



FORTUNA
SILVER MINES INC.

BUILDING SUSTAINABLE VALUE

2011 ANNUAL REPORT

Cover photo:
San Jose Mine, Mexico



Caylloma Mine, Peru



Our Vision

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

Our Mission

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

Our Values

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

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

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

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

We value integrity: We act according to our philosophy.

Symbols

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

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This annual report contains forward-looking statements. Please refer to the cautionary language under the heading "Cautionary Statement on Forward-Looking Statements" on page 55 of the Management's Discussion & Analysis.

FORTUNA SILVER MINES INC.

Fortuna Silver Mines Inc. is a profitable silver producer with two 100%-owned, low-cost mines in Peru and Mexico. One of Latin America's fastest growing silver miners, Fortuna has increased annual production steadily to approximately 2.8 million silver equivalent ounces since its establishment in 2005. Fortuna's growth strategy is to focus on exploration and development of opportunities within its 73,000 hectare land holdings in Peru and Mexico while also pursuing select advanced stage silver projects in Latin America.

Fortuna is headquartered in Vancouver, Canada and maintains management offices in Lima, Peru. Its common shares are listed on the New York Stock Exchange (FSM), Toronto Stock Exchange (FVI), Bolsa de Valores de Lima (FVI) and Frankfurt Stock Exchange (F4S.F).

PRODUCING MINES

San Jose Mine, Mexico

San Jose achieved commercial production in September 2011 at 1,000 tpd and is expected to produce 1.7 million ounces of silver and 15,000 ounces of gold in 2012. Fortuna plans to initiate an expansion program in 2012 to increase mine and mill production capacity to 1,500 tpd. When operating at design capacity, San Jose is projected to produce approximately 3.2 million ounces of silver and 25,000 ounces of gold annually. During 2012, the company's brownfields exploration program will focus on the testing and evaluation of opportunities developed in its 58,000 hectare land package.

Caylloma Mine, Peru

Over the past four years, the company has increased silver production at Caylloma by more than 200%. In 2011, the mine produced 2 million ounces of silver and 2,400 ounces of gold, plus base metal by-products. Caylloma's Mine life is projected at eight years. In 2012, Fortuna will conduct brownfields exploration to evaluate a number of high-grade silver targets on its 11,000 hectare land package.

Concentrate shipment at the San Jose Mine, Mexico





San Jose Mine, Mexico

2011 PERFORMANCE

Milestones

- Silver production increases by 31% to 2.5 million ounces
- Sales increase by 49% to a record US\$110 million
- Earnings per share increase by 7% to US\$0.16
- San Jose Mine achieves commercial production on time and on budget at 1,000 tpd in September
- Fortuna acquires option to purchase 100% interest in the Mario project in central Peru
- Exploration continues to increase mineral resources and reserves
- Common shares begin trading on the New York Stock Exchange

Financial Highlights

(Expressed in thousands of US dollars)	2011*	2010*	2009**
Sales	110,004	74,056	51,428
Operating income	38,065	27,728	14,383
Net income	19,533	16,003	623
Earnings per share	0.16	0.15	0.01
Cash flow from operations	35,508	21,713	13,686

* Figures expressed under IFRS

** Figures expressed under Canadian Generally Accepted Accounting Principles

Capital Share Structure

(As of April 13, 2012)	
Shares outstanding	125,268,751
Stock options	3,688,289
Warrants	0

Operating Highlights

	2011			2010	2009
	Caylloma Mine Peru	San Jose Mine Mexico ⁽⁵⁾	Consolidated	Caylloma Mine Peru	Caylloma Mine Peru
Processed Ore					
Tonnes milled	448,866	125,301		434,656	395,560
Average tpd milled	1,272	949		1,231	1,121
Cash Cost (US\$/oz Ag) ⁽¹⁾	(0.59)	4.51	0.37	(5.99)	(4.86)
Silver⁽²⁾					
Grade (g/t)	171	144		159.24	154.76
Recovery (%)	81.43	84.60		85.67	85.40
Production (oz)	2,008,488	490,555	2,499,043	1,906,423	1,682,546
Realized Price (US\$/oz) ⁽³⁾			31.11	18.18	13.09
Gold					
Grade (g/t)	0.36	1.36		0.40	0.47
Recovery (%)	45.71	84.40		46.28	46.45
Production (oz)	2,393	4,622	7,015	2,556	2,780
Realized Price (US\$/oz) ⁽³⁾			1,183	921	707
Lead					
Grade (%)	2.15	–		2.44	3.10
Recovery (%)	92.68	–		91.28	93.02
Production (000 lbs)	19,677	–	19,677	21,373	25,137
Realized Price (US\$/lb) ⁽³⁾			0.86	0.79	0.56
Zinc					
Grade (%)	2.68	–		3.10	3.66
Recovery (%)	88.46	–		87.99	89.07
Production (000 lbs)	23,424	–	23,424	26,137	28,442
Realized Price (US\$/lb) ⁽³⁾			0.66	0.60	0.39
Copper					
Grade (%)	0.18	–		0.21	0.25
Recovery (%) ⁽⁴⁾	2.03	–		51	–
Production (000 lbs)	36	–	80,275	1,026	190
Realized Price (US\$/lb) ⁽³⁾			2.65	2.60	1.53
No. of Employees			1,502	1,630	885

1 Net of by-product credits

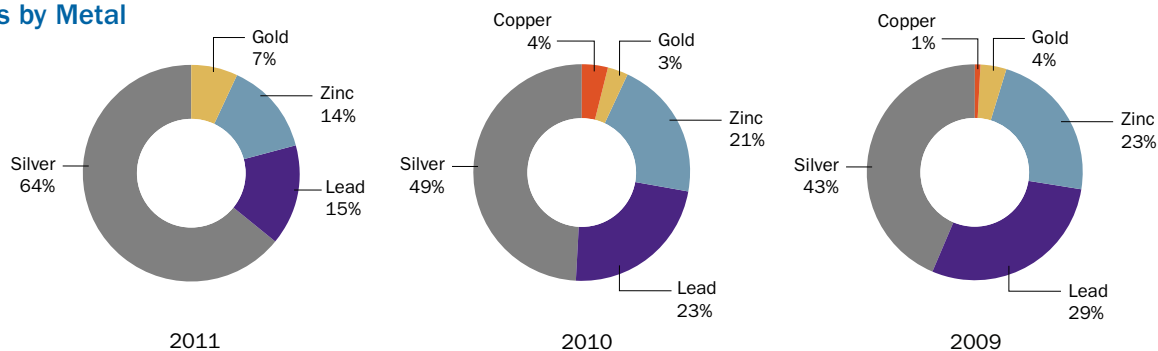
2 2011 Caylloma Mine silver recovery in lead concentrates. 2009 and 2010 Caylloma Mine silver recovery in lead and copper concentrates

3 Calculated based on contained metals and after deductions, treatment, and refining charges. Treatment charges are allocated to the base metals in Caylloma and to gold in San Jose. Net realized prices are based on provisional sales and are calculated before government royalties

4 Copper recovery in 2009 was not reported as circuit was fully commissioned in December 2009

5 Total production for 2011, includes pre-commissioning production. Commercial production as of September 1st, 2011: Tonnes milled: 116,410, average tpd milled: 954, silver grade (g/t): 150, silver recovery (%): 84.95, silver production (oz): 478,167, gold grade (g/t): 1.43, gold recovery (%): 84.62 and gold production (oz): 4,524

Sales by Metal





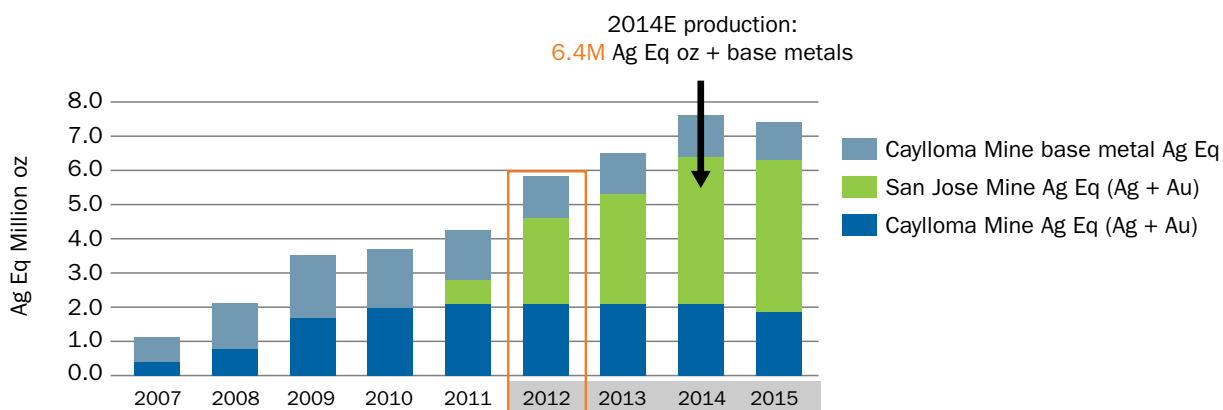
Opening Bell Ceremony at the New York Stock Exchange
January 17, 2012

OUTLOOK FOR 2012

Production Guidance

Mine	Silver (Moz)	Gold (koz)	Zinc (Mlbs)	Lead (Mlbs)
Caylloma, Peru	2.0	2.4	21.0	18.0
San Jose, Mexico	1.7	15.0	-	-
Total	3.7	17.4	21.0	18.0

2012 – 2015 Production Forecast



Ag Eq calculated using Ag = US\$30/oz, Au = US\$1,660/oz, Pb = US\$2,300/t and Zn = US\$2,000/t



Core shack at Caylloma Mine, Peru

HISTORICAL MILESTONES

2005

- Fortuna Silver Mines Inc. is established
- Shares begin trading on the Toronto Venture Exchange under the ticker “FVI”
- Fortuna acquires 100% interest in the Caylloma Mine

2006

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

2007

- Silver and gold resources increase significantly at San Jose project

2008

- Annual silver production increases by 85%
- Shares begin trading on the Bolsa de Valores de Lima under the ticker “FVI”

2009

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

2010

- Fortuna raises more than C\$80 million in two bought-deal financings
 - Common shares upgraded to Toronto Stock Exchange from Toronto Venture Exchange
 - San Jose Mine construction commences
-

MINERAL RESERVES & RESOURCES

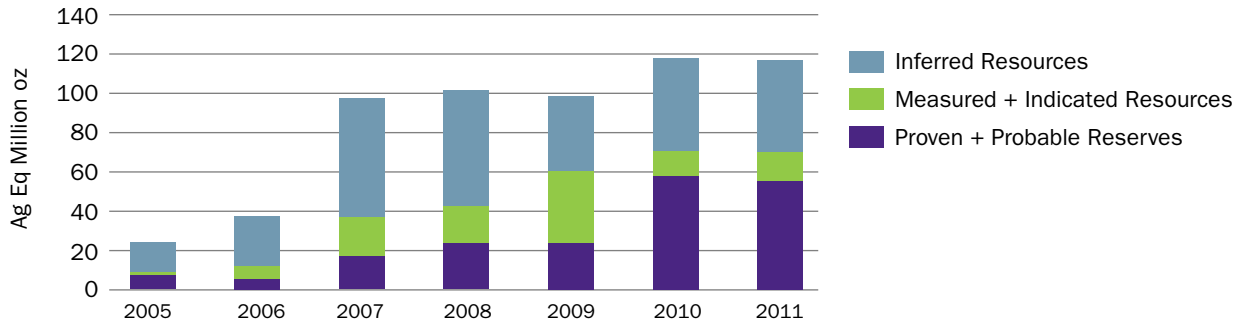
Mineral Reserves – Proven & Probable							Contained Metal	
Property	Classification	Tonnes (000)	Ag (g/t)	Au (g/t)	Pb (%)	Zn (%)	Ag (Moz)	Au (koz)
Caylloma, Peru								
Silver Veins	Proven	26	687	0.28	0.32	0.32	0.6	0.2
	Probable	755	365	0.42	0.06	0.06	8.9	10.3
	Proven + Probable	781	376	0.42	0.07	0.07	9.4	10.5
Polymetallic Veins								
	Proven	1,318	87	0.32	1.59	2.39	3.7	13.5
	Probable	2,543	86	0.31	1.58	2.27	7.1	25.5
	Proven + Probable	3,861	86	0.31	1.59	2.31	10.7	39.0
Combined – All Veins								
	Proven	1,344	98	0.32	1.57	2.35	4.2	13.7
	Probable	3,297	150	0.34	1.23	1.76	15.9	35.8
	Proven + Probable	4,642	135	0.33	1.33	1.93	20.2	49.5
San Jose, Mexico	Probable	3,600	204	1.59	N/A	N/A	23.6	183.7
Total	Proven + Probable	8,241	165	0.88	N/A	N/A	43.8	233.2

Mineral Resources – Measured and Indicated							Contained Metal	
Property	Classification	Tonnes (000)	Ag (g/t)	Au (g/t)	Pb (%)	Zn (%)	Ag (Moz)	Au (koz)
Caylloma, Peru								
	Measured	574	100	0.31	1.17	1.75	1.8	5.8
	Indicated	1,684	131	0.30	0.74	1.11	7.1	16.0
	Measured + Indicated	2,258	123	0.30	0.85	1.28	8.9	21.8
San Jose, Mexico	Indicated	376	243	2.12	N/A	N/A	2.9	25.6
Total	Measured + Indicated	2,634	140	0.56	N/A	N/A	11.9	47.4

Mineral Resources – Inferred							Contained Metal	
Property	Classification	Tonnes (000)	Ag (g/t)	Au (g/t)	Pb (%)	Zn (%)	Ag (Moz)	Au (koz)
Caylloma, Peru	Inferred	3,258	112	0.36	0.99	1.50	11.8	37.9
San Jose, Mexico	Inferred	3,072	223	1.80	N/A	N/A	22.0	178.1
Total	Inferred	6,330	166	1.06	N/A	N/A	33.8	216.0

1. Mineral Reserves and Mineral Resources are as defined by CIM Definition Standards on Mineral Resources and Mineral Reserves
2. Mineral Resources are exclusive of Mineral Reserves
3. Mineral Resources that are not Mineral Reserves do not have demonstrated economic viability
4. Caylloma Mineral Resources and Mineral Reserves are estimated as of June 30, 2011 and reported as of December 31, 2011 taking into account production-related depletion for the period of July 1, 2011 through December 31, 2011
5. Caylloma Mineral Reserves are estimated using break-even cut-off grades based on estimated NSR values using assumed metal prices of US\$26.59/oz Ag, US\$1,279.31/oz Au, US\$2,116/t Pb and US\$2,028/t Zn; historical metallurgical recovery rates of 82% for Ag, 45% for Au, 93% for Pb and 88% for Zn; and historic operating costs adjusted for inflation. Caylloma Mineral Resources are reported based on estimated NSR values using the aforementioned assumed metal prices and metallurgical recovery rates and a cut-off value of US\$30/t
6. Caylloma Mineral Resources include oxide material that is not amenable to processing in the existing flotation plant. Measured and Indicated Oxide Resources are estimated at 1,077,000 tonnes averaging 197 g/t Ag, 0.39 g/t Au, 1.00% Pb and 1.28% Zn. Inferred Oxide Resources are estimated at 544,000 tonnes averaging 143 g/t Ag, 0.27 g/t Au, 0.55% Pb and 0.94% Zn
7. San Jose Mineral Resources are estimated as of December 10, 2009 with Mineral Reserves estimated as of December 31, 2010 and actualized as of December 31, 2011 taking into account production-related depletion from start-up in August 2011 through December 31, 2011
8. San Jose Mineral Reserves are estimated using break-even cut-off grades based on assumed metal prices of US\$15.12/oz Ag and US\$897.51/oz Au, estimated metallurgical recovery rates of 88% for Ag and 90% for Au and projected operating costs. San Jose Mineral Resources are estimated and reported at a Ag Equivalent cutoff grade of 100 g/t, with Ag Eq in g/t = Ag (g/t) + Au (g/t) * ((US\$856.16/US\$13.75) * (91.5/92.5))
9. Totals may not add due to rounding procedures
10. N/A = Not Applicable

Sustainable Mineral Reserve and Resource Growth



Ag Eq calculated using Ag = US\$25.14/oz and Au = US\$1,391.63/oz



Grade control sampling at Caylloma Mine, Peru



Caylloma Mine, Peru

FUELING GROWTH

Fortuna's growth strategy is to focus on expanding its resource base by exploring for high-grade silver mineralization within its core land holdings in Peru and Mexico. To further leverage this growth, the company is selectively pursuing the acquisition of advanced-stage, silver-rich projects in Latin America with potential for low-cost operations.

The objective is to achieve annual production of 14 million silver equivalent ounces by 2016: 7 million ounces from current reserves and mine plans and 7 million from new reserves. To achieve this objective, management has implemented the following strategic initiatives in 2012:

Maximize production, profitability and cash flow

- Initiate expansion of San Jose's mill and mine production capacity to 1,500 tpd
- Focus on operational efficiencies to reduce cash costs
- Convert silver/gold concentrate to dore production at San Jose

Capitalize on brownfields exploration opportunities at San Jose and Caylloma

- Conduct 44,000 meters of exploration drilling
- Generate high-priority silver-gold targets through exploration of extensive land holdings

Pursue M&A opportunities in Latin America

- Evaluate advanced-stage projects with potential for at least 50% of revenue from silver
- Pursue projects with potential for low-cost operations

The objective is to achieve annual production of 14 million silver equivalent ounces by 2016: 7 million ounces from current reserves and mine plans and 7 million from new reserves.



Our consolidated production budget for 2012 is 3.7 million ounces of silver and 17,000 ounces of gold, a 48% increase in silver production and more than double the gold output of 2011.

CHIEF EXECUTIVE OFFICER'S LETTER

To our shareholders, employees and stakeholders,

2011 was a year of transformation marked by several important milestones. In September, we started commercial production on time and on budget at our San Jose Mine in Mexico. San Jose is our second operating mine and fundamental to the continued growth of silver and gold production in the next two years. Also in September, our shares began trading on the New York Stock Exchange, the world's premier securities market. Additionally, Fortuna achieved record sales and silver production.

