	12,163,851
SHARE SUBSCRIPTIONS (Note 15)	-	2,030,888
OBLIGATION TO ISSUE SHARES AND WARRANTS (Note 7)	-	4,584,954
CONTRIBUTED SURPLUS (Note 9)	6,084,540	296,313
DEFICIT	(8,219,182)	(3,870,895)
	41,206,762	15,205,111
	$ 59,208,123	$ 24,141,139

Nature of operations (Note 1)

Subsequent event (Note 5, 9, 17)

(See accompanying Notes)

APPROVED BY THE DIRECTORS:

Jorge Ganoza Durant,
Director

Simon Ridgway,
Director

FORTUNA SILVER MINES INC.

(Formerly Fortuna Ventures Inc.)

FOR THE FIFTEEN MONTH PERIOD ENDED DECEMBER 31, 2006
AND THE YEAR ENDED SEPTEMBER 30, 2005

Expressed in Canadian Dollars

CONSOLIDATED STATEMENTS OF DEFICIT

		15 month period ended Dec. 31, 2006		Year ended Sep. 30, 2005
DEFICIT - BEGINNING OF PERIOD	$	(3,870,895)	$	(3,265,262)
Net loss for the period		(4,348,287)		(605,633)
DEFICIT - END OF PERIOD	$	(8,219,182)	$	(3,870,895)

(See accompanying Notes)

FORTUNA SILVER MINES INC.

(Formerly Fortuna Ventures Inc.)

FOR THE FIFTEEN MONTH PERIOD ENDED DECEMBER 31, 2006
AND THE YEAR ENDED SEPTEMBER 30, 2005

Expressed in Canadian Dollars

CONSOLIDATED STATEMENT OF OPERATIONS

		15 month period ended Dec. 31, 2006		Year ended Sep. 30, 2005
Sales	$	3,371,698	$	-
Cost of sales including depletion, depreciation and accretion of $918,617		2,174,488		-
MINE OPERATING INCOME (LOSS)		1,197,210		-
Selling, general and administrative expenses		2,024,883		648,810
Stock-based compensation (Note 9)		4,132,075		228,721
Write-off of deferred exploration cos ts (Note 16)		40,218		182,657
		6,197,176		1,060,188
OPERATING INCOME (LOSS)		(4,999,966)		(1,060,188)
Interest and other income and expenses		470,002		279
Interest and finance expenses		(23,147)		-
Foreign exchange gain (Note 5)		673,031		454,276
Gain on disposal of investment (Note 4)		25,875		-
		1,145,761		454,555
LOSS BEFORE INCOME TAXES		(3,854,205)		(605,633)
Income tax provision (Note 10)		494,082		-
NET LOSS FOR THE PERIOD	$	(4,348,287)	$	(605,633)
Loss per share (Basic and Diluted)	$	(0.12)	$	(0.08)
Weighted average number of shares outstanding		36,834,106		7,186,858

(See accompanying Notes)

FORTUNA SILVER MINES INC.

(Formerly Fortuna Ventures Inc.)

FOR THE FIFTEEN MONTH PERIOD ENDED DECEMBER 31, 2006
AND THE YEAR ENDED SEPTEMBER 30, 2005

Expressed in Canadian Dollars

CONSOLIDATED STATEMENTS OF CASHFLOW

	15 month period ended Dec. 31, 2006	Year ended Sep. 30, 2005
OPERATING ACTIVITIES		
Net loss for the period	$ (4,348,287)	$ (605,633)
Items not involving cash		
Depletion, depreciation and amortization	739,088	3,043
Accretion expense	179,529	
Future Income tax	494,082	-
Write-off of deferred exploration costs	40,218	182,657
Non-cash gain on disposal of inves tment	(25,875)	-
Stock based compensation charge	4,132,075	228,721
Foreign Exchange gain on long-term debt	(200,700)	(287,100)
Foreign Exchange gain other	(71,552)	-
Changes in non-cash working capital items		
Accounts receivable and prepaid expenses	(2,255,756)	(65,220)
Inventory	(826,164)	-
Accounts payable	1,367,369	801,742
Net cash provided by (used in) operating activities	(775,973)	258,210
FINANCING ACTIVITIES		
Proceeds on is suance of common shares	25,589,238	8,267,674
Share subscriptions (Note 15)	-	2,030,888
Capital lease obligations	(29,281)	-
Payments received from related parties (Note 6)	(13,869)	-
Payments to related parties (Note 6)	32,222	8,925
Repayment of debt (Note 5)	(5,070,150)	(3,643,545)
Proceeds from loans (Note 5)	5,685,160	-
	26,193,320	6,663,942
INVESTING ACTIVITIES		
Mineral property expenditures	(20,656,849)	(793,124)
Bus ines s acquis ition expenditures	-	(641,018)
VAT on mineral properties expenditures	(3,301,501)	-
Purchase of long-term inves tment	(1,000,000)	-
Expenditures on plant & equipment	(4,667,990)	(34,074)
	(29,626,340)	(1,468,216)
INCREASE (DECREASE) IN CASH	(4,208,993)	5,453,936
Cash - beginning of period	5,850,257	396,321
CASH - END OF PERIOD	$ 1,641,264	$ 5,850,257
Supplementary disclosure of cash flow information:		
Cash paid for interest	$ 83,640	$ 83,025
Cash paid for income taxes	$ -	$ -