Creating sustainable value

At the start of 2012, we had capital and exploration budgets of US\$70 million for sustaining our aggressive long-term growth strategy. By mid-2013, I expect Fortuna to achieve an annual production rate of approximately 5.2 million ounces of silver and 27,000 ounces of gold from existing reserves and mine expansion plans. In the meantime, I am optimistic that our search for attractive silver projects in Latin America will enable us to further expand our property portfolio.

The listing of Fortuna's common shares on the New York Stock Exchange on September 19, 2011 and the opening bell ceremony on January 17, 2012 gave us many reasons to celebrate. Those highlights also caused us to pause and reflect on our achievements. As a group — management, directors and employees — we reminisced about the beginnings of Fortuna in 2004, when we came together with the vision of building a leading silver mining company in Latin America. We took this opportunity to renew our commitment to that vision and to our values.

Entering 2012 with ambitious yet realistic plans

Our consolidated production budget for 2012 is 3.7 million ounces of silver and 17,000 ounces of gold, a 48% increase in silver production and more than double the gold output of 2011. The San Jose Mine is scheduled to produce 1.7 million ounces of silver and 15,000 ounces of gold. Caylloma is expected to produce 2 million ounces of silver and 2,000 ounces of gold, plus base metals. Our estimated consolidated cash production cost is approximately US\$6 per ounce of silver, net of by-product credits. This is below the median production cost among silver producers.

The silver mining industry benefited from continued strong silver prices in 2011. Driven by growth in investment and industrial demand, silver prices averaged US\$35 per ounce, a 74% increase over the average price in 2010. At the same time, the industry faced challenges from rising operating costs. Our cash cost at Caylloma increased significantly over the year driven by industry related inflation mainly in wages and mining services which accentuated in Q4 2011. We do not expect significant cost increase in 2012 from our cost reported for Q4 2011. In response to these cost pressures, Fortuna has implemented several initiatives aimed at improving productivity, maintaining strong financial margins and increasing production.

Fortuna has implemented several initiatives aimed at improving productivity, maintaining strong financial margins and increasing production.

At the San Jose Mine, we will increase production capacity from 1,000 tpd to 1,500 tpd and build a silver-gold dore production facility, which will significantly reduce treatment charges related to the sale of gold and silver concentrates. The 2012 capital budget for these projects is US\$25 million. At the Caylloma Mine, we plan to invest US\$30 million in 2012 to improve underground mining efficiency and upgrade energy, plant and camp infrastructure. The projects at both mines will be pivotal in supporting our cost competitiveness and growth.

Generating new growth opportunities

The highlight of our exploration and project-generation activities in 2011 was the signing of an option agreement to acquire a 100% interest in the Mario Property. Located in central Peru, Mario is a post-discovery stage project with good potential for bulk-minable, epithermal gold-and-silver mineralization, as well as high-grade replacement style silver-and-base metal mineralization. Our first-phase drilling program at Mario started in November 2011 and continued into the first quarter of 2012.

At the Caylloma Mine, our exploration programs replaced 670,000 tonnes of reserves consumed through production. More importantly, this work increased reserves of the high-grade silver-rich veins in the central portion of our holdings. We now have a proven and probable reserve base of approximately 20 million ounces of silver, supporting an eight-year mine life.

Our exploration budget overall for 2012 is US\$15 million. This includes plans for drilling approximately 44,000 meters in brownfields and greenfields exploration programs at our projects in Peru and Mexico.

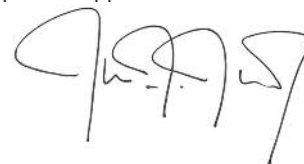
Maintaining our commitment to sustainability

As an organization, we remain committed to the three cornerstones of our values: maintaining the health and safety of our personnel, subscribing to the highest environmental standards and respecting our host communities.

Despite our best efforts to uphold safe work practices, a fatal accident at the Caylloma Mine in February 2012 claimed the life of Mr. Sixto Chambilla Apaza, a driller working for one of our mine contractors. This is the first fatal accident at Fortuna in six years of operations. Following a thorough analysis of the accident, we have adopted all recommendations of the investigation team. We are implementing company-wide measures to ensure that additional safeguards are in place to prevent violations of the safety regulations and procedures that led to this tragic accident.

Our company actively works as a strategic partner in the communities that host our operations. We collaborate with local stakeholders to identify opportunities where we can establish and participate in sustainable community development projects and social responsibility initiatives. During 2011, Fortuna funded US\$1.3 million in various projects. These ranged from genetic improvement of local Alpaca herds near our Caylloma Mine, to road construction and school scholarships in Mexico.

In closing, I commend the extraordinary group of people that make up our team. More than 1,500 employees and contractors located in three countries are working together every day to realize our vision. I also extend my thanks to our Board of Directors for their continued leadership and support.



Jorge A. Ganoza
President and Chief Executive Officer



Our goal is to become an industry leader in the Americas.

CHAIRMAN'S LETTER

To our shareholders and employees,

In 2004, we set out to build a company that would capitalize on the favourable long-term outlook for silver and on Latin America's growing dominance in silver production. Then, as now, our objectives are to create a leading silver producer, to generate rapid growth and to recruit and retain top talent to manage our growth.

I am delighted with how the Fortuna team continues to embrace our objectives and work tirelessly to meet them. We have made tremendous progress from our small beginnings as a junior resource company. Today, our growth potential is the strongest it has ever been, given the steadily increasing value and potential of our core assets. Since the formation of our company, we have always emphasized building sustainable value. Our goal is to become an industry leader in the Americas by maintaining a commitment to growth and to the well-being of our workers, neighbouring communities and the environment. Our success, however, won't be determined solely by the volume and value of the metals that we mine. Rather, it will also be measured by the economic, social and environmental sustainability of our operations. And in that respect, we have much to be proud of.

I believe that our approach to creating sustainable value was key to the fast-track development of our San Jose Mine. The Fortuna team quickly and efficiently advanced San Jose from acquisition and initial sampling to commercial production in just five years. This remarkable achievement adds considerable value to the reputation of our company. Similarly, the recent listing of our common shares on the New York Stock Exchange benefits both our company and our shareholders, providing additional liquidity to investors and access to capital to support Fortuna's growth plans.

Fortuna has evolved and grown rapidly in recent years, yet its strategy of focussing on silver projects in Latin America remains relevant. We believe that Latin America offers a rich hunting ground for new projects. The region hosts the top two silver producing countries in the world, Mexico and Peru, and boasts a safe, mining-friendly culture in most countries. Additionally, the outlook for silver demand remains bright. Industrial demand is forecast to grow by 36% from 2010 through 2015, according to the Silver Institute. Demand is expected to remain positive primarily because of the lack of substitution and the wide range of established and ever-growing new uses of silver that are vital to industry.

As always, it is my pleasure to thank the entire Fortuna family for their exceptional dedication, enthusiasm and teamwork. Like every mining company, we face challenges and opportunities day in and day out. Fortuna, however, has the credibility, industry expertise and solid financial growth to remain on track to achieving its long-term objectives. On behalf of my fellow directors, I also thank our shareholders for your continued loyalty and support.

A handwritten signature in black ink, appearing to read 'Simon Ridgway'. The signature is fluid and cursive, with a long horizontal stroke at the end.

Simon Ridgway
Chairman of the Board

SENIOR MANAGEMENT

Jorge A. Ganoza,
Geological Engineer

President, CEO and
Director



Jorge A. Ganoza is a geological engineer with over 16 years of experience in exploration, mining and business development throughout Latin America. A graduate of the New Mexico Institute of Mining in 1994, Jorge is a fourth generation miner from a Peruvian family that has owned and operated underground mines in Peru and Panama. Jorge also serves as a Chairman of the Board of Atico Mining Corporation, a TSX.V listed company.

Thomas I. Vehrs, Ph.D.

Vice President of
Exploration



Over the past 35 years, Dr. Thomas Vehrs has enjoyed a successful career in mineral exploration and mine development. During this time, he consulted to and held senior positions with several major mining companies and was a founder and acted as President and COO of Aquest Minerals Corp. Tom has worked extensively in Latin America developing and managing exploration programs with an emphasis on epithermal and porphyry-related mineralized systems. Tom also serves as an independent director of AQM Copper Inc.

Luis Dario Ganoza,
B. Sc. Engineering,
MBA, M. Sc.

Chief Financial
Officer



Luis D. Ganoza has 12 years of experience in the operation and financial management of mining companies. He has served as CFO of Fortuna Silver since 2006 and previously held the positions of Controller and Treasurer for a public mining company in Peru. Luis has a B.Sc. in mining engineering from the Universidad Nacional de Ingenieria in Peru, and an M.Sc. in accounting and finance from the London School of Economics. Luis also serves as a director of Atico Mining Corporation, a TSX.V listed company.

Manuel Ruiz-Conejo,
B. Sc. Engineering

Vice President of
Operations



A mining engineer with more than 25 years of experience, Manuel Ruiz-Conejo has worked for the most prolific polymetallic mines and mine contractors in Peru. As an engineer, he has participated in the execution of critical projects. As an executive, he has developed and supervised the implementation of several multimillion-dollar mining projects and numerous community relations initiatives. Manuel graduated from the Universidad Nacional de Ingenieria and from the Executive Management Program at the Universidad de Piura in Peru.

Cesar Pera

Vice President of
Human and
Organizational
Development



Cesar Pera is an organizational psychologist with a master's degree in organizational psychology from the University of Madrid. Cesar has over 25 years of experience in organizational development and change with Latin American companies. He served as President of the Peruvian Association of Human Resources and as Vice President of the Interamerican Federation of Human Management for the Andean region. Cesar serves as director of the Master's Degree Program in Organizational Development and People Management at the Universidad del Pacifico in Peru.

DIRECTORS

Simon RidgwayChairman
of the Board

Simon Ridgway is a prospector, a mining financier and a Casey Research Explorers' League inductee. Grassroots exploration is Simon's first love, and he has had a successful career as an explorationist since starting out in the Yukon Territory in the late 70s. Simon and the exploration teams under his guidance have discovered gold deposits in Honduras, Guatemala and Nicaragua. On the financial side, Mr. Ridgway has raised more than CAD\$350 million for exploration and development projects since 2003.

**Robert R. Gilmore,
CPA**

Robert Gilmore graduated from the University of Denver with a bachelor of science degree in business administration, accounting. Robert is a Certified Public Accountant and a member of the Colorado Society of Certified Public Accountants and the American Institute of CPAs. He has more than 30 years of experience working with resource companies and currently serves as Chairman of the Board for Eldorado Gold Corporation and as a director for Layne Christensen Company, a NASDAQ-listed US company with nearly US\$1 billion in revenues.

**Tomas Guerrero,
Geological Engineer**

Tomas Guerrero is a geological engineer with over 30 years of mine geology and mineral exploration experience in Latin America. Until 2001, Tomas served for ten years as Director of Explorations for the Hochschild Group, a leading public Peruvian mining company. Under his leadership, Hochschild discovered and put in production three mid-size gold-silver mines. He is currently the principle of BO Consulting, an engineering consulting firm serving the mining sector.

Michael Iverson

Michael Iverson has served as President and a director of Triple K Ventures Ltd. since 1975 and as President and a director of R.P.F. Custom Wood Fibre Ltd. since 1985. In 1997, Michael joined Sasha Ventures Ltd., a public company, as President and a director. In addition, Michael was Chief Executive Officer of Fortuna from 1998 to 2005, and has served as Secretary and a director of Niogold Mining Corp. since 1998.

Mario Szotlender

Mario Szotlender holds a degree in international relations and is fluent in several languages. He has directed Latin American affairs for numerous companies over the past 20 years, specializing in developing business opportunities and establishing relations within the investment community. He has been involved in various mineral exploration and development joint ventures and operations in Central and South America. Mario has served as President of Mena Resources Inc. and Rusoro Mining Ltd., and is currently a director of Radius Gold Inc. and Endeavour Silver Corp.

Thomas Kelly

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



Scholarship program for San Jose del Progreso community

SOCIAL RESPONSIBILITY

At Fortuna, we have implemented a series of projects aimed at improving health, education and infrastructure in the communities near our operations.

At San Jose, we signed an agreement in 2011 with the Municipality of San Jose del Progreso to implement several projects for improving the well-being of residents and the local infrastructure. The main projects include construction of a health post, sports court and daycare centre.

We also developed several programs in collaboration with the community aimed at improving education, health and culture. These include providing scholarships for primary and secondary school and college students, and home improvements such as upgrades to kitchens and construction of ecological bathrooms.

At Caylloma, an agreement signed in 2010 with the Municipality of Caylloma opened the door to local development projects that train community members to work in our mine and provide educational support.

Other initiatives include genetic enhancements of local alpaca herds to improve the quality of their wool and overall health, and support of the community's activities to develop a self-sustaining local economy. We are also helping local artisanal weavers improve weaving techniques, granting scholarships, funding summer-school programs and working to improve nutrition and health in the communities.



Program to improve kitchens at San Jose del Progreso community



San Jose del Progreso medical post



Alpaca herd genetic improvement program at Caylloma

Forging Strategic Partnerships

- Programs are based on respect for ethno-cultural diversity, open communication and effective interaction with all stakeholders.
- We work with communities towards self-development of economically sustainable activities to improve their quality of life.



Teaching children about caring for the environment at Caylloma

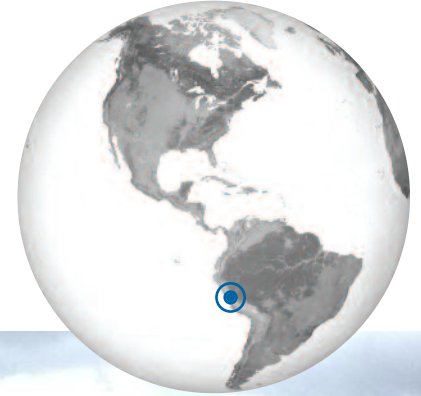


Pasture improvement program at Caylloma

CAYLLOMA MINE, PERU



- COMMODITIES:** Silver, gold, lead and zinc
OWNERSHIP: 100%
LAND PACKAGE: 11,000 hectares
LOCATION: Arequipa, Peru
(Latitude 15° 13" S, Longitude 71° 49" W)
DEPOSIT TYPE: Intermediate-sulphidation epithermal deposit
STATUS: Mill and underground mine operating at over 1,250 tpd
Exploration underway for veins with potential for high-grade silver mineralization



CAYLLOMA MINE



4,500 meters above sea level



1,300 tpd processing plant

2011 Results

Silver production reached 2 million ounces in 2011 and has exceeded forecasts every year since the mine and mill were upgraded in 2006.

In 2011, the cash cost per ounce of silver, net of by-product credits, was negative US\$0.59, compared to negative US\$5.99 in 2010. Cash costs were driven higher by inflationary pressure on labour costs and a decrease in by-product credits during the second half of the year. The decrease in by-product credits was due primarily to lower base metal prices (lead down 24%, zinc down 21%) and lower lead production, which declined by 13% from the previous year.

Exploration

Our exploration in 2011 led to the discovery of high-grade silver ore shoots in the Bateas vein and confirmed the exploration and discovery potential of this prolific mining district, which has been in semi-continuous production since the arrival of the Spaniards in the early 16th century.

Outlook

For 2012, the mine is scheduled to produce 2 million ounces of silver and 2,400 ounces of gold plus lead and zinc by-products. Our capital spending budget for the year is US\$25 million and includes a new tailings facility with total holding capacity for 17 years and improvements to the power grid, plant equipment, camp and other infrastructure.

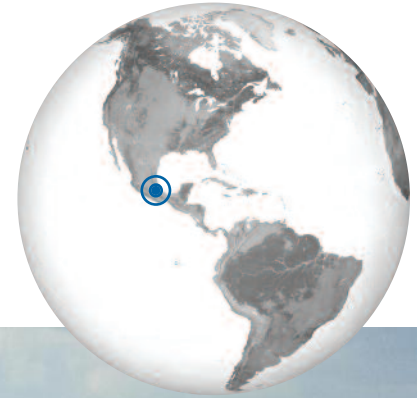
Fortuna will also continue to scope production expansion of the mine in 2012. In 2011, the company received approval for an Environmental Impact Study to increase production capacity up to 2,250 tpd. An updated reserve and resource estimate has been completed and will be used to evaluate the next phase of mine expansion.

The company's exploration plans for 2012 include 24,000 meters of diamond drilling and 3,500 meters of underground drifting. This work will focus on high-grade silver targets, including extensions of bonanza-style mineralization in the following areas:

- **Bateas vein:** Drilling will test the projected intersection with the San Cristobal vein that, along with the Bateas vein, has been a prominent producer throughout the mine's history.
- **Animas vein:** Drilling will target ore-grade intersections from earlier exploration programs of the Nancy structure, a subsidiary structure to the Animas vein.



- COMMODITIES:** Silver and gold
- OWNERSHIP:** 100%
- LAND PACKAGE:** 58,000 hectares
- LOCATION:** Taviche Mining District, Oaxaca, Mexico
(Latitude 16° 41" N, Longitude 96° 42" W)
- DEPOSIT TYPE:** High-grade, low-sulphidation, epithermal vein deposit
- STATUS:** Mill and underground mine operating at 1,000 tpd
Expansion to 1,500 tpd design capacity initiated in 2012
Exploration for high-grade silver veins underway



SAN JOSE MINE



1,600 meters above sea level



Ocotlan Grey Water Treatment Plant –
source of 20% of San Jose's water balance

2011 Results

In July 2011, the company completed construction and commissioning of the San Jose Mine on time and on budget. Commercial production commenced on September 1, 2011 at a rate of 1,000 tpd. San Jose's total metal production for 2011 was 490,555 ounces of silver and 4,622 ounces of gold at a cash cost of US\$4.51 per silver equivalent ounce, net of by-product credits.⁽¹⁾

Exploration

The San Jose land package holds potential for discovery of new gold-and-silver-bearing deposits within the 58,000 hectare concession area located in the general vicinity of the existing mill at San Jose.

In 2012, the company's program will focus on the continued exploration and evaluation of the southern extension of the Bonanza and Trinidad veins at the San Jose Mine as well as exploration of other targets within the district. Targets in evaluation and under consideration for drill testing include vein systems outcropping in the Tlacolula concession and the La Altona vein system in the Taviche District area. Early stage exploration activities will also be carried out in a number of locations within the concession area where previous work has identified significant gold and silver geochemical anomalies.

Outlook

For 2012, Fortuna expects the San Jose Mine to produce 1.7 million ounces of silver and 15,000 ounces of gold. The company has initiated construction activities to expand mine and mill capacity to 1,500 tpd. Once completed, San Jose is expected to produce at a rate of approximately 3.2 million ounces of silver, 25,000 ounces of gold, or 4.6 million silver equivalent ounces per year. The capital budget for the expansion project is US\$30.7 million.

¹ Total production for 2011, includes pre-commissioning production. Commercial production as of September 1st, 2011: Tonnes milled: 116,410, average tpd milled: 954, silver grade (g/t): 150, silver recovery (%): 84.95, silver production (oz): 478,167, gold grade (g/t): 1.43, gold recovery (%): 84.62 and gold production (oz): 4,524.

MARIO PROPERTY, PERU



- COMMODITIES:** Silver, gold, lead and zinc
- OWNERSHIP:** Option to earn 100% interest
- LAND PACKAGE:** 4,900 hectares
- LOCATION:** Junin, central Peru
- MINERALIZATION:** Massive sulphide replacement bodies, veins, mantos, hydrothermal breccias, disseminations and skarn-type bodies
- STATUS:** Exploration stage

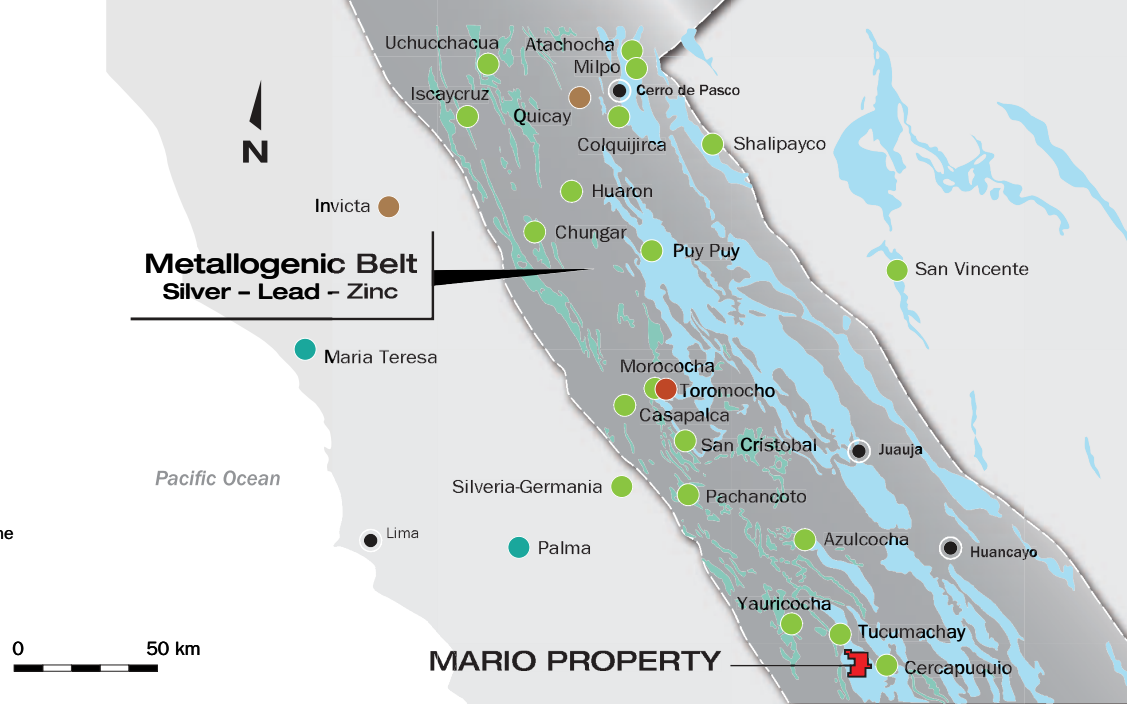


MARIO PROPERTY



LEGEND

- Ag-Pb-Zn mine
- Au-Ag mine
- Cu-Porphyry mine
- Cu-Pb-Zn mine
- City
- Jumasha Limestone
- Pucara Limestone



Overview

Located in the Central Peru silver-lead-zinc metallogenetic belt, the Mario Project represents a potential growth opportunity for the company. Through option agreements signed with Crocodile Gold Corp. in May of 2011 and with Consorcio Empresarial Agmin S.A.C. in July of 2011, Fortuna acquired an option to earn a 100% interest in combined 4,900 hectare property.

Prior exploration of the property by Teck-Cominco Peru SA (1998-2000), Sulliden Exploration Inc. (2000-2003) and Franc-Or Resources Corporation (2006-2008), identified significant ore-grade intercepts of silver-gold-lead-zinc mineralization associated with a late Tertiary diatreme breccia and intrusive dome complex. The combined program of Teck-Cominco, Sulliden and Franc-Or included project-scale mapping and sampling, geophysical surveys and approximately 14,000 meters of diamond drilling.

Exploration and outlook

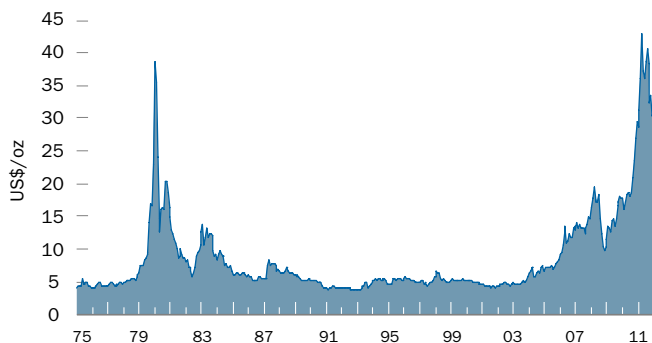
In 2011, Fortuna completed detailed geologic mapping, geochemical sampling and detailed geophysical surveys in the Mario Project area. A 7,000 meter first phase drill program was initiated in November of 2011 and is projected for completion in April of 2012. The drill program will focus on the exploration and evaluation of disseminated gold-silver mineralization in the diatreme breccia as well as the testing of high-grade silver-lead-zinc replacement style deposits in limestone units in contact with the diatreme breccia.



Drilling at Mario Property

Silver Price

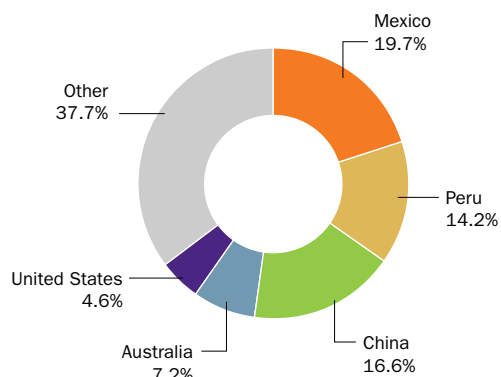
Monthly Average Comex Through April 16, 2012



Source: CPM Group

2011 Silver Production by Country

774.9 million ounces



Source: CPM Group

SILVER ANALYSIS

Average price hits new high

Silver prices averaged US\$35.29 in 2011, up 73.8% from 2010 and a record nominal high, surpassing the annual average price of US\$20.65 in 1980. In 2011 dollar terms, the average price of silver in 1980 was US\$65.14.

Silver prices continued to surge in the first few months of 2011, driven by momentum buying throughout the period. Prices dropped after peaking in April and trended lower for the remainder of the year.

Silver demand, primarily from fabrication of consumer electronics and solar panels, helped boost demand overall as the global economy continued to expand.

Higher mine output boosts supply

Total silver supply rose to 995.1 million ounces, up 2.3% from 2010. Mine production accounted for the majority of the increase, rising 27.8 million ounces from 2010 levels.

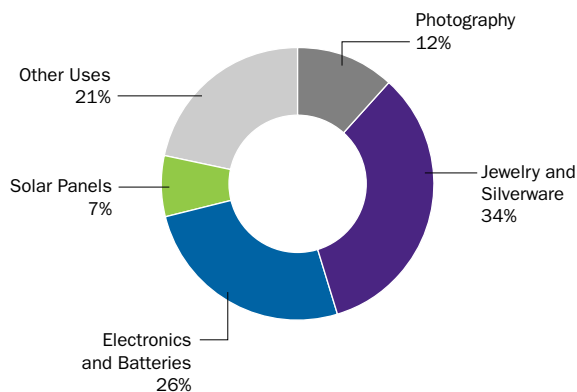
Mexico was the world's largest producer silver in 2011. Mine output was a record 152.8 million ounces, up 18.8% from 128.6 million ounces in 2010.

Peruvian silver output fell to 109.8 million ounces in 2011, from 116.9 million ounces in 2010. Much of the decline can be attributed to lower silver production at the largest silver producing mines in the country.

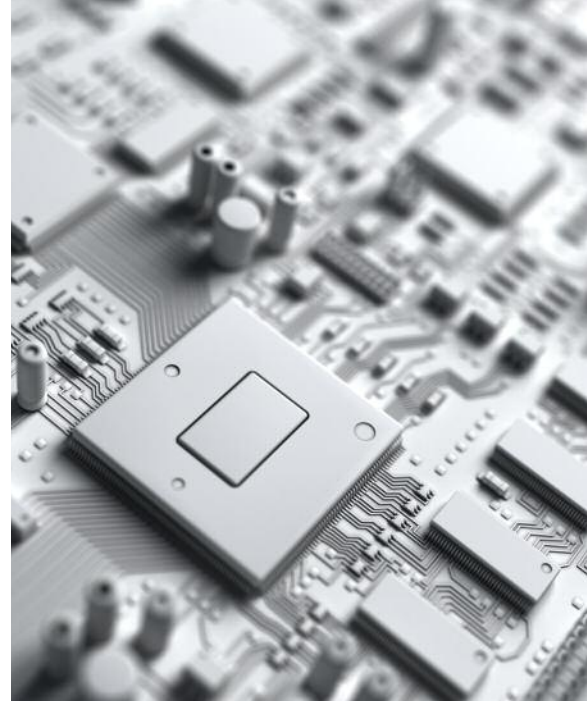
Secondary supply of silver fell 1.2% year-over-year, totalling 277.1 million ounces in 2011. Secondary supply growth was curbed by a sharp drop in Indian scrap supplies, which fell to 4.8 million ounces, down two-thirds from 2010 levels.

2011 Total Fabrication Demand for Silver

861.9 million ounces



Source: CPM Group



Mobile devices containing silver boosted demand

Economic expansion drives fabrication demand

Fabrication demand for silver rose to 861.9 million ounces in 2011, a 2.2% increase from 843.5 million ounces in 2010. Fabrication demand increased as the global economy continued to expand, while demand from the photography sector again declined, as digital cameras commanded an ever larger market share.

Silver used in consumer electronics rose, as healthy demand for mobile devices containing silver helped boost demand for the metal. Demand from the solar panel industry rose at a slower pace in 2011, up 23.1% to an estimated 59.8 million ounces, compared with nearly 100% growth in 2010.

Higher prices slow investment demand

Silver investment demand waned in 2011, which weighed heavily on prices after April. Some investors began exiting the silver market at this time, booking profits. Weaker economic growth in the second half of the year further contributed to investor disinterest in silver.

Combined silver exchange traded product (ETP) holdings stood at 565.4 million ounces at the end of 2011. This was down 4.5% from 591.8 million ounces at the end of 2010, and the first annual decrease in holdings since the silver ETP was introduced in 2000. However, sales of US Mint Silver Eagle coins reached a record 39.9 million ounces in 2011, up 15.0% from a year ago.

Outlook

In 2012, fabrication demand for silver is forecast to rise further, but at a slower pace than in recent years. Healthy consumer and industrial demand is expected to continue, boosting industrial silver consumption, including that used in solar panels. Silver coin sales, however, may decline in 2012 from 2011 levels.

Source: CPM Group

FINANCIAL REVIEW

MANAGEMENT'S DISCUSSION & ANALYSIS

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MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED DECEMBER 31, 2011

As at March 23, 2012

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

Management's Discussion and Analysis ("MD&A") is intended to help the reader understand the significant factors that have affected Fortuna Silver Mines Inc. and its subsidiaries' ("Fortuna" or the "Company") performance and such factors that may affect its future performance. For a comprehensive understanding of Fortuna's financial condition and financial performance, this MD&A should be read in conjunction with the Company's audited consolidated financial statements for year ended December 31, 2011 and the related notes contained therein. The Company reports its financial position, financial performance and cash flows in accordance with the International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). This MD&A refers to various non-GAAP financial measures, such as cash cost per tonne of processed ore, cash cost per ounce of payable silver, adjusted net income (loss), cash generated by operating activities before changes in working capital, income taxes, and interest income, used by the Company to manage and evaluate operating performance and ability to generate cash and are widely reported in the silver mining industry as benchmarks for performance, but do not have a standardized meaning and may differ from methods used by other companies with similar descriptions. The Company believes that certain investors use these non-GAAP financial measures to evaluate the Company's performance. Accordingly, non-GAAP financial measures should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS. To facilitate a better understanding of these measures as calculated by the Company, we have provided detailed descriptions and reconciliations as required.

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

BUSINESS OF THE COMPANY

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

Fortuna is a publicly traded company incorporated and domiciled in Canada and is listed on the New York Stock Exchange under the trading ticker symbol "FSM", and on the Toronto Stock Exchange and Lima Stock Exchange under the trading ticker symbol "FVI".

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

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

RECENT DEVELOPMENTS AND 2011 HIGHLIGHTS

FATAL ACCIDENT REPORT

It is with great sorrow the Company informs that on February 26, 2012 a fatal accident claimed the life of a driller and injured a supervisor, both working for the Company's mine contractor operating the Animas vein on Level 12 of the Caylloma mine. All mine operations were stopped immediately. The supervisor is in stable condition and recovering in a hospital in Arequipa. Mine operations resumed on February 28, 2012. Fortuna's senior operations management team traveled to the mine site the same day of the accident and a corporate investigation of this tragic accident was launched. Findings indicate the crew of contractors suffered a premature detonation on a round of rib and ditch blast. Levels of responsibility and breaches of safety regulations and procedures that led to the accident were identified as a result of the investigation. Under the recommendations of the investigation report, Fortuna is implementing companywide measures to ensure additional safeguards are in place against violations of safety regulations and procedures.

This is the first tragic accident in the history of Fortuna's operations. The Company has a culture of zero tolerance for insecure acts and conditions and is acting accordingly.

FINANCIAL AND OPERATING RESULTS

During the quarter ended December 31, 2011, the Company generated a net loss of \$1.76 million (Q4 2010: income \$4.33 million) on operating income of \$4.44 million (Q4 2010: \$8.03 million) and sales of \$31.05 million (Q4 2010: \$23.91 million).

During the year ended December 31, 2011, the Company generated a net income of \$19.53 million (2010: income \$16.00 million) on operating income of \$38.07 million (2010: \$27.73 million) and sales of \$110.00 million (2010: \$74.06 million).

Silver ounces produced during the quarter ended December 31, 2011 were 913,803 (Q4 2010: 481,802) ounces, 90% above the prior year. Gold ounces produced during the quarter ended December 31, 2011 were 4,153 (Q4 2010: 1,822) ounces, 128% above the prior year.

Silver ounces produced during the year ended December 31, 2011 were 2,486,655 (2010: 1,906,423) ounces, 30% above the prior year. Gold ounces produced during the year ended December 31, 2011 were 6,843 (2010: 2,556) ounces, 168% above the prior year.

During the quarter ended December 31, 2011 silver comprised 68% (Q4 2010: 55%) of revenue and the realized silver price was \$27.64 (Q4 2010: \$23.73) per ounce. San Jose contributed to our consolidated revenue stream for the full quarter after commencing operations in September 2011. As at the end of 2011, San Jose had accumulated approximately \$4.4 million worth of silver-gold concentrate inventory based on average prices for the quarter. Consolidated cash cost per ounce, for the quarter, net of by-product credits, was \$5.11 (Q4 2010: negative \$6.31). Refer to cash cost per silver ounce and cash cost per tonne (non-GAAP financial measures) for reconciliation of cash cost to the cost of sales.

During the year ended December 31, 2011 silver comprised 65% (2010: 49%) of revenue and the realized silver price was \$31.11 (2010: \$18.18) per ounce. Consolidated cash cost per ounce, for the year, net of by-product credits, was \$0.37 (2010: negative \$5.99). Refer to cash cost per silver ounce and cash cost per tonne (non-GAAP financial measures) for reconciliation of cash cost to the cost of sales.

Cash generated by operating activities before changes in working capital, income taxes, and interest income for the year ended December 31, 2011 totalled \$53.35 million, up from \$31.34 million in 2010.

Commercial production at the San Jose silver and gold mine was delivered on September 1, 2011 on-time and on-budget after fifteen months of construction and commissioning. The mine and mill are operating within design parameters at a rate of 1,000 tpd with a planned investment in infrastructure, in 2012 and 2013, to expand to 1,500 tpd by Q3 2013. Cash cost per Ag oz, net of by-product credits, for 2011 was \$4.51.

CORPORATE HIGHLIGHTS

On April 19, 2011 the Company announced changes to the Board of Directors with the appointment of Mr. Thomas Kelly and the resignation of Mr. Jeffrey Franzen.

On May 26, 2011 Mr. Jorge Ganoza Aicardi resigned as Vice-President, Operations. Effective August 1, 2011 Mr. Manuel Ruiz-Conejo, previously Vice-President, Project Development was appointed to the position.

The Company's common shares began trading on the New York Stock Exchange ("NYSE") at the opening of trading on Monday, September 19, 2011 (refer to Sedar.com for releases dated August 29, 2011 and September 15, 2011).

Effective at the market open on December 19, 2011, the Company was added to the S&P/TSX Composite.