Non-cash transactions (Note 12)
(See accompanying Notes)

01. NATURE AND CONTINUANCE OF OPERATIONS

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

The Company's continuing operations and the recoverability of amounts shown for its exploration stage mineral properties are dependent upon the availability of the necessary financing to complete the exploration and development of such mineral property interests, and upon future profitable production or proceeds from the disposition of its mineral property interests. Future profitable production is primarily dependent on the quality of ore resources, ability to obtain permits, future metal prices, operating and environmental costs, fluctuations in currency exchange rates, political risks and varying levels of taxation.

These financial statements have been prepared on a going concern basis, which assumes the realization of assets and liquidation of liabilities in the normal course of business. As at December 31, 2006 the Company had working capital of approximately $.11 million. Subsequent to the period end, the Company raised $34.2 million via a closed brokered private placement, which is expected to be sufficient to fund its planned activities for 2007. The ability of the Company to continue as a going concern may be dependent upon its ability to raise equity financing and to achieve profitable operations. It may be necessary to raise further financing to fund future activities and there can be no assurances that the Company will be able to obtain additional financing or achieve positive cashflows.

02. SIGNIFICANT ACCOUNTING POLICIES

The Company changed its year end from September 30, to December 31, and therefore the current year end reflects a fifteen month period ended December 31, 2006 and the comparative figures reflect the 12 month period ended September 30, 2005.

a) Basis of presentation:
The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include the accounts of the Company's wholly owned subsidiaries, Minera Bateas SAC (Bateas) and Fortuna Silver (Barbados) Inc. and of the Company's 76% interest in Compania Minera Cuzcatlan SA, a variable interest entity for which a non-controlling interest has been recorded to reflect the 24% interest of the Company's partner. All significant intercompany balances and transactions have been eliminated on consolidation.

b) Use of 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 period. Significant items subject to such estimates and assumptions include the determination of mineral reserves, the carrying amount of mineral property, plant and equipment, assay grades of metal concentrates sold, inventories and future income taxes, provisions for asset retirement obligation and reclamation, fair value estimation of acquisitions and stock based compensation. Actual results could differ from those estimates.

c) Revenue Recognition

Revenue arising from the sale of metal concentrates is recognized when title and 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 and final commodity prices are set on a specified quotational period, either one or three months after delivery. The Company's metal concentrates are provisionally priced at the time of sale based on the prevailing market price.

d) Cash and equivalents

Cash and cash equivalents include highly liquid investments with original maturities of ninety days or less.

e) Short-term investments

Short-term investments will typically consist of a portfolio of money market instruments and highly liquid debt securities which the Company regards as available for sale within a one year horizon. These investments are recorded at cost, less any amount for impairment.

f) Mineral Properties, Plant and Equipment

Mineral Properties

The Company defers the cost of acquiring, maintaining its interest, exploring and developing mineral properties until such time as the properties are placed into production, abandoned, sold or considered to be impaired in value. Costs of producing properties, including capitalized interest are amortized on a unit of production basis over proven and probable reserves and costs of abandoned properties are written-off. Proceeds received on the sale of interests in mineral properties are credited to the carrying value of the mineral properties, with any excess included in operations. Write-downs due to impairment in value are charged to operations.

For operating mines all replacement and expansion exploration within the mineral deposit is capitalized and amortized on a unit of production basis over proven and probable reserves as part of the production cost.

Plant and Equipment

Plant and equipment are recorded at cost. Plant and equipment is depreciated over the estimated economic life of the asset as follows:

Buildings, mine site	Life of mine
Buildings, other	20 – 30 years
Machinery and equipment	5 years
Furniture and other equipment	3 – 5 years
Transport units	3 – 5 years

Property under capital leases is initially recorded at the present value of minimum lease payments at the inception of the lease.