RESULTS OF OPERATIONS

CONSOLIDATED METAL PRODUCTION

Consolidated Metal Production	QUARTERLY RESULTS Three months ended December 31,		YEAR TO DATE RESULTS Years ended December 31,	
	2011	2010	2011	2010
Silver (Oz)*	913,803	481,802	2,486,655	1,906,423
Gold (Oz)*	4,153	1,822	6,843	2,556
Lead (000's lb)	4,396	5,338	19,678	21,373
Zinc (000's lb)	5,688	6,158	23,425	26,137
Copper (000's lb)	0	987	36	4,596

* Caylloma: Silver in lead and copper concentrates; San Jose: Silver in silver and gold concentrates.

The Company's silver production in Q4 of 2011 was 90% higher than Q4 2010 as a result of higher silver production from Caylloma of 11% and the contribution from San Jose for its first full quarter under commercial operations.

The Company's silver production in 2011 was 30% higher than in 2010 as a result of higher silver production from Caylloma of 5% and the contribution from San Jose for the second half of the year.

CONSOLIDATED PRODUCTION HIGHLIGHTS FOR Q4 2011:

- Silver production of 913,803 ounces; 90% increase over Q4 2010;
- Gold production of 4,153 ounces; 128% increase over Q4 2010;
- Lead production of 4,396 (000's) pounds; 18% decrease over Q4 2010, and,
- Zinc production of 5,688 (000's) pounds; 8% decrease over Q4 2010.

CONSOLIDATED PRODUCTION HIGHLIGHTS FOR 2011:

- Silver production of 2.49 million ounces; 30% increase over 2010;
- Gold production of 6,843 ounces; 168% increase over 2010;
- Lead production of 19,678 (000's) pounds; 8% decrease over 2010, and,
- Zinc production of 23,425 (000's) pounds; 10% decrease over 2010.

MANAGEMENT'S DISCUSSION AND ANALYSIS
CAYLLOMA MINE PRODUCTION

Mine Production	QUARTERLY RESULTS		YEAR TO DATE RESULTS	
	Three months ended December 31,		Years ended December 31,	
	2011	2010	2011	2010
Silver*				
Grade (g/t)	177.42	159.51	170.91	159.24
Recovery %*	80.82	83.69	81.43	85.67
Production (Oz)*	536,426	481,802	2,008,488	1,906,423
Gold				
Grade (g/t)	0.35	0.40	0.36	0.40
Recovery %*	44.97	51.00	45.71	46.28
Production (Oz)*	591	734	2,393	2,556
Lead				
Grade (%)	1.85	2.37	2.15	2.44
Recovery %	92.39	90.93	92.68	91.28
Production (000's lb)	4,396	5,338	19,678	21,373
Zinc				
Grade (%)	2.47	2.87	2.68	3.10
Recovery %	89.73	86.77	88.46	87.99
Production (000's lb)	5,688	6,158	23,425	26,137
Copper				
Production (000's lb)	0	987	36	4,596
Unit Costs				
Production cash cost (US\$/oz ag)**	6.67	(6.31)	(0.59)	(5.99)
Production cash cost (US\$/tonne)	79.68	64.55	68.98	58.43
Unit Net Smelter Return (US\$/tonne)	188.42	185.96	217.70	163.59

* Caylloma: Silver in lead and copper concentrates.

** Net of by-product credits.

SUMMARY OF Q4 2011 CAYLLOMA MINE PRODUCTION RESULTS:

- Silver production of 536,426 ounces; 11% increase over Q4 2010;
- Gold production of 591 ounces; 68% decrease over Q4 2010;
- Lead production of 4,396 ('000's) pounds; 18% decrease over Q4 2010;
- Zinc production of 5,688 ('000's) pounds, 8% decrease over Q4 2010; and,
- Cash cost per silver ounce, net of by-product credits, \$6.67 (refer to cash cost per silver ounce and cash cost per tonne (non-GAAP financial measures) for reconciliation of cash cost to the cost of sales).

SUMMARY OF 2011 CAYLLOMA MINE PRODUCTION RESULTS:

- Silver production of 2,008,488 ounces; 5% increase over 2010;
- Gold production of 2,319 ounces; 9% decrease over 2010;
- Lead production of 19,678 ('000's) pounds; 8% decrease over 2010;
- Zinc production of 23,425 ('000's) pounds; 10% decrease over 2010; and,
- Cash cost per silver ounce, net of by-product credits, negative \$0.59 (refer to cash cost per silver ounce and cash cost per tonne (non-GAAP financial measures) for reconciliation of cash cost to the cost of sales).

MANAGEMENT'S DISCUSSION AND ANALYSIS

DISCUSSION ON CAYLLOMA MINE OPERATIONS

Silver production at Caylloma for the year was 2,008,488 ounces with mill feed being sourced mainly from the Animas (88%), Bateas (6%), and Soledad (5%) veins. The increase in silver production for the year compared to the same period last year was achieved through higher throughput and head grades in spite of a decrease in metallurgical recovery rates of 5%. Higher grades are a result of an increase in mill feed contribution from the high silver grade ore shoot on level 6 in Animas vein and bonanza ore from Bateas vein. The reduction in metallurgical recoveries is a result of mixed sulfide-oxide material on level 6 of the Animas vein.

In January 2011, production of copper-silver concentrate was discontinued at Caylloma due to a material deterioration in treatment and refining smelter charges with respect to 2010. The Company is monitoring market conditions to evaluate restarting the circuit. Copper accounted for 0.18% of sales in 2011 (2010: 3.68%).

The new high-grade silver ore shoots that were discovered through the extension of exploration and development drifts from current production areas on the 10th and 12th levels of the Bateas Vein (refer to press release dated April 14, 2011) entered into production in late June. Exploration drifting towards the northeast area of the Bateas Vein was stopped by the end of September 2011 in order to improve ventilation and infrastructure for auxiliary services in levels 10 and 12. By mid December 2011, a ventilation shaft from surface to level 12 was completed, and two more shafts between levels 10 and 12 should be completed by the end of March 2012 to resume exploration drifting.

In June 2011, the Company received the approval of the environmental impact study for the construction of a plant expansion to 1,500 tpd encompassing a new tailings facility. The construction of the tailings dam for the first two years of operation concluded in late 2011. The tailings pipeline and pumping system is scheduled for completion in June 2012. Total design capacity of the tailings facility including future expansions is for 9 years of operation at the current mill throughput rate.

In May 2011, the Company submitted to the Ministry of Energy and Mines ("MEM"), in Peru, the application for construction permit of the tailings facility. Approval of this permit has not been received as of March 23, 2012. All technical and surface rights observations made by MEM in November 2011 have been addressed and the Company is awaiting final resolution. Although the Company is working closely with MEM and expects to receive the permits on time, the delay in obtaining this permit represents a risk for the commissioning of the new tailings facility in June 2012 which could lead to a subsequent temporary stoppage of operations.

Cash cost per payable ounce of silver, for the year ended December 31, 2011, was negative \$0.59 net of by-product credits compared to negative \$5.99 in 2010. This increment was driven by a cash cost increase and lower base metal credits in the second half of 2011, with special emphasis in the fourth quarter. Cash cost per oz throughout 2011 went from negative \$5.82 in Q1 2011 to \$6.67 in Q4 2011. The sharp increment throughout the year is explained by a decrease in by-product credits of \$9.40/oz and a 29% unit cash cost per tonne increase. The decrease in by-product credits was primarily due to lower base metal prices (lead 24%, zinc 21%) and lower lead production (13%). The unit cost increments reflect cost increases in qualified labor and industry related services that have been mounting in the Peruvian underground mining industry since late 2010. For 2012, the Company anticipates cost pressures to continue; several productivity and cost control initiatives are included in the 2012 operational and capital budgets.

Capital expenditures for the year ended December 31, 2011 amounted to \$17.1 million. The main components were the first phase of the new tailings facility (\$7.8 million), mine development (\$3.7 million), and camp infrastructure and ancillary facilities (\$1.7 million).

Capital expenditures budgeted for the year 2012 amount to \$25.1 million which includes the second phase of the new tailings facility (\$4.8 million), upgrading of the processing plant (\$8.2 million), mine camp improvements (\$4.8 million), and mine development (\$4.5 million).

A total of 10,551 meters were drilled in Caylloma in 2011 with close to 50% of the program allocated to Animas vein and the other 50% distributed among high grade silver targets at La Plata, San Cristobal, and Bateas veins. A total of 3,642 meters of exploration drifting were done with 50% allocated to Bateas and San Cristobal veins, and 40% allocated to Animas vein.

The brownfields exploration budget for 2012, amounts to \$7.2 million including 3,552 meters of drifting and 16,000 meters of drilling.

Cash cost is a non-GAAP financial measure, refer to cash cost per silver ounce and cash cost per tonne (non-GAAP financial measures) for reconciliation of cash cost to the cost of sales.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SAN JOSE MINE PRODUCTION***

Mine Production	QUARTERLY RESULTS		YEAR TO DATE RESULTS	
	Three months ended December 31,		Years ended December 31,	
	2011	2010	2011	2010
Tonnes milled	87,884	0	116,410	0
Average tons milled per day	955	0	954	0
Silver*				
Grade (g/t)	159.00	0.00	150.40	0.00
Recovery %*	84.00	0.00	84.95	0.00
Production (Oz)*	377,377	0	478,167	0
Gold				
Grade (g/t)	1.48	0.00	1.43	0.00
Recovery %*	84.90	0.00	84.62	0.00
Production (Oz)*	3,562	0	4,524	0
Unit Costs				
Production cash cost (US\$/oz ag)**	2.85	na	4.51	na
Production cash cost (US\$/tonne)	47.16	na	50.73	na
Unit Net Smelter Return (US\$/tonne)	147.31	0.00	147.33	0.00

* San Jose: Silver in silver gold concentrates.

** Net of by-product credits.

*** From commercial production, which commenced on September 1, 2011.

SUMMARY OF Q4 2011 SAN JOSE MINE PRODUCTION RESULTS:

- Silver production of 377,377 ounces;
- Gold production of 3,562 ounces; and,
- Cash cost per silver ounce, net of by-product credits, \$2.85 (refer to cash cost per silver ounce and cash cost per tonne (non-GAAP financial measures) for reconciliation of cash cost to the cost of sales).

SUMMARY OF 2011 SAN JOSE MINE PRODUCTION RESULTS:

- Silver production of 478,167 ounces;
- Gold production of 4,524 ounces; and,
- Cash cost per silver ounce, net of by-product credits, \$4.51 (refer to cash cost per silver ounce and cash cost per tonne (non-GAAP financial measures) for reconciliation of cash cost to the cost of sales).

DISCUSSION ON SAN JOSE MINE OPERATIONS

Production at the San Jose silver and gold mine commenced on September 1, 2011 on-time and on-budget after fifteen months of construction and commissioning. The mine and mill are operating within design parameters at a rate of 1,000 tpd with a planned investment in infrastructure, in 2012 and 2013, to expand to 1,500 tpd by Q3 2013. Cash cost per tonne of processed ore was \$50.73.

Mine production is currently taking place above level 1,400 on blocks K, L, and M with production targets being met according to plan. Production in level 1,300 is scheduled to commence during the second quarter of 2012, 3 months ahead of the original mine plan. As of the end of the second week of March 2012, the main ramp reached the 1,300 meter elevation where production blocks C and D will be developed by year end as the mine moves towards the planned expansion of 1,500 tpd.

The plant is processing ore at an average throughput rate of 1,000 tpd. Metallurgical recovery is still undergoing an adjustment process and remains within 95% of design parameters. Concentrate grade is already at planned levels for the current head grades.

Capital expenditures budgeted for the year 2012, amounts to \$30.7 million which includes a new concentrate leaching facility to produce dore bars (\$12 million), ramp and mine development (\$9.2 million), tailings dam expansion to support 1,500 tpd (\$4.5 million), processing plant expansion (\$1.6 million), a hydraulic fill plant and the underground power grid (\$2.6 million).

MANAGEMENT'S DISCUSSION AND ANALYSIS

A total of 13,527 meters were drilled in San Jose and our surrounding properties in 2011 with 60% of the program directed to test the southern extension of the San Jose deposit ("San Ignacio") and the balance allocated to new target zones Taviche and El Rancho. A follow up program for San Ignacio in 2012 will continue testing for extensions of mineralization open to the south of existing reserves.

The 2012 brownfields program amounts to \$5.8 million including over 15,000 meters of drilling.

Violent acts have claimed the life of two members of the San Jose del Progreso community on January 18 and March 15, 2012. These murders are being investigated by local authorities and mourned by the entire community. Continuous violence in Mexico and in the state of Oaxaca is a concern for the Company. Security measures are being taken to ensure the safeguard of our personnel.

Cash cost, cash cost per silver ounce, and cash cost per tonne are non-GAAP financial measures, refer to cash cost per silver ounce and cash cost per tonne (non-GAAP financial measures) for reconciliation of cash cost to the cost of sales.

CAYLLOMA MINE AND SAN JOSE MINE* CONCENTRATES

Mine Concentrates	QUARTERLY RESULTS Three months ended December 31,				YEAR TO DATE RESULTS Years ended December 31,			
	2011		2010		2011		2010	
	Caylloma	San Jose	Caylloma	San Jose	Caylloma	San Jose	Caylloma	San Jose
Silver Gold								
Opening Inventory (t)	0	538	0	0	0	0	0	0
Production (t)	0	2,276	0	0	0	2,958	0	0
Sales (t)	0	2,084	0	0	0	2,227	0	0
Adjustment (t)	0	0	0	0	0	0	0	0
Closing Inventory (t)	0	730	0	0	0	730	0	0
Ag in concentrate (g/t)**	0	5,155	0	0	0	5,028	0	0
Au in concentrate (g/t)**	0	49	0	0	0	48	0	0
Zinc								
Opening Inventory (t)	273	0	540	0	263	0	369	0
Production (t)	4,964	0	5,467	0	20,569	0	22,291	0
Sales (t)	4,920	0	5,749	0	20,490	0	22,419	0
Adjustment (t)	-12	0	5	0	-37	0	22	0
Closing Inventory (t)	305	0	263	0	305	0	263	0
Zn in concentrate (%)**	51.98	0.00	51.09	0.00	51.66	0.00	53.86	0.00
Lead								
Opening Inventory (t)	232	0	404	0	188	0	408	0
Production (t)	3,599	0	3,829	0	15,767	0	15,015	0
Sales (t)	3,590	0	4,053	0	15,760	0	15,250	0
Adjustment (t)	14	0	8	0	60	0	14	0
Closing Inventory (t)	255	0	188	0	255	0	188	0
Ag in concentrate (g/t)**	4,636	0	1,685	0	3,881	0	1,499	0
Pb in concentrate (%)**	55.41	0.00	63.23	0.00	56.61	0.00	64.56	0.00
Copper								
Opening Inventory (t)	4	0	44	0	29	0	46	0
Production (t)	0	0	448	0	80	0	2,085	0
Sales (t)	0	0	464	0	104	0	2,117	0
Adjustment (t)	0	0	1	0	-1	0	15	0
Closing Inventory (t)	4	0	29	0	4	0	29	0
Ag in concentrate (g/t)**	0	0	19,056	0	15,876	0	17,644	0
Cu in concentrate (%)**	0.00	0.00	21.62	0.00	20.23	0.00	22.31	0.00

* Commercial production commenced on September 1, 2011.

** Grades from commercial production.

PROPERTY OPTION AGREEMENTS

MARIO PROPERTY

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

1. \$0.50 million on signing of agreement;
2. \$0.50 million on or before six months from the signing of the agreement;
3. \$0.50 million on or before 12 months from the signing of the agreement; and,
4. \$2.50 million on or before 24 months from the signing of the agreement.

The transfer of the property to the Company is subject to a 1% net smelter return ("NSR") royalty on production from the property payable to Crocodile Gold ("Crocodile"). The Company shall have the right to purchase the NSR royalty from Crocodile at any time during the five-year period following the final option payment for the sum of \$3.0 million. The property is also subject to a 2% NSR royalty on production payable to Teck Cominco and a 0.5% NSR royalty on production payable to Socrate Capital Inc., with each royalty in turn subject to certain buy-back provisions.

As at December 31, 2011, \$1.0 million has been paid under the agreement.

DON MARIO PROPERTY

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

1. \$0.20 million on signing the agreement;
2. \$0.30 million after 12 months from signing the agreement;
3. \$0.50 million after 24 months from signing the agreement; and,
4. \$2.00 million after 36 months from signing the agreement.

Under the terms of the agreement, once the option is exercised and technical report is prepared under National Instrument 43-101 and published, if the pre-feasibility study indicates that the property contains more than five million silver equivalent ounces, the Company would further pay AGMIN, one dollar for each additional resource and reserves indicated in the pre-feasibility report. The Company has the option to buy-out the additional pay-out for a further \$3.0 million, subject to certain conditions.

As at December 31, 2011, \$0.20 million has been paid under the agreement.

ANNUAL FINANCIAL RESULTS

Expressed in \$000's, except per share data*/**	Years Ended December 31,		
	2011*	2010*	2009**
Sales	110,004	74,056	51,428
Operating income	38,065	27,728	14,383
Income	19,533	16,003	623
Earnings per share, basic	0.16	0.15	0.01
Earnings per share, diluted	0.16	0.14	0.01
Total assets	271,606	233,870	139,738
Leases and long term liabilities	2,764	3,166	1,454

* Figures for 2011 and 2010 expressed under IFRS.

** Figures for 2009 expressed under Canadian Generally Accepted Accounting Principles ("CAD GAAP").

The comparative financial information for 2009 is presented in accordance with Canadian Generally Accepted Accounting Principles ("CAD GAAP") and was not required to be restated to IFRS in this MD&A.

During the year ended December 31, 2011 the Company generated net income of \$19.53 million (2010: \$16.00 million) on operating income of \$38.07 million (2010: \$27.73 million). The increase in net income is mainly attributable to higher mine operating income of \$60.97 million (2010: \$39.21 million) driven by higher sales at Caylloma and the contribution of the San Jose mine, offset by higher selling, general and administrative expenses of \$19.84 million (2010: \$10.98 million), income taxes of \$18.80 million (2010: \$11.51 million), impairment of mineral properties, property, plant and equipment of \$1.89 million (2010: \$nil), exploration and evaluation costs of \$1.72 million (2010: \$0.55 million), and lower gain on commodity contracts of \$0.48 million (2010: \$0.74 million).