Impairment
Management reviews the carrying value of mineral properties, plant, and equipment when events or changes in circumstances indicate that their carrying values may not be recoverable. Impairment of an asset is considered to exist if total estimated future cash flows on an undiscounted basis expected to be generated by the asset are less than the carrying amount of the asset. If a shortfall exists, the asset is written down to the fair value. Amounts shown for properties represent costs incurred net of write-downs and recoveries, and are not intended to represent present or future values.

g) Asset Retirement Obligation
The fair value of an obligation associated with the retirement of a tangible long-lived asset is recorded in the period in which it is incurred and a reasonable estimate of the fair value can be made, with a corresponding increase to the carrying amount of the related asset. The liability is accreted over time for changes in the fair value of the liability through charges to accretion, which is included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized in a manner consistent with the depletion and depreciation of the related asset.

h) Inventories
Ore stockpile and finished goods inventories are valued at the lower of production cost and net realizable value. Production costs include all mine site costs. Materials and supplies are valued at weighted average cost less allowances for obsolescence.

i) Income Taxes
The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the date of substantive enactment. Future tax assets are recognized to the extent that they are considered more likely than not to be realized.

j) Stock-based Compensation
The Company has a share option plan which is described in note 9. The Company records all stock-based compensation for options using the fair value method such that stock-based payments are measured at fair value and expensed over their vesting period with a corresponding increase to contributed surplus. Upon exercise of share purchase options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital.

k) Basic and Diluted Loss Per Share
Basic loss per share (“LPS”) is calculated by dividing the net loss applicable to common shareholders by the weighted average number of common shares outstanding for the year. Potentially dilutive outstanding options and warrants are excluded from the calculation of LPS, as they would be anti-dilutive.

02. SIGNIFICANT ACCOUNTING POLICIES (continued)

l) Foreign Currency Translation
The Company's subsidiaries are accounted for as integrated foreign operations. Monetary items denominated in a foreign currency are translated into Canadian dollars at exchange rates prevailing at the balance sheet date and non-monetary items are translated at exchange rates prevailing when the assets were acquired or obligations incurred. Foreign currency denominated revenue and expense items are translated at the exchange rates prevailing at the transaction date. Gains or losses arising from the translations are included in operations.

m) Financial Instruments
The carrying value of cash and cash equivalents, receivables, accounts payable and accrued liabilities approximate their fair value. The fair value of the Company's investments is disclosed in Note 4. The fair values of the Company's loans approximate their fair value due to the short period to maturity. See Note 5.

03. CASH AND CASH-EQUIVALENTS

Cash and cash-equivalents include a term deposit of $140,297 securing a Stand By Letter of Credit issued on behalf of one of the Company's subsidiaries and which expires on August 21, 2007. These funds are restricted until the expiry of the Stand By Letter of Credit.

04. INVESTMENTS

Long-term Investments
The Company purchased by way of a private placement 5,000,000 shares of Continuum Resources Ltd. at a price of $0.20 per share for a total purchase price of $1,000,000. Continuum is required to use the proceeds to perform geological work on several silver projects that Continuum holds in the State of Oaxaca, Mexico, and for the acquisition of additional silver targets in that State. Continuum has granted to the Company an exclusive right to review all data prepared by or made available to Continuum in respect of those properties and an exclusive right to acquire an undivided 60% interest in Continuum's interest in any of those properties upon the Company conducting additional exploration activities on a property in an amount not less than the greater of (a) twice the amount expended by Continuum on that property and (b) $500,000.

In November 2006 the Company and Continuum purchased a 100% interest in the San Jose property, where the Company holds a majority interest of 76%. As part of the purchase agreement the Company paid to the property owner 1,293,750 previously held shares of Continuum which were valued at $0.22 per share. The remaining shares in possession of the Company are carried at cost with a total value of $741,250. At December 31, 2006 the market value of these shares was $1,260,125.

05. LOANS

On June 27, 2006 the Company paid the last installment of the US$4,500,000 non-interest bearing promissory note it executed in June of 2005 in connection with the acquisition of the Caylloma mine. The cancellation of this liability generated a foreign exchange gain of $200,700 for a recorded amount paid of $5,070,150.

On November 21 2006 the Company borrowed $4,600,000 from Quest Capital Corporation in connection with the acquisition of the San Jose property. The loan was due on May 30, 2007 but was paid back on January 15, 2007 and it bore interest of 12 %. As additional consideration for the facility 153,333 shares of the Company were issued to the lender as payment of a bonus in the amount of $276,000.

On October 30, 2006 a revolving credit line of US$ 950,000, with a CDN value of $1,078,915 as of December 31, 2006, was taken for working capital purposes from Traxys North America. This credit was paid back on February 8, 2007 and it bore interest of Libor + 1.5% plus a variable utilization fee. Interest of $6,245 was accrued during the period.

The Company has capital lease obligations of $142,045 at December 31, 2006. These are related to the acquisition of mining equipment, have a 3 year term, and bear interest at a fixed rate of 8.5%. The current portion of the capital lease, $44,945, is shown under "Loans".

06. RELATED PARTY TRANSACTIONS

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

	15 months Ended Dec. 31 2006	Year Ended Sep. 30 2005
Mineral property costs – geological fees	$174,332	$115,468
Consulting fees	$ 75,342	$ 7,371
Salaries and wages	$ 16,384	$ 79,185
Management fees	$146,146	$ 2,629

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

At December 31, 2006, accounts payable and accrued liabilities included $395 (2005: $181,036) to an officer of the Company.

At December 31, 2006, due to related parties consists of $41,147 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 December 31, 2006, due from related parties consists of $13,869 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.

07. MINERAL PROPERTIES, PLANT & EQUIPMENT

Plant and Equipment comprise of the following:

	15 month period ended December 31, 2006			Year ended September 30, 2005		
	Cost	Accumulated Depreciation	Net	Cost	Accumulated Depreciation	Net
Buildings	$ 2,329,922	$ 10,241	$ 2,319,681	$ 1,163,891	$ -	$ 1,163,891
Machinery & equipment	6,454,156	132,778	6,321,378	1,897,540	450	1,897,090
Transport units	131,029	5,852	125,177	6,800	-	6,800
Furniture and other equipment	301,013	14,449	286,565	95,687	2,594	93,093
Work in progress	107,746	-	107,746	-	-	-
	$ 9,323,866	$ 163,320	$ 9,160,546	$ 3,163,918	$ 3,043	$ 3,160,874

Mineral Properties
Mineral Properties are located in Peru and Mexico and comprise of the following:

	15 month period ended December 31, 2006				Year ended September 30, 2005			
	Cost	Write-offs	Accumulated Amortization	Net	Cost	Write-offs	Accumulated Amortization	Net
Mexico-San Jose	$18,580,057	-	$ -	$18,580,057	$ -	$ -	$ -	$ -
Peru-Caylloma	23,166,440	-	571,628	22,594,812	15,040,182	-	-	15,040,182
Other	51,767	40,218	-	11,549	191,128	182,657	-	8,471
	$41,798,264	$ 40,218	$ 571,628	$ 41,186,418	$15,231,310	$ 182,657	$ -	$15,048,653

The carrying amount for San Jose includes $336,493 of capitalized interest on loans (Note 5). Additions for development and capitalized exploration consist of $8,126,258 for the 15 month period ended December 31, 2006 at Peru Caylloma and $43,296 at other properties.

Caylloma Mine, Peru

On June 27, 2005 the Company completed the acquisition of the Caylloma Silver Mine located in southern Peru, by acquiring 100% of the outstanding common shares of Minera Bateas S.A.C. (Bateas). Bateas was incorporated in Peru on March 23, 2005 to facilitate the sale to the Company and its assets consisting of mining rights to properties located in southern Peru and other property and equipment located on the properties. The purchase price consisted of US$7,550,000 and the issue of shares and share purchase warrants up to 10.803% of the fully diluted capital of the Company until such time as the Company subsequently completed equity financings of $10 million. This resulted in 2,472,365 shares and 2,475,355 share purchase warrants being issued. The Company also paid a $220,000 finder's fee in connection with the transaction. A 2% net smelter returns royalty payable to the vendors will accrue after 21 million ounces of silver have been recovered from the property. This acquisition was accounted for using the purchase method of accounting.

The allocation of fair value and liabilities of assets acquired and the consideration paid are summarized as follows:

Net assets acquired, at fair value	
Property, plant and equipment	$4,708,284
Mineral rights	12,772,059
Less: asset retirement obligations	(1,578,440)
Less: future tax liability	(1,207,149)
	$14,694,754
Consideration	
Cash and acquisition costs	$641,018
Shares issued on acquisition date – 574,744 at $0.345 per share	198,287
Fair value of share purchase warrants issued on acquisition date	69,000
Convertible note payable of US$2,950,000	3,643,545
Note payable of US$4,500,000	5,557,950
Shares issued on completion of equity financing on November 17, 2005 1,897,621 at $1.43 per share	2,713,598
Fair value of share purchase warrants issued on completion of equity financing on November 17, 2005	1,871,356
	$14,694,754

The fair value of the share purchase warrants was determined using the Black-Scholes option pricing model using the following assumptions:

	Issued Jun. 27 2005	Issued Nov. 17 2005
Expected dividend yield	0.0%	0.0%
Expected volatility	34.2%	93.8%
Risk-free interest rate	3.75%	3.6%
Expected term in years	2 years	2 years

07. MINERAL PROPERTIES, PLANT & EQUIPMENT (continued)

San Jose Project, Mexico

In November 2005, the Company entered into an agreement (the "Option Agreement") with Continuum Resources Ltd. ("Continuum") whereby the Company was granted the option to acquire a 70% interest in Continuum's rights to earn an 80% interest in the San Jose Project, Mexico.