Sales, for the year end December 31, 2011, increased by 49% to \$110.00 million (2010: \$74.06 million), compared to the prior year. The sales increase is mainly a result of higher realized prices for silver, gold, lead and zinc of 71%, 29%, 9% and 9%, respectively, and higher metals sold for silver and gold of 23% and 124%, respectively, offset by lower metal sold for lead and zinc of 8% and 11%, respectively.

MINE METAL SOLD AND PRICES

Mine Metal Sold and Prices	YEAR TO DATE RESULTS					
	2011			2010		
	Caylloma	San Jose	Consolidated	Caylloma	San Jose	Consolidated
Silver						
Sales (Oz)*	2,004,457	320,599	2,325,056	1,894,703	–	1,894,703
Net Realized Price (US\$/Oz)**	31.91	26.42	31.11	18.18	–	18.18
Gold						
Sales (Oz)*	2,438	2,952	5,391	2,411	–	2,411
Net Realized Price (US\$/Oz)**	1,116.09	1,230.34	1,183.39	920.85	–	920.85
Lead						
Sales (000's lb)*	19,685	–	19,685	21,461	–	21,461
Net Realized Price (US\$/lb)**	0.86	–	0.86	0.79	–	0.79
Zinc						
Sales (000's lb)*	23,323	–	23,323	26,306	–	26,306
Net Realized Price (US\$/lb)**	0.66	–	0.66	0.60	–	0.60
Copper						
Sales (000's lb)*	52	–	52	1,021	–	1,021
Net Realized Price (US\$/lb)**	2.65	–	2.65	2.60	–	2.60

* Contained metal in concentrate. The current and subsequent period may include final settlement quantity adjustments from prior periods.

** Calculated based on contained metals and after deductions, treatment, and refining charges.

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

Net realized prices are based on provisional sales and are calculated before governmental royalties.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Cost of sales, for the year ended December 31, 2011, increased by 41% to \$49.03 million (2010: \$34.84 million) compared to the prior year. The increase is primarily attributable to 18% higher unit production cash costs per tonne of processed ore in Caylloma and an overall throughput increase of 30%. The higher unit production cash cost per tonne of processed ore reflect cost increases in qualified labor and industry related services that have been mounting in the Peruvian underground mining industry since late 2010. (Refer to cash cost per silver ounce and cash cost per tonne (non-GAAP financial measures), discussion on Caylloma mine operations, and discussion on San Jose mine operations).

Selling, general and administrative expenses, for the year ended December 31, 2011, increased by 81% to \$19.84 million (2010: \$10.98 million). The increase is primarily attributable to share-based payments of \$4.79 million in 2011 compared to a net recovery of \$0.42 million in 2010, a \$2.61 million increase in corporate general and administrative expenses mainly as a result of higher salaries and professional fees related to the growth of the company, the New York Stock Exchange ("NYSE") listing, and \$0.87 million from Cuzcatlan as a result of the commencement of commercial production in the second half of 2011.

	Expressed in \$ millions	
	Year ended December 31,	
	2011	2010
Corporate general and administrative expenses	\$ 9.97	\$ 7.36
Bateas general and administrative expenses	3.36	3.83
Cuzcatlan general and administrative expenses	0.87	–
Foreign exchange	0.22	0.21
Share-based payments	4.79	(0.42)
Peruvian workers' participation	0.63	–
	\$ 19.84	\$ 10.98

Exploration and evaluation costs, for the year ended December 31, 2011, increased to \$1.72 million (2010: \$0.55 million) as the Company pursues its exploration program.

Impairment of mineral properties, property, plant and equipment, for year ended December 31, 2011, amounted to \$1.89 million (2010: \$nil) as the Company has taken an impairment charge related to the Taviche property comprised of: \$1.08 million on the tailing dam, \$0.14 million on the mine infrastructure, and \$0.67 million on equipment, machinery, and buildings.

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

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

Net gain on commodity contract, for the year ended December 31, 2011, was \$0.48 million (2010: \$0.74 million). The gain is related to short term contracts used to fix the final settlement price on metal contained in concentrate delivered throughout the period.

Interest income, for the year ended December 31, 2011, increased by 68% to \$0.83 million (2010: \$0.49 million). The increase in interest income is primarily attributable to interest earned on long term receivables through the sale of assets and higher invested cash balances at the first half of the year.

Interest expense, for the year ended December 31, 2011, decreased by 21% to \$0.56 million (2010: \$0.71 million) as a result of a reduction in standby and commitment fees, compared to the prior year.

Income taxes, for the year ended December 31, 2011, increased by 63% to \$18.80 million (2010: \$11.51 million) due to higher income recorded at Bateas and deferred tax arising from Cuzcatlan.

Income tax provision is comprised of \$14.61 million of current income tax expense and \$4.19 million of deferred income tax expense mainly related to our Peruvian and Mexican operations.

QUARTERLY INFORMATION

The following table provides information for the eight fiscal quarters ended December 31, 2011:

Expressed in \$000's, except per share data*	Quarters ended							
	31-Dec-11	30-Sep-11	30-Jun-11	31-Mar-11	31-Dec-10	30-Sep-10	30-Jun-10	31-Mar-10
Sales	31,047	32,543	24,528	21,886	23,909	18,039	14,565	17,543
Operating income	4,437	14,886	10,665	8,077	8,031	1,030	9,629	9,038
Income before taxes	4,443	14,948	10,754	8,190	8,033	780	9,666	9,034
Income (loss)	(1,755)	10,309	6,197	4,782	4,333	(773)	6,719	5,724
Earnings per share, basic	(0.01)	0.08	0.05	0.04	0.04	(0.01)	0.06	0.06
Earnings per share, diluted	(0.01)	0.08	0.05	0.04	0.04	(0.01)	0.06	0.05
Total assets	271,606	270,259	253,287	242,564	233,870	180,473	175,445	170,198
Leases and long term liabilities	2,764	2,873	2,988	3,384	3,166	2,653	1,384	1,306

* Figures for 2011 and 2010 expressed under IFRS.

The past eight quarters show a consistent trend of sales growth with a marginal decline in Q4 2011 from Q3 2011. This trend reflects the surge in silver price since the beginning of 2010 and the commencement of commercial production at the San Jose mine starting in September 2011.

FOURTH QUARTER FINANCIAL RESULTS

Expressed in \$'000's	Three months ended December 31,	
	2011	2010
Sales	\$ 31,047	\$ 23,909
Cost of sales	17,782	9,804
Mine operating income	13,265	14,105
Other expenses		
Selling, general and administrative expenses	5,871	4,583
Exploration and evaluation costs	605	202
Net gain on commodity contracts	442	725
Loss on disposal of mineral properties, property, plant and equipment	16	2
Loss on disposal of investment	-	119
Write-off of deferred exploration costs	-	443
Impairment of mineral properties, property, plant and equipment	1,894	-
Operating income	4,437	8,031
Finance items		
Interest income	155	159
Interest expense	(149)	(157)
Net finance income	6	2
Income before tax	4,443	8,033
Income taxes	6,198	3,700
(Loss) Income for the period	\$ (1,755)	\$ 4,333

During the fourth quarter ended December 31, 2011 the Company generated net loss of \$1.76 million (Q4 2010: \$4.33 million) on operating income of \$4.44 million (Q4 2010: \$8.03 million). The decrease in net income compared to the same period in 2010 is mainly attributable to lower mine operating income of \$13.27 million (Q4 2010: \$14.11 million), higher selling, general and administrative expenses of \$5.87 million (Q4 2010: \$4.58 million), impairment of mineral properties, property, plant and equipment of \$1.89 million (Q4 2010: \$nil), exploration and evaluation costs of \$0.61 million (Q4 2010: \$0.20 million), and income taxes of \$6.20 million (Q4 2010: \$3.70 million). The decrease in mine operating income in spite of the contribution from the San Jose mine in 2011 and a higher silver price is explained by lower revenue from base metals of \$4 million, negative price adjustments in Caylloma associated with the sharp fall in silver price in the fourth quarter, and higher unit costs of 23% at Caylloma.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Sales, for the fourth quarter ended December 31, 2011 increased by 30% to \$31.05 million (Q4 2010: \$23.91 million) compared to the same quarter a year ago with San Jose contributing \$11.39 million (Q4 2010: \$nil). Sales at Caylloma decreased by 18% to \$19.66 (Q4 2010: \$23.91), in spite of higher silver prices (20%) and higher silver sold (11%), mainly due to lower lead and zinc sold (22% and 13% respectively) with lower lead and zinc prices (23% and 15%, respectively) representing \$4.25 million of decreased revenue, and a negative final sales adjustments of \$2.33 million (Q4 2010: positive \$1.85 million) associated with the sharp fall in silver price in the quarter.

MINE METAL SOLD AND PRICES

Mine Metal Sold and Prices	QUARTERLY RESULTS					
	Three months ended December 31,					
	2011			2010		
	Caylloma	San Jose	Consolidated	Caylloma	San Jose	Consolidated
Silver						
Sales (Oz)*	547,542	300,411	847,952	494,451	–	494,451
Net Realized Price (US\$/Oz)**	28.58	26.08	27.64	23.73	–	23.73
Gold						
Sales (Oz)*	597	2,770	3,367	696	–	696
Net Realized Price (US\$/Oz)**	1,245.14	1,227.19	1,229.99	1,031.09	–	1,031.09
Lead						
Sales (000's lb)*	4,385	–	4,385	5,605	–	5,605
Net Realized Price (US\$/lb)**	0.67	–	0.67	0.87	–	0.87
Zinc						
Sales (000's lb)*	5,613	–	5,613	6,487	–	6,487
Net Realized Price (US\$/lb)**	0.54	–	0.54	0.64	–	0.64
Copper						
Sales (000's lb)*	–	–	–	221	–	221
Net Realized Price (US\$/lb)**	–	–	–	3.07	–	3.07

* Contained metal in concentrate. The current and subsequent period may include final settlement quantity adjustments from prior periods.

** Calculated based on contained metals and after deductions, treatment, and refining charges.

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

Net realized prices are based on provisional sales and are calculated before governmental royalties.

Cost of sales, for the fourth quarter ended December 31, 2011 increased by 81% to \$17.78 million (Q4 2010: \$9.80 million) compared to the prior year. The increase is primarily attributable to the contribution of the San Jose mine which was in production for the full quarter resulting in an overall throughput increase of 82%, and to 23% higher unit production cash costs per tonne of processed ore at Caylloma (Refer to cash cost per silver ounce and cash cost per tonne (non-GAAP financial measures)).

Selling, general and administrative expenses, for the fourth quarter ended December 31, 2011 increased by 28% to \$5.87 million (Q4 2010: \$4.58 million). The increase is primarily attributable to share-based payments of \$1.20 million (Q4 2010: \$0.76 million), a \$0.75 million increase in corporate general and administrative expenses, mainly as a result of higher salaries and professional fees related to the growth of the Company, and \$0.67 million from Cuzcatlan (Q4 2010: \$nil).

	Expressed in \$ millions	
	Three months ended December 31,	
	2011	2010
Corporate general and administrative expenses	\$ 2.90	\$ 2.15
Bateas general and administrative expenses	0.82	1.50
Cuzcatlan general and administrative expenses	0.67	–
Foreign exchange	0.19	0.17
Share-based payments	1.20	0.76
Peruvian workers' participation	0.09	–
	\$ 5.87	\$ 4.58

Exploration and evaluation costs, for the fourth quarter ended December 31, 2011 increased to \$0.61 million (Q4 2010: \$0.20 million) as the Company pursues its exploration program.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Impairment of mineral properties, property, plant and equipment, for the fourth quarter ended December 31, 2011, amounted to \$1.89 million (Q4 2010: \$nil) as the Company has taken an impairment charge related to the Taviche property comprised of: \$1.08 million on the tailing dam, \$0.14 million on the mine infrastructure, and \$0.67 million on equipment, machinery, and buildings.

Net loss on commodity contract, for the fourth quarter ended December 31, 2011, was \$0.44 million (Q4 2010: \$0.73 million). The loss is related to short term contracts used to fix the final settlement price on metal contained in concentrate delivered throughout the period.

Interest income, for the fourth quarter ended December 31, 2011 decreased by 3% to \$0.16 million (Q4 2010: \$0.16 million) as a result of a reduction in cash balances.

Interest expense, for the fourth quarter ended December 31, 2011 decreased by 5% to \$0.15 million (Q4 2010: \$0.16 million) as a result of a reduction in the balance of finance leases.

Income taxes, for the fourth quarter ended December 31, 2011 increased by 68% to \$6.20 million (Q4 2010: \$3.70 million) due to higher recorded income at Bateas and deferred tax arising from Cuzcatlan.

CASH COST PER SILVER OUNCE AND CASH COST PER TONNE (NON-GAAP FINANCIAL MEASURES)

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

The following table presents a reconciliation of cash costs per tonne of processed ore and cash cost per ounce of payable silver to the cost of sales in the consolidated financial statements for the three months and years ended December 31, 2011 and 2010.

CONSOLIDATED MINE CASH COST

Consolidated Mine Cash Cost	Expressed in \$000's		Expressed in \$000's	
	Q4 2011	YTD Q4 2011	Q4 2010	YTD Q4 2010
Cost of sales ^{2,3}	17,782	49,030	9,804	34,844
Add/(Subtract)				
Change in concentrate inventory	415	2,142	(295)	(305)
Depletion and depreciation in concentrate inventory	(207)	(781)	124	5
Inventory adjustment	-	-	525	290
Government royalties and mining taxes	(385)	(1,322)	(320)	(788)
Workers participation	(436)	(3,141)	(881)	(2,320)
Depletion and depreciation ²	(3,752)	(9,060)	(1,711)	(6,327)
Cash cost	13,417	36,868	7,246	25,399
Total processed ore (tonnes)	204,248	565,276	112,257	434,656
Cash cost per tonne of processed ore (\$/t)	65.69	65.22	64.55	58.43
Cash cost	13,417	36,868	7,246	25,399
Add/(Subtract)				
By-product credits ¹	(11,252)	(40,267)	(10,544)	(37,825)
Refining charges	2,234	4,280	410	1,576
Cash cost applicable per payable ounce	4,399	881	(2,888)	(10,850)
Payable silver ounces	860,565	2,352,759	457,712	1,811,102
Cash cost per ounce of payable silver (\$/oz)	5.11	0.37	(6.31)	(5.99)

¹ By-product credits as included in the provisional sales.

² 2010 and 2011 figures in accordance with IFRS.

³ Includes depletion, depreciation, distribution, community relations, government royalties and mining taxes, and workers participation.

MANAGEMENT'S DISCUSSION AND ANALYSIS
CAYLLOMA MINE CASH COST

Caylloma Mine Cash Cost	Expressed in \$000's		Expressed in \$000's	
	Q4 2011	YTD Q4 2011	Q4 2010	YTD Q4 2010
Cost of sales ^{2,3}	11,777	42,236	9,804	34,844
Add/(Subtract)				
Change in concentrate inventory	92	206	(295)	(305)
Depletion and depreciation in concentrate inventory	(12)	(97)	124	5
Government royalties and mining taxes	(385)	(1,322)	(320)	(788)
Workers participation	(436)	(3,141)	(881)	(2,320)
Depletion and depreciation ²	(1,764)	(6,919)	(1,711)	(6,327)
Cash cost	9,272	30,963	7,246	25,399
Total processed ore (tonnes)	116,363	448,866	112,257	434,656
Cash cost per tonne of processed ore (\$/t)	79.68	68.98	64.55	58.43
Cash cost	9,272	30,963	7,246	25,399
Add/(Subtract)				
By-product credits ¹	(6,773)	(34,676)	(10,544)	(37,825)
Refining charges	900	2,590	410	1,576
Cash cost applicable per payable ounce	3,399	(1,123)	(2,888)	(10,850)
Payable silver ounces	509,605	1,908,064	457,712	1,811,102
Cash cost per ounce of payable silver (\$/oz)	6.67	(0.59)	(6.31)	(5.99)

¹ By-product credits as included in the provisional sales.

² 2010 and 2011 figures in accordance with IFRS.

³ Includes depletion, depreciation, distribution, community relations, government royalties and mining taxes, and workers participation.

SAN JOSE MINE CASH COST

San Jose Mine Cash Cost	Expressed in \$000's	
	Q4 2011	YTD Q4 2011
Cost of sales ^{2,3}	6,005	6,794
Add/(Subtract)		
Change in concentrate inventory	323	1,936
Depletion and depreciation in concentrate inventory	(195)	(684)
Depletion and depreciation ²	(1,988)	(2,141)
Cash cost	4,145	5,905
Total processed ore (tonnes)	87,884	116,410
Cash cost per tonne of processed ore (\$/t)	47.16	50.73
Cash cost	4,145	5,905
Add/(Subtract)		
By-product credits ¹	(4,479)	(5,591)
Refining charges	1,334	1,690
Cash cost applicable per payable ounce	1,000	2,004
Payable silver ounces	350,961	444,695
Cash cost per ounce of payable silver (\$/oz)	2.85	4.51

Commercial production commenced on September 1, 2011.

¹ By-product credits as included in the provisional sales.

² 2010 and 2011 figures in accordance with IFRS.

³ Includes depletion, depreciation, distribution, community relations, government royalties and mining taxes, and workers participation.

LIQUIDITY AND CAPITAL RESOURCES

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

The Company's cash and cash equivalents as at December 31, 2011 totalled \$38.73 million, and short term investments totalled \$17.00 million. The \$31.87 million decrease (2010: \$37.38 million increase) in cash and cash equivalents at December 31, 2011 compared to the end of the prior year is largely due to the use of \$45.48 million on the construction of the San Jose mine. In 2010, the \$37.38 million increase in cash is primarily a result of the \$74.92 million net proceeds on the issuance of shares. As at December 31, 2011, working capital amounted to \$63.90 million (2010: \$97.07 million). The 2011 decrease in working capital reflects: decreases in cash and cash equivalents and short term investments; increases in trade and other payables due to related parties, derivative liabilities, provisions, and current portion of long term liabilities; offset by increases in derivative assets, accounts receivable and other assets, GST/HST and value added tax receivable, inventories.