In September 2006, the Company and Continuum agreed to form a jointly owned Mexico company to be held 76% by the Company and 24% by Continuum, which company would purchase a 100% interest in the San Jose Project from the underlying property owner. The Option Agreement was superseded by this agreement.

In November 2006, this company, Compañia Minera Cuzcatlan ("Cuzcatlan"), paid the purchase price consisting of US$9,000,000 cash (in addition to this the transaction commanded payment of US$1,350,000 on account of the 15% goods and services tax applicable under Mexican law). Additionally the Company issued to the property owner 168,417 shares of the Company and 1,293,750 shares of Continuum already owned by the Company. In order to provide part of the cash payment due to the property owner, the Company borrowed $4.6 million pursuant to a credit facility granted by Quest Capital Corp. of Vancouver, BC. The loan was secured by the Peru assets of the Company. In consideration for the loan, the Company issued 153,333 shares to Quest Capital Corp. (Note 5.)

Of the US$9,000,000 cash purchase price paid by Cuzcatlan, US$8,760,000 was contributed by the Company and on completion of the acquisition of the San Jose Project, the Company and Continum entered into a shareholders agreement which governs the operations of Cuzcatlan. The Company is the operator of the work programs and the Company and Continuum, must contribute to the costs thereof in proportion to its ownership percentage in Cuzcatlan.

Cuzcatlan has been accounted for as a variable interest entity, as defined in CICA Accounting Guideline 15 *Consolidation of Variable Interest Entities* and has been consolidated from the date of acquisition. A non-controlling interest of $3,226,631 has been recorded as at December 31, 2006.

08. INVENTORIES

Inventories comprise of the following:

		15 months ended Dec. 31, 2006		Year ended Sep. 30, 2005
Ore stock piles	$	77,664	$	-
Concentrate stock piles		165,551		-
Materials and supplies		582,949		-
Total	$	826,164	$	-

09. SHARE CAPITAL

Authorized
Unlimited common shares without par value

		Number of Shares		Amount
Balance, September 30, 2004	$	6,452,691	$	3,697,482
Cancellation of shares for debt		(4,000)		(1,000)
Cancellation of escrow shares		(87,470)		(6,123)
Private placement for cash		11,100,000		8,250,000
Property acquis ition		574,744		198,287
Exercise of options		47,500		17,575
Exercise of warrants		2,000,000		600,000
Transfer of contributed surplus on exercise of options				7,530
		13,630,774		9,066,269
Less issue costs				(599,900)
Balance, September 30, 2005	$	20,083,465	$	12,163,851
Exercise of options		650,000		423,775
Exercise of warrants		6,124,631		5,600,546
Private placement for cash		16,700,000		22,050,000
Private placement commission non-cash transaction (Note 12)		760,261		1,140,392
Property acquisition non-cash transaction (Note 12)		1,897,621		2,713,598
Property finders fee non-cash transaction (Note 12)		50,000		68,000
Property acquisition non-cash transaction (Note 12)		168,417		284,625
Loan fee (Note 12)		153,333		275,999
Transfer of contributed surplus on exercise of options				215,256
Less issue costs (Non-cash amount $1,140,443)				(1,594,638)
Balance, December 31, 2006	$	46,587,728	$	43,341,404

The private placement for cash of $22,050,000 includes $2,030,888 received in September 2005. (Note 15)

09. SHARE CAPITAL (continued)

Stock Options

The Company has established a formal stock option plan in accordance with the policies of the TSX Venture Exchange under which it is authorized to grant options up to 10% of its outstanding shares to officers, directors, employees and consultants. The exercise price of each option equals the market price of the Company's stock as calculated on the date of grant. Upon the Company becoming a Tier 1 issuer on the TSX Venture Exchange on January 13, 2006, the options are for a maximum term of ten years.

A summary of stock options granted and exercised under the Company's stock option plan is as follows:

	15 months ended Dec. 31, 2006		Year ended Sep. 30, 2005	
	Number of Options	Weighted Average Exercised Price	Number of Options	Weighted Average Exercised Price
Outstanding, beginning year	860,000	$ 0.56	-	$ -
Granted	3,555,000	1.70	907,500	0.55
Exercised	(650,000)	0.65	(47,500)	0.37
Outstanding, end of period	3,765,000	$ 1.62	860,000	$ 0.56

The following stock options were outstanding and exercisable at December 31, 2006:

Number of Shares	Exercise Price $	Expiry Date
125,000	2.29	*March 30, 2007
162,500	0.37	December 2, 2009
72,500	0.72	July 13, 2010
40,000	0.80	July 24, 2010
75,000	1.35	November 17, 2010
655,000	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
225,000	1.61	Sept. 13, 2016
50,000	1.90	Nov. 20, 2016
50,000	1.96	Nov. 23, 2016
3,765,000		

* 50,000 of these options were exercised subsequent to December 31, 2006 and the balance expired unexercised.

Warrants
A summary of share purchase warrants issued and exercised is as follows:

	15 months ended Dec. 31, 2006		Year ended Sep. 30, 2005	
	Number of Warrants	Weighted Average	Number of Warrants	Weighted Average
Outstanding, beginning year	13,114,117	$ 0.91	2,000,000	$ 0.30
Issued	13,576,699	1.40	13,114,117	0.91
Exercised	(6,124,631)	0.91	(2,000,000)	0.30
Outstanding, end of period	20,566,185	$ 1.23	13,114,117	$ 0.91

The following share purchase warrants were outstanding at December 31, 2006:

Number of Warrants	Exercise Price $	Expiry Date
26,875	1.50	*February 20, 2007
940,912	1.85	September 23, 2007
8,670,000	1.25	September 26,2007
270,085	0.80	September 26,2007
1,366,833	1.25	**October 6, 2007
114,056	0.80	October 6, 2007
6,702,069	1.85	March 23, 2008
862,117	0.345	June 27, 2010
1,613,238	0.345	Nov 17, 2010
20,566,185		

* These warrants were exercised in full subsequent to December 31, 2006.
** Pursuant to the terms of these warrants, the exercise price increased from $1.00 per share to $1.25 per share effective October 7, 2006.

Escrow Securities
87,470 shares held in escrow pursuant to an escrow agreement dated July 1, 1991 were cancelled by the regulatory authorities on March 9, 2005. The issued share capital reflects the cancellation of these shares.

As at June 1, 2005, there were placed in escrow 495,422 common shares and warrants and options to purchase up to 694,800 common shares. As at September 30, 2005, 733,880 shares and 337,320 warrants and options remained in escrow. As at December 31, 2006, all of the securities had been released, and the Company had no securities held in escrow.

09. SHARE CAPITAL (continued)

Stock-Based Compensation

The Company uses the fair value based method of accounting for share options granted to consultants, directors, officers and employees. The non-cash compensation charge of $4,132,075 recognized for the fifteen months ended December 31, 2006 is associated with the granting of options to a consultant, directors and employees. These compensation charges have been determined under the fair value method using the Black-Scholes option pricing model with the following assumptions:

	15 months ended Dec. 31, 2006	Year ended Sep. 30, 2005
Risk-free interest rate	2.93% - 4.59%	2.93% - 3.75%
Expected stock price volatility	43.0% - 92.0%	43.0% - 88.0%
Expected term in years	5 & 10	1 - 5
Expected dividend yield	0%	0%

10. INCOME TAXES

Income tax expense differs from the amount that would be computed by applying the combined federal and provincial statutory income tax rate of 34.12% (2005 – 34.12%) to loss before income taxes. The reasons for the differences are as follows:

	15 months ended Dec. 31, 2006	Year ended Sep. 30, 2005
Expected Tax recovery	$ (1,315,055)	$ (141,299)
Non-deductible items	1,429,801	(31,552)
Differences in tax rates in foreign jursidictions and non-recoginition benefits	379,336	172,851
	$ 494,082	$ -

The tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities at December 31, 2006 and September 30, 2005 are presented below:

	15 months ended Dec. 31, 2006	Year ended Sep. 30, 2005
Future tax assets (all arising in Canada):		
Non-capital losses	$ 725,296	$ 163,749
Financing costs	473,036	-
Mineral properties	512,027	563,560
Less valuation allowance	(1,710,359)	(727,309)
	-	-
Future tax liabilities:		
Mineral properties - Peru	(2,624,247)	(1,207,149)
Mineral properties - Mexico	(2,286,130)	-
	(4,910,377)	(1,207,149)
Net future income tax liability	$ (4,910,377)	$ (1,207,149)

At December 31, 2006, the Company has net operating loss carryforwards for Federal income tax purposes of $2,339,665 which are available to offset future Federal taxable income, if any, through 2026.