During the fourth quarter ended December 31, 2011, cash generated by operating activities before changes in non-cash working capital items, income taxes paid, and interest income paid and received was \$10.45 million (Q4 2010: \$7.60 million).

During the year ended December 31, 2011, cash generated by operating activities before changes in non-cash working capital items, income taxes paid, and interest income paid and received was \$49.76 million (2010: \$28.68 million). Changes in non-cash working capital items amounted to \$3.60 million (2010: \$2.66 million), and income taxes paid and interest income paid and received amounted to \$14.25 million (2010: \$6.97 million), resulting in net cash provided by operating activities of \$35.51 million (2010: \$21.71 million).

Cash generated by operating activities before changes in working capital, income taxes, and interest income is calculated as follows:

OPERATING ACTIVITIES

	Three months ended December 31		Years ended December 31,	
	2011	2010	2011	2010
Net income	\$ (1,755)	\$ 4,333	\$ 19,533	\$ 16,003
Items not involving cash				
Depletion and depreciation	3,943	1,782	9,421	6,462
Accretion of provisions	57	42	173	163
Income tax expense	6,199	3,700	18,802	11,510
Share-based payments (recovery)	475	676	3,682	(501)
Unrealized (gain) on commodity contracts	1,089	(325)	(116)	(2,922)
Write-off of deferred exploration costs	-	443	-	443
Impairment of mineral properties, property, plant and equipment	1,894	-	1,894	-
(Gain) loss on disposal of mineral properties, property, plant and equipment	16	6	(59)	127
Accrued interest on long term loans receivable and payable	7	14	24	50
	11,925	10,671	53,354	31,335
Changes in non-cash working capital items				
Accounts receivable and other assets	1,693	(3,091)	(3,085)	(4,788)
Inventories	2,189	(144)	(7,273)	(1,536)
Trade and other payables	(963)	165	6,829	3,677
Due to/from related parties	183	(2)	134	(9)
Provisions	(201)	-	(201)	-
Cash provided by operating activities before interest and income taxes	\$ 10,448	\$ 7,599	\$ 49,758	\$ 28,679

MANAGEMENT'S DISCUSSION AND ANALYSIS

Cash consumed by the Company for the fourth quarter ended December 31, 2011, in investing activities totalled \$31.64 million (Q4 2010: \$24.77 million) with \$16.24 million (Q4 2010: \$14.37 million) for mineral properties, property, plant and equipment, \$0.63 million (Q4 2010: receipts \$0.14 million) net advances on deposits on long term assets, \$15.05 million (Q4 2010: \$9.48 million) net purchases of short term investments, offset by receipts of VAT \$0.28 million (Q4 2010: payments \$1.13 million), and proceeds on disposal of mineral properties, property, plant and equipment \$nil (Q4 2010: \$0.07 million).

Cash consumed by the Company, for the year ended December 31, 2011, in investing activities totalled \$69.86 million (2010: \$58.06 million) with \$76.68 million (2010: \$36.71 million) for mineral properties, property, plant and equipment, \$3.57 million (2010: advances \$4.66 million) for net receipts on deposits on long term assets, \$3.73 million net redemptions (2010: purchases \$13.85 million) of short term investments, payments of VAT of \$0.52 million (2010: \$2.92 million), and offset by proceeds on disposal of mineral properties, property, plant, and equipment of \$0.04 million (2010: \$0.08 million). The total investment in San Jose amounted to \$45.48 million.

During the fourth quarter ended December 31, 2011, cash provided by financing activities totalled \$1.95 million (Q4 2010: \$42.73 million) with repayment of finance lease obligations of \$0.30 million (Q4 2010: \$0.26 million), offset by cash provided by net proceeds on the issuance of common shares of \$2.25 million (Q4 2010: \$42.99 million).

During the year ended December 31, 2011, cash provided by financing activities totalled \$2.48 million (2010: \$73.74 million) with repayment of finance lease obligations of \$1.18 million (2010: \$1.18 million), offset by cash provided by net proceeds on the issuance of common shares of \$3.66 million (2010: \$74.92 million).

In 2010, the Company entered into a credit agreement with the Bank of Nova Scotia for a \$20 million senior secured revolving credit facility ("credit facility") to be refinanced or repaid on or within two and one-half years or before December 2012. The credit facility is secured by a first ranking lien on Bateas and its assets and bears interest and fees at prevailing market rates. In the event that utilization under the credit facility is less than \$10 million, a commitment fee of 1.50% per annum is payable quarterly on the unutilized portion of the available credit facility. No funds were drawn from this credit facility during the year.

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

PROSPECTUS FEBRUARY 18, 2010 CLOSED MARCH 2, 2010 SAN JOSE PROJECT FINANCING

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

* Excludes over-allotment.

** US CAD FX rate at 1.0

PROSPECTUS DECEMBER 17, 2010 CLOSED DECEMBER 23, 2010 SAN JOSE PROJECT FINANCING**

	Expressed in CAD \$ millions		
	Expected use of proceeds*	Actual use of proceeds**	Variance
Planned expansion	\$ 14.5	\$ -	\$ 14.5
Exploration programs	5.5	10.7	(5.2)
Working capital	17.7	26.3	(8.6)
Total	\$ 37.7	\$ 37.0	\$ 0.7

* Excludes over-allotment.

** Funds to be utilized post development.

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

CONTRACTUAL OBLIGATIONS

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

	Expressed in \$ millions				
	Expected payments due by period as at December 31, 2011				
	Less than 1 year	1-3 years	4-5 years	After 5 years	Total
Trade and other payables	\$ 17.16	\$ -	\$ -	\$ -	\$ 17.16
Due to related parties	0.21	-	-	-	0.21
Derivative liabilities	0.09	-	-	-	0.09
Income tax payable	3.92	-	-	-	3.92
Long term liabilities	1.53	2.77	-	-	4.30
Operating leases	0.70	1.41	1.18	0.53	3.82
Provisions	0.73	0.85	0.77	3.73	6.08
	\$ 24.34	\$ 5.03	\$ 1.95	\$ 4.26	\$ 35.58

CAPITAL COMMITMENTS (EXPRESSED IN \$'000'S)

As at December 31, 2011, \$8.12 million of capital commitments not disclosed elsewhere in the consolidated financial statements, and forecasted to be expended within one year, includes the following: \$5.80 million for the ramp development at the San Jose property located in Mexico; \$2.25 million for the tailing dam, concentrator plant and electrical infrastructure renewal, and mine camp development at the Caylloma Property; and \$0.08 million for software development.

OTHER COMMITMENTS (EXPRESSED IN \$'000'S)

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

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

The Company, jointly with Radius Gold Inc., a related party by way of common directors, has entered into an office premise lease located in Canada, effective on November 28, 2011, the date the Company commenced carrying on business in the premises. The shared office with Radius has been finalized with the Company obligated to pay 50% of the total rent payable. The lease term is eight years with the Company's annual net rent payable, on 3,195 rentable square feet, as follows:

- years one to two \$111;
- years three to five \$115; and,
- years six to eight \$118.

In addition, estimated operating costs, utilities, and realty taxes is \$71 in the first year of occupancy. During 2011, the Company has advanced 50% of the three month security deposit in the amount of \$47.

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

The lease also includes the use of additional space for mini-warehouse and parking spots, the obligation for which is \$58 per annum for the first year and is subject to an annual increase of 3% as stated above until the end of the lease. As at December 31, 2011, the Company has advanced rent \$159 (2010: \$426) and provided a security deposit of \$44. On March 15, 2011, the Company entered into a one year office premise lease located in Mexico with an annual lease obligation of \$37.

	Expected payments due by period as at December 31, 2011				
	Less than 1 year	1-3 years	4-5 years	After 5 years	Total
Office premises – Canada	\$ 181	\$ 549	\$ 372	\$ 359	\$ 1,461
Office premises – Peru	363	758	805	172	2,098
Office premises – Mexico	8	-	-	-	8
Total office premises	\$ 552	\$ 1,307	\$ 1,177	\$ 531	\$ 3,567
Computer equipment – Peru	128	75	-	-	203
Computer equipment – Mexico	16	28	-	-	44
Total computer equipment	\$ 144	\$ 103	\$ -	\$ -	\$ 247
Total operating leases	\$ 696	\$ 1,410	\$ 1,177	\$ 531	\$ 3,814

On February 17, 2012, the Company entered into a one year office premise lease, effective March 1, 2012, located in Mexico with an annual lease obligation of \$18.

OTHER CONTINGENCIES (EXPRESSED IN \$'000'S)

In February 2009, the Environmental Assessment and Oversight Agency ("OEFA") in Peru, alleged the Company had five violations: two were for breaches of recommendations; two for excess of total suspended solids in water over the maximum allowable; and an alleged unauthorized discharge of effluent. The Ministry of Energy and Mines in Peru ("OSINERGMIN") decided to close the two alleged violations for failure to adopt recommendations and punish the Company for the three alleged violations and imposed a fine of \$200 in 2010. The Company appealed on June 23, 2010. Subsequent to December 31, 2011 and on February 22, 2012, the alleged unauthorized discharge of effluent was dismissed and confirmed a fine of \$133 for the two alleged violations of excess of total suspended solids in water over the maximum allowable. The Company is proceeding with an administrative appeal to the Ministry of Energy and Mines in Peru ("OSINERGMIN") for the remaining two alleged offenses. The Company believes it is more likely than not that it will defend itself successfully in the claims and therefore has not recorded a provision for the potential exposure relating to these alleged violations.

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

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

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

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

Banco Bilbao Vizcaya Argentaria, S.A., a third party, has established a bank letter of guarantee on behalf of Bateas in favor of the Peruvian mining regulatory agency in compliance with local regulation associated with the approved Bateas' mine closure plan, for the sum of \$439. This bank letter of guarantee expires 360 days from December 2011.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Company acts as guarantor to finance lease obligations held by two of its mining contractors. These finance lease contracts are related to the acquisition of mining equipment deployed at the Caylloma mine. As at December 31, 2011, these obligations amounted to \$231 with \$74 maturing in 2012 and \$157 maturing in 2013.

OFF-BALANCE SHEET ARRANGEMENTS

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

DERIVATIVES

	Expressed in \$ millions			
	December 31, 2011		December 31, 2010	
	Assets	Liabilities	Assets	Liabilities
Lead forward contracts	–	0.05	–	0.01
Zinc forward contracts	0.07	–	–	0.01
Silver forward contracts	–	0.04	–	0.11
Total	\$ 0.07	\$ 0.09	\$ –	\$ 0.13

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

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

RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability directly, or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control, related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties. The consolidated financial statements include the financial statements of Fortuna Silver Mines Inc. and its subsidiaries listed in the following table:

Name	Country of Incorporation	Equity interest as at December 31,	
		2011	2010
Minera Bateas S.A.C.	Peru	100%	100%
Fortuna Silver Mines Peru S.A.C.	Peru	100%	100%
Compania Minera Cuzcatlan SA	Mexico	100%	100%
Fortuna Silver Mexico, S.A. de CV	Mexico	100%	n/a
Fortuna Silver (Barbados) Inc.	Barbados	100%	100%
Continuum Resources Ltd.	Canada	100%	100%

Fortuna Silver Mexico, S.A. de CV was incorporated in 2011.

MANAGEMENT'S DISCUSSION AND ANALYSIS

A) PURCHASE OF GOODS AND SERVICES

The Company entered into the following related party transactions:

Transactions with related parties	Expressed in \$'000's	
	Years ended December 31,	
	2011	2010
Salaries and wages ^{1,2}	\$ 173	\$ 174
Other general and administrative expenses ²	292	185
Leasehold improvements ²	93	–
	\$ 558	\$ 359

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

² Radius Gold Inc. ("Radius") has directors in common with the Company and shares office space, and is reimbursed for salaries and wages, general and administrative costs, and leasehold improvements incurred on behalf of the Company.

During the year ended December 31, 2011, the Company transferred two mining concessions to Focus Ventures Ltd., a Company with directors in common, in exchange for a 1% net smelter return royalty.

During the year ended December 31, 2011, the Company issued 6,756 (2010: 7,813) common shares, at a fair market value of \$4.44 (2010: \$2.56) per share and paid \$0.03 million cash (2010: \$0.02 million) to Radius, under the option to acquire a 60% interest in Tlacolula silver project located in the State of Oaxaca, Mexico.

Subsequent to the year ended December 31, 2011 to March 23, 2012, the Company issued 8,605 common shares, at a fair market value of \$5.81 per share and paid \$0.05 million cash to Radius, under the option to acquire a 60% interest in Tlacolula silver project located in the State of Oaxaca, Mexico.

B) KEY MANAGEMENT COMPENSATION

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

	Expressed in \$'000's	
	Years ended December 31,	
	2011	2010
Salaries and other short term employee benefits	\$ 3,492	\$ 2,633
Directors fees	333	300
Consulting fees	416	174
Share-based payments	4,398	188
	\$ 8,639	\$ 3,295

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

Consulting fees includes fees paid to two non-executive directors in both 2011 and 2010.

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

Amounts due to/(from) related parties

Amounts due to/(from) related parties	Expressed in \$'000's	
	December 31,	December 31,
	2011	2010
Owing from a director and officer ³	\$ (36)	\$ (1)
Owing to a company with common directors ²	205	41
	\$ 169	\$ 40

³ Owing from a director includes non-interest bearing advances to a director and officers at December 31, 2011 and one officer and director at December 31, 2010.

SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

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

i. Critical Judgments

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

ii. Estimates

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

FINANCIAL INSTRUMENTS AND RELATED RISKS (EXPRESSED IN 000'S)

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

A) FAIR VALUE OF FINANCIAL INSTRUMENTS

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

The amortized value of long term receivables approximates their fair value as these are measured at the amortized cost using the effective interest method. The fair value of the lease and long term liabilities is \$5,531 as at December 31, 2011.

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

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

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

	Expressed in \$'000's			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 38,730	\$ –	\$ –	\$ 38,730
Short term investments	17,000	–	–	17,000
Trade receivable from concentrate sales	–	11,287	–	11,287
Derivatives	–	(17)	–	(17)
	\$ 55,730	\$ 11,270	\$ –	\$ 67,000

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

	Expressed in \$'000's			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 70,298	\$ –	\$ –	\$ 70,298
Short term investments	20,509	–	–	20,509
Trade receivable from concentrate sales	–	12,551	–	12,551
Derivatives	–	(133)	–	(133)
	\$ 90,807	\$ 12,418	\$ –	\$ 103,225

There were no changes in the levels during the year ended December 31, 2010.

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

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

During the year ended December 31, 2011, there have been no changes in the classification of financial assets and liabilities in levels 1, 2, and 3 of the hierarchy.

B) CURRENCY RISK

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

As at December 31, 2011, the Company is exposed to currency risk through the following assets and liabilities denominated in Canadian dollars, Nuevo Soles and Mexican Pesos (all amounts are expressed in thousands of Canadian dollars, thousands of Nuevo Soles or thousands of Mexican Pesos):

	Expressed in \$'000's					
	December 31, 2011			December 31, 2010		
	Canadian Dollars	Nuevo Soles	Mexican Pesos	Canadian Dollars	Nuevo Soles	Mexican Pesos
Cash and cash equivalents	\$ 18,457	S/. 1,396	\$ 1,758	\$ 54,782	S/. 741	\$ 2,201
Accounts receivable and other assets	42	5,657	58,939	71	1,304	42,452
Deposits on long term assets	–	–	–	–	–	24,209
Trade and other payables	(1,580)	(17,993)	(24,310)	(625)	(15,493)	(6,390)
Provisions, current	–	(1,351)	(3,163)	–	–	–
Income tax payable	–	(10,581)	–	–	(11,775)	–
Leases and long term liabilities	(2,691)	–	–	(1,999)	–	–
Provisions	–	(8,079)	(17,494)	–	(9,169)	(19,959)
Total	14,228	(30,951)	15,730	52,229	(34,392)	42,513
Total US\$ equivalent	13,950	(11,476)	1,125	52,219	(12,244)	3,440

Based on the above net exposure as at December 31, 2011, and assuming that all other variables remain constant, a 10% depreciation or appreciation of the US dollar against the above currencies would result in an increase or decrease, as follows: impact to other comprehensive income of \$1,550 (2010: \$5,802) and a net loss of \$1,150 (2010: \$978).

C) CREDIT RISK

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

The Company's maximum exposure to credit risk at December 31, 2011 is as follows:

	Expressed in '000's	
	December 31, 2011	December 31, 2010
Cash and cash equivalents	\$ 38,730	\$ 70,298
Short term investments	17,000	20,509
Accounts receivable	14,391	12,551
Derivative assets	70	–
Due from related parties	36	–
GST/HST and value added tax receivable	4,777	3,542
	\$ 75,004	\$ 106,900

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

D) LIQUIDITY RISK

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

Refer to Contractual Obligations for the expected payments due as at December 31, 2011.

CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

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

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

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

IFRS 7 Financial Instruments: Disclosures (Amendment)

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

IAS 12 Income Taxes (Amendment)

IAS 12 *Income Taxes*, amendments regarding Deferred Tax: Recovery of Underlying Assets introduces an exception to the existing principle for the measurement of deferred tax assets and liabilities arising on investment property measured at fair value, and the requirement that deferred tax on non-depreciable assets measured using the revaluation model in IAS 16 should always be measured on a sale basis. The amendment is effective for annual periods beginning on or after January 1, 2012.

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

IAS 1 Presentation of Financial Statements (Amendment)

The amendments to IAS 1 *Presentation of Financial Statements* require companies preparing financial statements in accordance with IFRSs to group together items within OCI that may be reclassified to the profit or loss section of the income statement. The amendments retain the 'one or two statement' approach at the option of the entity and only revise the way other comprehensive income is presented: requiring separate subtotals for those elements which may be 'recycled' (e.g. cash-flow hedging, foreign currency translation), and those elements that will not (e.g. fair value through

MANAGEMENT'S DISCUSSION AND ANALYSIS

OCI items under IFRS 9). In addition, the tax associated with items presented before tax to be shown separately for each of the two groups of OCI items (without changing the option to present items of OCI either before tax or net of tax).

The amendment is effective for annual periods beginning on or after July 1, 2012.