11. SEGMENTED INFORMATION

Details of identifiable assets by geographic segments are as follows:

	Dec. 31, 2006	Sep. 30, 2005
Canada		
Current assets	$ 1,852,778	$ 5,846,705
Investments	741,250	-
Plant and equipment	9,326	18,624
	$ 2,603,354	$ 5,865,329
Peru		
Current assets	$ 5,020,408	$ 82,452
Plant and equipment	9,146,296	-
Mineral properties	22,594,813	18,179,522
	$ 36,761,517	$ 18,261,974
Guatemala		
Current assets	$ -	$ 2,455
Plant and equipment	2,910	2,910
	$ 2,910	$ 5,365
Mexico		
Current assets	$ 1,246,722	$ -
Mineral properties	18,580,057	8,471
Plant and equipment	2,014	-
	$ 19,828,793	$ 8,471
Latin America - General		
Mineral properties	$ 11,549	$ -
	$ 59,208,123	$ 24,141,139

All revenues are generated in Peru.

12. SUPPLEMENTARY DISCLOSURE OF NON-CASH TRANSACTIONS

Investing and financing activities that do not have a direct impact on current cash flows are excluded from the statements of cash flows.

The following non-cash transactions occurred:

For the year ended September 30, 2005	Number of Shares	Amount
Escrow shares were cancelled by regulatory authorities with the amount representing the original price paid for these shares transferred to contributed surplus	87,470	$ 6,123
Shares issued for debt were cancelled and relating debt transferred back to payables	4,000	$ 1,000
Shares issued for the acquisition of Minera Bateas	574,744	$ 198,287

15 months ended December 31, 2006	Number of Shares	Amount
Shares issued for property acquisition, previously booked as an obligation	1,897,621	$ 2,713,598
Warrants issued for property acquisition, previously booked as an obligation	1,613,238	$ 1,871,356
Shares issued for property finders fee	50,000	$ 68,000
Shares issued for commission on private placement	760,261	$ 1,140,392
Shares issued for property acquisition	168,417	$ 284,625
Continuum investment shares issued for property acquisition	1,293,750	$ 284,625
Shares issued for consideration on Quest loan	153,333	$ 275,999

13. ACCOUNTS RECEIVABLE AND PREPAIDS

	Dec. 31, 2006	Sep. 30, 2005
GST and value added taxes	$ 3,737,849	$ 39,730
Accounts receivable	1,561,785	-
Advances and other receivables	279,376	215
Prepaid expenses and deposits	59,601	41,410
	$ 5,638,611	$ 81,355

During the fourth quarter of 2006 the Company advanced several payments on behalf of Continuum Resources Ltd. in connection to the acquisition of San Jose for a total of USD $612,000. This amount was reimbursed on March 2, 2007 and is shown as a net of $279,376 after offsetting payables from Cuzcatlan to Continuum reflected in the Companys consolidated Balance Sheet.

14. ASSET RETIREMENT OBLIGATION

The Company has recorded an Asset Retirement Obligation of $1,757,970 as of December 31, 2006. This is the result of having accreted the previously reported Asset Retirement Obligation of $1,578,441 as of September 30, 2005 by $179,529. The accretion expense was calculated over the fifteen month period using a rate of 9%. The initial amount was based on an estimate prepared by an independent third party at the time of acquisition as to the cost of reclamation associated with the Caylloma property. The Company is currently reviewing its reclamation obligations at the property in light of changing regulations and on the basis of further data in respect of the mine life.

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.

Future changes, if any, to the estimated liability as a result of amended requirements, laws, regulations and operating assumptions 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 property, plant and equipment balance.

15. SHARE SUBSCRIPTIONS

The Company recorded share subscriptions of $2,030,888 as at September 30, 2005 for the funds received on the private placement completed on October 7, 2005 for 4,000,000 units at $0.75 per unit for a total of $3,000,000. The Company paid finder's fees consisting of $153,587 cash and 231,056 share purchase warrants in connection with this transaction in October 2005.The share purchase warrants are exercisable into one common share of the Company for a price of $0.80 until October 6, 2007.

16. WRITE-OFF OF DEFERRED EXPLORATION COSTS

In 2004, the Company was granted an option to earn a 60% interest in the El Tambor Project, Guatemala in consideration of the Company incurring exploration expenditures totalling US$4 million over four years. In 2005, this agreement was terminated by the Company as management decided to focus its exploration and development activities in Peru, and as at December 31, 2006, $39,511 (2005 - $108,707) was written off. Other write offs as at December 31, 2006 related to $707 of project investigation costs (2005 $73,950).

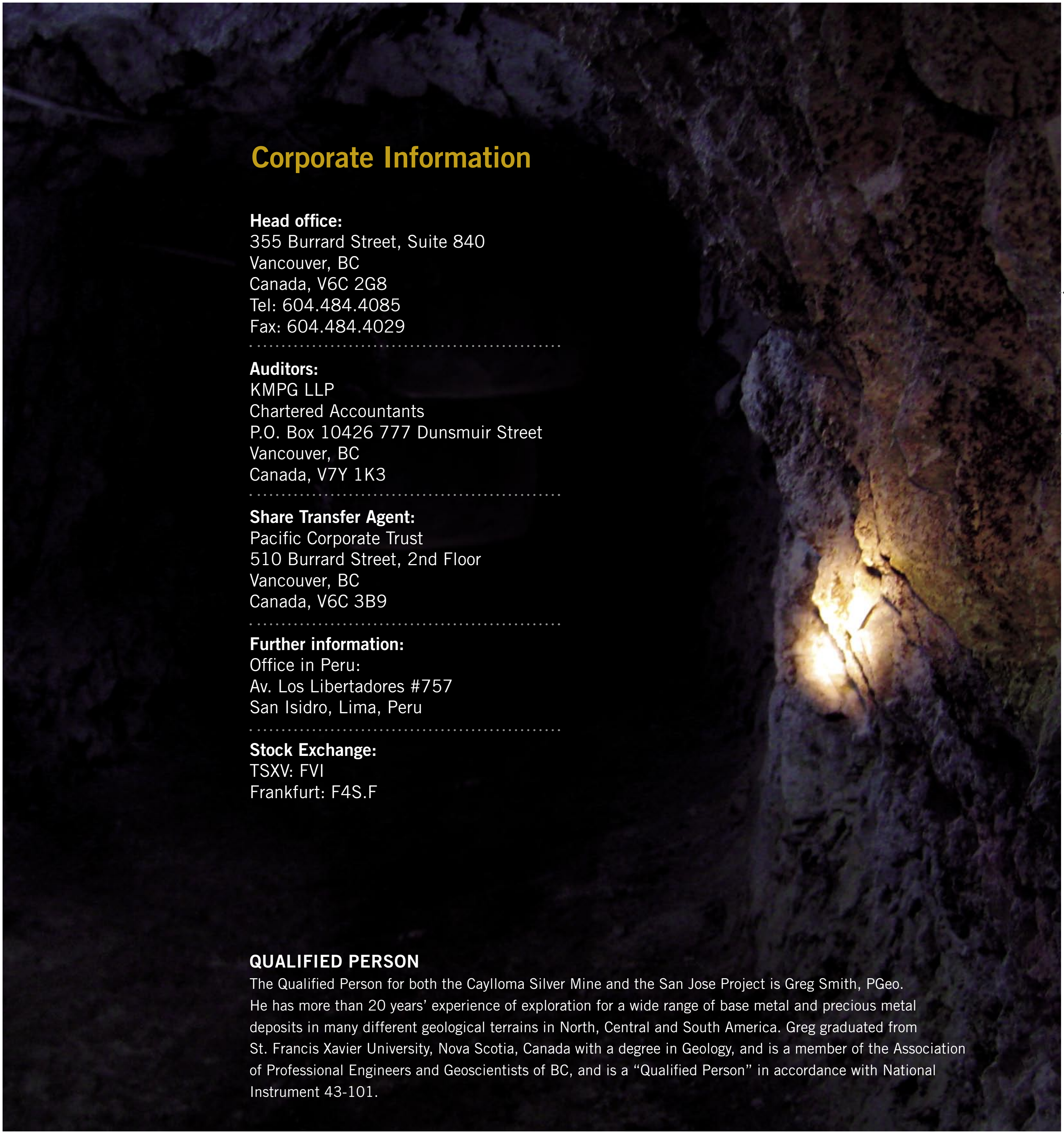
17. SUBSEQUENT EVENTS

On January 11, 2007 the Company closed a brokered private placement by which it issued 18.0 million units at a price of $1.90 per unit, to raise gross proceeds of $34.2 million. Each unit consisted of one common share plus one-half common share purchase warrant. Each whole warrant entitles the owner to purchase one additional share of the Company for 18 months at a price of $2.30.

Subsequent to December 31, 2006 the Company received $782,405 from 610,000 options exercised and $3.7 million from 2,128,450 warrants exercised.

18. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform to the current year's presentation.



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Stock Exchange:
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Frankfurt: F4S.F

QUALIFIED PERSON

The Qualified Person for both the Caylloma Silver Mine and the San Jose Project is Greg Smith, PGeo. He has more than 20 years' experience of exploration for a wide range of base metal and precious metal deposits in many different geological terrains in North, Central and South America. Greg graduated from St. Francis Xavier University, Nova Scotia, Canada with a degree in Geology, and is a member of the Association of Professional Engineers and Geoscientists of BC, and is a "Qualified Person" in accordance with National Instrument 43-101.

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