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

IFRS 7 *Financial Instruments: Disclosures in Respect of Offsetting* (Amendment)

At its meeting on December 13-15, 2011, the IASB approved amendments to IFRS 7, *Financial Instruments: Disclosures*, with respect to offsetting financial assets and financial liabilities. The common disclosure requirements issued by the IASB and the FASB in December 2011 are intended to help investors and other users to better assess the effect or potential effect of offsetting arrangements on a company's financial position. Companies and other entities are required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The required disclosures should be provided retrospectively.

IFRS 10 *Consolidated Financial Statements*

IFRS 10 *Consolidated Financial Statements* replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements, and SIC12 *Consolidation - Special Purpose Entities*. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. This standard (i) requires a parent entity (an entity that controls one or more other entities) to present consolidated financial statements; (ii) defines the principle of control, and establishes control as a basis for consolidation; (iii) sets out how to apply the principle of control whether an investor controls an investee and therefore must consolidate the investee; and (iv) sets out the accounting requirements for the preparation of consolidated financial statements.

IFRS 10 is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. IFRS 10 may be adopted to an earlier accounting period, but in doing so, an entity must disclose the fact that it has early adopted the standard and apply IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IAS 27 *Separate Financial Statements* (as amended in 2011), IAS 28 *Investments in Associates and Joint Ventures* (as amended in 2011).

IFRS 11 *Joint Arrangements*

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

IFRS 12 *Disclosure of Interests in Other Entities*

IFRS 12 combines the disclosure requirements for an entity's interest in subsidiaries, joint arrangements, associates and structured entities into one comprehensive disclosure standard. This standard requires the disclosure of information that enable users of financial statements to evaluate the nature of, and risks associated with, its interest in other entities and the effects of those interests on its financial position, financial performance and cash flows. This standard is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted, and entities are permitted to incorporate any of the new disclosures into their financial statements before that date.

IFRS 13 *Fair Value Measurement*

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

IAS 19 *Post-employment Benefits*

On June 16, 2011 the IASB issued amendments to IAS 19, *Employee Benefit*, in order to improve the accounting for pensions and other post-employment benefits.

The amendments make important improvements by:

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

The amendments are effective for financial years beginning on or after January 1, 2013. Earlier application is permitted.

IAS 27 *Separate Financial Statements*

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

IAS 28 *Investments in Associates and Joint Ventures*

IAS 28 prescribes the accounting for investments in associates and to set the requirements for the application of the equity method when accounting for investments in associates and joint ventures. This standard is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted.

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

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

At its meeting on December 13-15, 2011, the IASB approved amendments to IFRS 7, *Financial Instruments: Disclosures*, with respect to offsetting financial assets and financial liabilities. As part of this project the IASB also clarified aspects of IAS 32, *Financial Instruments: Presentation*. The amendments to IAS 32 address inconsistencies in current practice when applying the requirements. The amendments are effective for annual periods beginning on or after January 1, 2014 and are required to be applied retrospectively.

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

IFRS 9 *Financial Instruments - Classification and Measurement*

IFRS 9, *Financial Instruments*: IFRS 9 introduces the new requirements for the classification, measurement and de-recognition of financial assets and financial liabilities. Specifically, IFRS 9 requires all recognized financial assets that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* to be subsequently measured at amortized cost or fair value, and all financial liabilities classified as subsequently measured at amortized cost except for financial liabilities as at FVTPL. The amendments are effective for annual periods beginning on or after January 1, 2015, with earlier application permitted.

MANAGEMENT'S DISCUSSION AND ANALYSIS

OTHER DATA

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

As at March 23, 2012, there are 481,465 DSU outstanding with a fair value of \$2.98 million and 265,231 RSU outstanding with a fair value of \$1.45 million.

SHARE POSITION AND OUTSTANDING WARRANTS AND OPTIONS

The Company's outstanding share position as at March 23, 2012 is 125,268,751 common shares. In addition, a total of 3,696,560 incentive stock options are currently outstanding as follows:

Type of Security	No. of Shares	Exercise Price (CAD\$)	Expiry Date
Incentive Stock Options:	8,271	\$4.46	March 30, 2012
	1,663,651	\$4.46	June 8, 2014
	200,000	\$1.35	February 5, 2016
	50,000	\$2.29	March 30, 2016
	10,000	\$1.75	May 8, 2016
	2,500	\$0.85	July 5, 2016
	225,000	\$1.55	July 5, 2016
	225,000	\$1.66	July 10, 2016
	35,000	\$0.85	January 11, 2017
	350,000	\$2.22	January 11, 2017
	184,138	\$6.67	February 20, 2017
	38,000	\$0.85	June 27, 2017
	25,000	\$0.85	October 24, 2017
	250,000	\$0.85	October 5, 2018
	230,000	\$0.85	November 5, 2018
	200,000	\$0.83	July 6, 2019
Total Outstanding Options	3,696,560		

INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

Effective January 1, 2011, Canadian publicly listed entities were required to prepare their financial statements in accordance with IFRS. Due to the requirement to present comparative financial information, the effective transition date is January 1, 2010. Refer to Note 23 of the consolidated financial statements for the year ended December 31, 2011.

Our IFRS conversion team identified three phases to our conversion: Scoping and Diagnostics, Analysis and Development, and Implementation and Review.

We have now completed our IFRS conversion project through implementation. Review and post-implementation will continue in future periods, as outlined below.

The following outlines our transition project, IFRS transitional impacts and the on-going impact of IFRS on our financial results.

MANAGEMENT'S DISCUSSION AND ANALYSIS

TRANSITIONAL FINANCIAL IMPACT

Equity Impact

As a result of the policy choices we have selected and the changes we were required to make under IFRS, we have recorded a reduction in our equity of approximately \$1.20 million and \$3.42 million as at January 1, 2010 and December 31, 2010, respectively. The table below outlines adjustments to our equity on adoption of IFRS on January 1, 2010 and December 31, 2010.

Expressed in \$ millions	January 1, 2010	December 31, 2010
Equity, CAD GAAP	\$ 112.56	\$ 206.01
Adjustments:		
Effect of foreign exchange on inventory, deposits on long term assets, and mineral properties, property, plant and equipment	(2.54)	(5.34)
Deferred income tax adjustments	1.48	1.94
Transfer of accumulated other comprehensive income to retained earnings	2.90	2.90
Reset accumulated other comprehensive income to zero	(2.90)	(2.90)
Adjustment to revise provisions	(0.32)	(0.25)
Adjustment for depletion on mineral properties related to provisions	0.18	0.23
Total IFRS adjustments to Equity	(1.20)	(3.42)
Equity, IFRS	\$ 111.36	\$ 202.59

Note: There may be differences due to rounding of decimal places.

A reconciliation of our comprehensive income under CAD GAAP and IFRS for the year ended December 31, 2010 and a discussion of the impact of IFRS on our cash flows are provided below.

Comprehensive Income Impact

As a result of the policy choices we have selected and the changes we were required to make under IFRS, we have also recorded an increase in our net income of approximately \$3.0 million for the year ended December 31, 2010. We have recorded a decrease in our total comprehensive income of approximately \$2.2 million for the year ended December 31, 2010.

The following is a summary of the adjustments to comprehensive income for year ended December 31, 2010 under IFRS (all of which are outlined in the notes to our consolidated financial statements):

Expressed in \$ millions	Year ended December 31, 2010		
	CAD GAAP	Effect of Transition to IFRS	IFRS
Income (loss) for the year	\$ 13.0	\$ 3.0	\$ 16.0
Other comprehensive income (loss)			
Transfer of unrealized loss to realized loss upon reduction of net investment, net of taxes	2.1	(2.1)	–
Unrealized (loss) gain on translation to presentation currency on foreign operations	5.9	(3.2)	2.7
Other comprehensive income	8.0	(5.3)	2.7
Total comprehensive income for the year	\$ 20.9	\$ (2.2)	\$ 18.7

Note: There may be differences due to rounding of decimal places.

Cash Flow Impact

The adoption of IFRS has had no material impact on the net cash flows of the Company. The changes made to the Consolidated Statements of Financial Position and Consolidated Statements of Comprehensive Income have resulted in reclassifications of various amounts on the Consolidated Statements of Cash Flows, however there is no net impact on cash and cash equivalents.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Statement Presentation Changes

The transition to IFRS has resulted in financial statement presentation changes in our financial statements, most significantly on the consolidated statement of income. The changes to the balance sheet relate mainly to the combining of mineral properties, property, plant and equipment and renaming of asset retirement obligations to provisions; future income tax liability to deferred income tax liabilities; and contributed surplus to share option and warrant reserve.

The following is a summary of the significant changes to our consolidated statement of income:

- expenses by function and nature – our statement of income presents expenses by function. Accordingly, depreciation, depletion, and accretion are no longer presented as a separate line item on the statement of income but depreciation and depletion are included in cost of sales. Accretion of provisions is included in interest expense;
- government royalties to cost of sales from selling, general and administrative expenses;
- distribution costs to cost of sales from selling, general and administrative expenses;
- community relation costs to cost of sales from selling, general and administrative expenses;
- other income and expenses from interest and other income and expenses to selling, general and administrative expenses;
- interest expense includes interest on debt financing and accretion of provisions; and,
- current workers participation from income tax to cost of sales and selling, general and administrative expenses.

In addition, exploration and evaluation costs moved from selling, general and administrative expenses.

The above changes are reclassifications within our statement of income so there is no net impact to our income as a result of these changes.

Control Activities

For all changes to policies and procedures that have been identified, the effectiveness of internal controls over financial reporting and disclosure controls and procedures has been assessed and any changes have been implemented. In addition, controls over the IFRS changeover process have been implemented, as necessary. We have identified and implemented the required accounting process changes that resulted from the application of IFRS accounting policies and these changes were not material. We have completed the design, implementation and documentation of the internal controls over accounting process changes resulting from the application of IFRS accounting policies and these changes were not material. We applied our existing control framework to the IFRS changeover process. All accounting policy changes and transitional financial position impacts were subject to review by senior management and the Audit Committee of the Board of Directors.

Business Activities and Key Performance Measures

We have assessed the impact of the IFRS transition project on our financial covenants and key ratios. The transition did not significantly impact our covenants and key ratios that have an equity component.

We have also reviewed the impact of the IFRS transition project on our compensation arrangements. We have identified compensation arrangements that are calculated based on indicators in our financial statements. We are continuing to work with our Human Resources department to ensure that all compensation arrangements incorporate indicators from our financial statements prepared under IFRS in accordance with our compensation policies.

Information Technology and Systems

The IFRS transition project did not have a significant impact on our information systems for the convergence periods. We also do not expect significant changes in the post-convergence periods.

Review

The post-implementation phase will involve continuous monitoring of changes in IFRS in future periods. We note that the standard-setting bodies that determine IFRS have significant ongoing projects that could impact the IFRS accounting policies that we have selected. In particular, there may be additional new or revised IFRSs or IFRICs in relation to financial instruments, hedge accounting, discontinued operations, leases and revenue recognition. We also note that the International Accounting Standards Board is currently working on an extractive industries project, which could significantly impact our financial statements primarily in the areas of capitalization of exploration costs and disclosures. We have processes in place to ensure that potential changes are monitored and evaluated. The impact of any new IFRSs and IFRIC Interpretations will be evaluated as they are drafted and published.

OTHER RISKS AND UNCERTAINTIES

There have been no major changes from the reported risks factors outlined in the Annual Information Form for the financial year ended December 31, 2011.

CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

The Company's management, with the participation of the Chief Executive Officer and the Chief Financial Officer, have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in the rules of the SEC and the Canadian Securities Administrators ("CSA") as of December 31, 2011, and have concluded that such disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 and Canadian securities laws is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and Canadian securities laws and (ii) accumulated and communicated to them Company's management, including its principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

Management concludes that, as of December 31, 2011, the Company's internal control over financial reporting was effective and no material weaknesses were identified.

OUTLOOK

SAN JOSE MINE, MEXICO

Exploration at San Jose in 2012 will continue to focus on the evaluation and advancement of multiple mineral occurrences outlined through mapping and stream and soil sampling on the 58,000 hectare land package the Company controls in the area surrounding the San Jose Mine. A 15,000 meter drill program has been budgeted for the year to drill test new targets and follow-up on the results of the 2011 program.

CAYLLOMA MINE, PERU

For 2012, the mine is scheduled to produce 2 million ounces of silver with additional by-product gold, lead and zinc. Capital projects budgeted for the year total \$25 million and include a new tailings facility with total holding capacity for seventeen years, camp improvements, upgrading of the power grid and plant equipment and infrastructure optimizations.

MANAGEMENT'S DISCUSSION AND ANALYSIS

2012 PRODUCTION GUIDANCE

For 2012, the Company is scheduled to produce 3.7 million ounces of silver and 17,400 ounces of gold production or 4.6 million Ag Eq ounces plus base metal credits.

Mine	Silver (M oz)	Gold (k oz)	Zinc (M lbs)	Lead (M lbs)
Caylloma, Peru	2.0	2.4	21.0	18.0
San Jose, Mexico	1.7	15.0	--	--
Total	3.7	17.4	21.0	18.0

- 2012 forecast silver production of 3.7 million ounces and gold production of 17,400 ounces or 4.6 million Ag Eq ounces plus base metal credits (Ag = US\$30/oz, Au = US\$1,660/oz; metallurgical recoveries of 88% and 90% for Ag and Au respectively)
- Ag Eq = Silver Equivalent

MINING TAX IN PERU

Effective October 1, 2011, the Peruvian Government approved a change in the tax law for the mining sector which consists of a progressive royalty scheme based on operating margins. Management expects that the impact on taxes paid by its Peruvian subsidiary under the current metal price environment will be between 2 and 3 added percentage points on the total royalty and mining tax.

CAUTIONARY STATEMENT ON FORWARD-LOOKING STATEMENTS

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

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

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

REPORT OF INDEPENDENT REGISTERED CHARTERED ACCOUNTANTS

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

We have audited the accompanying consolidated financial statements of Fortuna Silver Mines Inc. and subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2011, December 31, 2010 and January 1, 2010, and the consolidated statements of income, statements of comprehensive income, statements of changes in equity, and statements of cash flows for the years ended December 31, 2011 and December 31, 2010, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Fortuna Silver Mines Inc. and subsidiaries as at December 31, 2011, December 31, 2010 and January 1, 2010 and their financial performance and cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

(Signed) Deloitte & Touche LLP

Independent Registered Chartered Accountants
March 23, 2012
Vancouver, Canada

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31,

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

	Notes	2011	2010 23 h)
Sales	18	\$ 110,004	\$ 74,056
Cost of sales	21	49,030	34,844
Mine operating income		60,974	39,212
Other expenses			
Selling, general and administrative expenses	10 a) b), 21	19,840	10,984
Exploration and evaluation costs	21	1,715	547
Net gain on commodity contracts		(481)	(736)
(Gain) loss on disposal of mineral properties, property, plant and equipment		(59)	127
Loss on disposal of investment		–	119
Write-off of deferred exploration costs		–	443
Impairment of mineral properties, property, plant and equipment	8	1,894	–
Operating income		38,065	27,728
Finance items			
Interest income		830	493
Interest expense		(560)	(708)
Net finance income (expense)	20	270	(215)
Income before tax		38,335	27,513
Income taxes	13	18,802	11,510
Income for the year		\$ 19,533	\$ 16,003
Earnings per Share – Basic	14 e) i	\$ 0.16	\$ 0.15
Earnings per Share – Diluted	14 e) ii	\$ 0.16	\$ 0.14
Weighted average number of shares outstanding – Basic	14 e) i	123,295,063	108,120,452
Weighted average number of shares outstanding – Diluted	14 e) ii	124,711,984	110,564,767
Expenses by Nature	21		

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

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

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

	Notes	2011	2010 23 i)
Income for the year		\$ 19,533	\$ 16,003
Other comprehensive income			
Unrealized gain on translation of net investment		751	–
Unrealized (loss) gain on translation to presentation currency on foreign operations		(79)	2,723
Other comprehensive income		672	2,723
Total comprehensive income for the year		\$ 20,205	\$ 18,726

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31,

(Expressed in thousands of US Dollars)

	Notes	Years ended December 31,	
		2011	2010 23 i)
OPERATING ACTIVITIES			
Net income		\$ 19,533	\$ 16,003
Items not involving cash			
Depletion and depreciation		9,421	6,462
Accretion of provisions		173	163
Income tax expense		18,802	11,510
Share-based payments (recovery)		3,682	(501)
Unrealized (gain) on commodity contracts		(116)	(2,922)
Write-off of deferred exploration costs		–	443
Impairment of mineral properties, property, plant and equipment		1,894	–
(Gain) loss on disposal of mineral properties, property, plant and equipment		(59)	127
Accrued interest on long term loans receivable and payable		24	50
		53,354	31,335
Changes in non-cash working capital items			
Accounts receivable and other assets		(3,085)	(4,788)
Inventories		(7,273)	(1,536)
Trade and other payables		6,829	3,677
Due to/from related parties		134	(9)
Provisions		(201)	–
Cash provided by operating activities before interest and income taxes		49,758	28,679
Income taxes paid		(15,007)	(7,301)
Interest income paid		(80)	(127)
Interest income received		837	462
Net cash provided by operating activities		35,508	21,713
INVESTING ACTIVITIES			
Purchase of short term investments		(49,671)	(47,675)
Redemptions in short term investments		53,406	33,817
Expenditures on mineral properties, property, plant and equipment		(76,676)	(36,711)
Payments of value added taxes on purchase of property, plant and equipment		(522)	(2,915)
Advances of deposits on long term assets		(31,859)	(4,661)
Receipts of deposits on long term assets		35,424	–
Proceeds on disposal of mineral properties, property, plant and equipment		41	81
Net cash used in investing activities		(69,857)	(58,064)
FINANCING ACTIVITIES			
Proceeds from long term debt		18	–
Repayment of long term debt		(18)	–
Net proceeds on issuance of common shares		3,656	74,922
Repayment of finance lease obligations		(1,178)	(1,187)
Net cash provided by financing activities		2,478	73,735
Effect of exchange rate changes on cash and cash equivalents		303	2,151
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS		(31,871)	37,384
Cash and cash equivalents – beginning of year	3	70,298	30,763
CASH AND CASH EQUIVALENTS – END OF YEAR	3	\$ 38,730	\$ 70,298
Supplemental cash flow information	15		

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

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Expressed in thousands of US Dollars)

Notes	December 31, 2011	December 31, 2010 23 g)	January 1 2010 23 g)	
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	3	\$ 38,730	\$ 70,298	\$ 30,763
Short term investments	4	17,000	20,509	6,034
Derivative assets	5	70	–	37
Accounts receivable and other assets	6	15,609	13,454	8,635
GST/HST and value added tax receivable	6	4,777	3,542	601
Inventories	7	11,291	4,018	2,328
		87,477	111,821	48,398
NON-CURRENT ASSETS				
Deposits on long term assets	6	2,260	4,686	16
Deferred income tax assets	13 b)	36	–	–
Mineral properties, property, plant and equipment	8	181,833	117,363	85,175
Total assets		\$ 271,606	\$ 233,870	\$ 133,589
LIABILITIES AND EQUITY				
CURRENT LIABILITIES				
Trade and other payables	9	\$ 17,156	\$ 9,303	\$ 5,136
Due to related parties	10 c)	169	40	49
Derivative liabilities	5	87	133	3,092
Provisions	12	727	–	–
Income tax payable	13 a)	3,923	4,192	2,949
Current portion of long term liability	11	1,512	1,083	1,038
		23,574	14,751	12,264
NON-CURRENT LIABILITIES				
Leases and long term liabilities	11	2,764	3,166	1,454
Provisions	12	4,247	4,881	2,917
Deferred income tax liabilities	13 b)	12,710	8,482	5,593
		43,295	31,280	22,228
EQUITY				
Share capital		186,540	180,403	104,701
Share option and warrant reserve		10,495	11,116	14,315
Retained earnings (deficit)		27,881	8,348	(7,655)
Accumulated other comprehensive income		3,395	2,723	–
		31,276	11,071	(7,655)
		228,311	202,590	111,361
		\$ 271,606	\$ 233,870	\$ 133,589
Contingencies and capital commitments	19			
Subsequent events	22			

APPROVED BY THE DIRECTORS:

“Jorge Ganoza Durant”, Director
Jorge Ganoza Durant

“Robert R. Gilmore”, Director
Robert R. Gilmore

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

FOR THE YEARS ENDED DECEMBER 31,
(Expressed in thousands of US Dollars, except for share amounts)

	Notes	Attributable to Equity Holders of the Company						
		Share Capital		Share Option and Warrant Reserve	Retained Earnings (Deficit)	Accumulated Other Compre- hensive Income (AOCI")	Total Retained Earnings (Deficit) and AOCI	Total Equity
		Shares	Amount					
Balance – December 31, 2010		122,497,465	\$ 180,403	\$ 11,116	\$ 8,348	\$ 2,723	\$ 11,071	\$ 202,590
Issuance of shares under bought deal financing, net of issuance costs		–	(95)	–	–	–	–	(95)
Exercise of options		2,441,700	3,751	–	–	–	–	3,751
Issuance of shares for property	14 a)	6,756	30	–	–	–	–	30
Transfer of contributed surplus on exercise of options		–	2,451	(2,451)	–	–	–	–
Share-based payments on option grants		–	–	1,830	–	–	–	1,830
Income for the year		–	–	–	19,533	–	19,533	19,533
Unrealized gain on translation of net investment		–	–	–	–	751	751	751
Unrealized (loss) on translation to presentation currency on foreign operations		–	–	–	–	(79)	(79)	(79)
Total comprehensive income for the year					19,533	672	20,205	20,205
Balance – December 31, 2011		124,945,921	\$ 186,540	\$ 10,495	\$ 27,881	\$ 3,395	\$ 31,276	\$ 228,311
Balance – December 31, 2009		94,982,652	\$ 104,701	\$ 14,315	\$ (7,655)	\$ –	\$ (7,655)	\$ 111,361
Issuance of shares under bought deal financing, net of issuance costs		26,507,500	73,919	–	–	–	–	73,919
Exercise of options		999,500	1,004	–	–	–	–	1,004
Issuance of shares for property	14 a)	7,813	20	–	–	–	–	20
Transfer of contributed surplus on exercise of options		–	759	(759)	–	–	–	–
Share-based payments (recoveries) on option grants		–	–	(2,440)	–	–	–	(2,440)
Income for the year		–	–	–	16,003	–	16,003	16,003
Unrealized gain on translation to presentation currency on foreign operations		–	–	–	–	2,723	2,723	2,723
Total comprehensive income for the year					16,003	2,723	18,726	18,726
Balance – December 31, 2010	23 f)	122,497,465	\$ 180,403	\$ 11,116	\$ 8,348	\$ 2,723	\$ 11,071	\$ 202,590

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

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

1. CORPORATE INFORMATION

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

Fortuna is a publicly traded company incorporated and domiciled in Canada and is listed on the New York Stock Exchange under the trading ticker symbol "FSM", and on the Toronto Stock Exchange and Lima Stock Exchange under the trading ticker symbol "FVI".

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

2. BASIS OF CONSOLIDATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Statement of Compliance

These consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The policies applied in these consolidated financial statements are based on IFRS issued and effective as at December 31, 2011. The Board of Directors approved these financial statements for issue on March 23, 2012.

b) Basis of Consolidation

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

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

c) Revenue Recognition

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

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

d) Cash and Cash Equivalents

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

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

e) Mineral Properties, Property, Plant and Equipment

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

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

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

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

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

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

i. Evaluation and Exploration Assets

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

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

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

Proceeds received from the sale of interests in exploration and evaluation assets are credited to the carrying value of the mineral properties, with any excess included in income.

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

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

ii. Operational Mining Properties and Mine Development

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

Costs of producing properties are amortized on a unit-of-production basis over proven and probable reserves, and costs of abandoned properties are written-off.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

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

iii. Commercial Production

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

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

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

f) Asset Impairment

Assets are assessed for impairment at each reporting date when changes in events or circumstances occur that indicate the assets may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less cost to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash inflows or cash generating units. These are typically individual mines or development projects. Brownfields exploration projects, located close to existing mine infrastructure, are assessed for impairment as part of the associated mine cash generating unit.

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

The cash flow forecasts are based on best estimates of expected future revenues and costs, including the future cash costs of production, capital expenditure and reclamation and closures costs.

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

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

g) Provisions

i. Decommissioning and restoration provisions

Future obligations to retire an asset, including dismantling, remediation and ongoing treatment and monitoring of the site related to normal operations are initially recognized and recorded as a liability based on estimated future cash flows discounted at a credit adjusted risk-free rate. The decommissioning and restoration provision ("DRP") is adjusted at each reporting period for changes to factors including the expected amount of cash flows required to discharge the liability, the timing of such cash flows and the credit adjusted risk-free discount rate.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

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

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

ii. Environmental disturbance restoration provisions

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

iii. Other provisions

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

h) Inventories

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

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

i) Income taxes

Income tax expense consists of current and deferred tax expense. Income tax is recognized in the income or loss.

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

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

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

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

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

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

j) Share-Based Payments

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

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

i. Stock Option Plan

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

ii. Deferred Share Unit ("DSU") Plan

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

iii. Restricted Share Unit ("RSU") Plan

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

k) Earnings (Loss) per Share

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

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

l) Foreign Currency Translation

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

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

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

m) Financial Instruments

i. *Financial Assets*

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

a) *Financial Assets at Fair Value Through Profit or Loss*

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

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

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

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

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

c) *Loans and Receivables*

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

d) *Available-For-Sale ("AFS") Assets*

AFS financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories.

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

The Company does not have any assets classified as AFS.

e) *Impairment of Financial Assets*

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

Objective evidence of impairment could include the following:

- significant financial difficulty of the issuer or counterparty;
- default or delinquency in interest or principal payments; or
- it has become probable that the borrower will enter bankruptcy or financial reorganization.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

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

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

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

f) *Derecognition of Financial Assets*

A financial asset is derecognized when:

- the contractual right of the asset's cash flows expire; or
- if the Company transfers the financial asset and substantially all risks and reward of ownership to another entity.

ii. *Financial Liabilities*

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

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

iii. *Classification and Subsequent Measurements*

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

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

iv. *Effective Interest Method*

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

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n) Segment Reporting

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

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

o) Leases

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

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

p) Share Capital

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

q) Related Party Transactions

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

r) Significant Accounting Judgments and Estimates

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

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

i. Critical Judgments

- The analysis of the functional currency for each entity of the Company. In concluding that the United States dollar ("US\$") functional currency for its Peruvian and Mexican entities and the Canadian and Barbados entities have a Canadian dollar ("CAD\$") functional currency, management considered the currency that mainly influences the cost of providing goods and services in each jurisdiction in which the Company operates. As no single currency was clearly dominant the Company also considered secondary indicators including the currency in which funds from financing activities are denominated and the currency in which funds are retained.
- In concluding when commercial production has been achieved, the Company considered the following factors:
 - all major capital expenditures to bring the mine to the condition necessary for it to be capable of operating in the manner intended by management have been completed;
 - the mine or mill is operating as per design capacity and metallurgical recoveries were achieved; and,
 - the ability to sustain ongoing production of ore at a steady or increasing level.
- The identification of reportable segments, basis for measurement and disclosure of the segmented information.

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- The determination of estimated useful lives and residual values of tangible and long-lived assets and the measurement of depreciation expense.
- The identification of impairment indicators, cash generating units and determination of value in use and the write down of tangible and long lived assets.
- Measurement of financial instruments involve significant judgments related to interpretation of the terms of the instrument, identification, classification, impairment and the overall measurement to approximate fair values.

ii. *Estimates*

- the recoverability of amounts receivable which are included in the consolidated statements of financial position;
- the estimation of assay grades of metal concentrates sold in the determination of the carrying value of accounts receivable which are included in the consolidated statements of financial position and included as sales in the consolidated statements of income;
- the carrying value of the short term investments and the recoverability of the carrying value which are included in the consolidated statements of financial position;
- the determination of net realizable value of inventories on the consolidated statements of financial position;
- the estimated useful lives of property, plant and equipment which are included in the consolidated statements of financial position and the related depreciation included in the consolidated statements of income;
- the determination of mineral reserves, carrying amount of mineral properties, and depletion of mineral properties included in the consolidated statements of financial position and the related depletion included in the consolidated statements of income;
- review of tangible and intangible assets carrying value, the determination of whether these assets are impaired and the measurement of impairment charges or reversals which are included in the consolidated statements of income;
- the determination of the fair value of financial instruments and derivatives included in the consolidated statements of financial position;
- the fair value estimation of share-based awards included in the consolidated statements of financial position and the inputs used in accounting for share-based compensation expense in the consolidated statements of income;
- the provision for income taxes which is included in the consolidated statements of income and composition of deferred income tax asset and liabilities included in the consolidated statement of financial position;
- the recognition of deferred income tax assets, amounts recorded for uncertain tax positions, the measurement of income tax expense and indirect taxes included in the consolidated statement of financial position;
- the inputs used in determining the net present value of the liability for provisions related to decommissioning and restoration included in the consolidated statements of financial position;
- the inputs used in determining the various commitments and contingencies accrued in the consolidated statements of financial position; and,
- the assessment of indications of impairment of each mineral properties and related determination of the net realizable value and write-down of those properties where applicable.

s) **New Accounting Standards**

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

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

IFRS 7 Financial Instruments: Disclosures (Amendment)

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

IAS 12 Income Taxes (Amendment)

IAS 12 *Income Taxes*, amendments regarding Deferred Tax: Recovery of Underlying Assets introduces an exception to the existing principle for the measurement of deferred tax assets and liabilities arising on investment property measured at fair value, and the requirement that deferred tax on non-depreciable assets measured using the revaluation model in IAS 16 should always be measured on a sale basis. The amendment is effective for annual periods beginning on or after January 1, 2012.

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

IAS 1 Presentation of Financial Statements (Amendment)

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

The amendment is effective for annual periods beginning on or after July 1, 2012.

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

IFRS 7 Financial Instruments: Disclosures in Respect of Offsetting (Amendment)

At its meeting on December 13-15, 2011, the IASB approved amendments to IFRS 7, *Financial Instruments: Disclosures*, with respect to offsetting financial assets and financial liabilities. The common disclosure requirements issued by the IASB and the FASB in December 2011 are intended to help investors and other users to better assess the effect or potential effect of offsetting arrangements on a company's financial position. Companies and other entities are required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The required disclosures should be provided retrospectively.

IFRS 10 Consolidated Financial Statements

IFRS 10 *Consolidated Financial Statements* replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements, and SIC12 *Consolidation - Special Purpose Entities*. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. This standard (i) requires a parent entity (an entity that controls one or more other entities) to present consolidated financial statements; (ii) defines the principle of control, and establishes control as a basis for consolidation; (iii) sets out how to apply the principle of control whether an investor controls an investee and therefore must consolidate the investee; and (iv) sets out the accounting requirements for the preparation of consolidated financial statements.

IFRS 10 is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. IFRS 10 may be adopted to an earlier accounting period, but in doing so, an entity must disclose the fact that it has early adopted the standard and apply IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IAS 27 *Separate Financial Statements* (as amended in 2011), IAS 28 *Investments in Associates and Joint Ventures* (as amended in 2011).

IFRS 11 Joint Arrangements

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

IFRS 12 Disclosure of Interests in Other Entities

IFRS 12 combines the disclosure requirements for an entity's interest in subsidiaries, joint arrangements, associates and structured entities into one comprehensive disclosure standard. This standard requires the disclosure of information that enable users of financial statements to evaluate the nature of, and risks associated with, its interest in other entities and the effects of those interests on its financial position, financial performance and cash flows. This standard is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted, and entities are permitted to incorporate any of the new disclosures into their financial statements before that date.

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IFRS 13 Fair Value Measurement

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

IAS 19 Post-employment Benefits

On June 16, 2011 the IASB issued amendments to IAS 19, *Employee Benefit*, in order to improve the accounting for pensions and other post-employment benefits.

The amendments make important improvements by:

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

The amendments are effective for financial years beginning on or after January 1, 2013. Earlier application is permitted.

IAS 27 Separate Financial Statements

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

IAS 28 Investments in Associates and Joint Ventures

IAS 28 prescribes the accounting for investments in associates and to set the requirements for the application of the equity method when accounting for investments in associates and joint ventures. This standard is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted.

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

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

At its meeting on December 13-15, 2011, the IASB approved amendments to IFRS 7, *Financial Instruments: Disclosures*, with respect to offsetting financial assets and financial liabilities. As part of this project the IASB also clarified aspects of IAS 32, *Financial Instruments: Presentation*. The amendments to IAS 32 address inconsistencies in current practice when applying the requirements. The amendments are effective for annual periods beginning on or after January 1, 2014 and are required to be applied retrospectively.

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

IFRS 9 Financial Instruments - Classification and Measurement

IFRS 9, *Financial Instruments*: IFRS 9 introduces the new requirements for the classification, measurement and de-recognition of financial assets and financial liabilities. Specifically, IFRS 9 requires all recognized financial assets that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* to be subsequently measured at amortized cost or fair value, and all financial liabilities classified as subsequently measured at amortized cost except for financial liabilities as at FVTPL. The amendments are effective for annual periods beginning on or after January 1, 2015, with earlier application permitted.

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3. CASH AND CASH EQUIVALENTS

	December 31, 2011	December 31, 2010	January 1, 2010
Cash	\$ 25,652	\$ 61,118	\$ 21,863
Cash equivalents	13,078	9,180	8,900
	\$ 38,730	\$ 70,298	\$ 30,763

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

4. SHORT TERM INVESTMENTS

	December 31, 2011	December 31, 2010	January 1, 2010
Held for trading short term investments	\$ 17,000	\$ 20,509	\$ 6,034

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

5. DERIVATIVE ASSETS AND DERIVATIVE LIABILITIES

	December 31, 2011		December 31, 2010		January 1, 2010	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Lead Asian options	\$ -	\$ -	\$ -	\$ -	\$ 2	\$ -
Zinc Asian options	-	-	-	-	-	263
Lead forward contracts	-	53	-	14	-	1,356
Zinc forward contracts	70	-	-	6	-	1,473
Silver forward contracts	-	34	-	113	35	-
Total	\$ 70	\$ 87	\$ -	\$ 133	\$ 37	\$ 3,092

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

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

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**6. ACCOUNTS RECEIVABLE AND OTHER ASSETS AND DEPOSITS
ON LONG TERM ASSETS**

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

	December 31, 2011	December 31, 2010	January 1, 2010
Current			
Trade receivables from concentrate sales	\$ 11,287	\$ 11,224	\$ 7,154
Current portion of long term receivables - net	891	39	121
Prepaid expenses	1,171	903	313
Deposits	47	-	24
Advances and other receivables	2,213	1,288	1,023
Accounts receivable and other assets	\$ 15,609	\$ 13,454	\$ 8,635
GST/HST and value added tax receivable	\$ 4,777	\$ 3,542	\$ 601

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

	December 31, 2011	December 31, 2010	January 1, 2010
Non-current			
Long term receivables	\$ 1,415	\$ 47	\$ 137
Less: current portion of long term receivables	(891)	(39)	(121)
Non-current portion of long term receivables – net	524	8	16
Deposits on equipment	1,167	3,097	-
Deposits paid to contractors	448	1,581	-
Other	121	-	-
	\$ 2,260	\$ 4,686	\$ 16

As at December 31, 2011, the Company had \$100 trade receivables (2010: \$nil) (January 1, 2010: \$nil) which were past due with no impairment. The Company's allowance for doubtful accounts is \$nil for all reporting periods.

The aging analysis of these trade receivables is as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
0-30 days	\$ 9,518	\$ 9,754	\$ 7,154
31-60 days	911	1,057	-
61-90 days	758	413	-
over 90 days	100	-	-
	\$ 11,287	\$ 11,224	\$ 7,154

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7. INVENTORIES

For the years ended December 31, 2011, \$31,655 (2010: \$22,270) of inventory was expensed in cost of sales and there has been no impairment during 2011 (2010: \$nil).

	December 31, 2011	December 31, 2010	January 1, 2010
Concentrate stock piles	\$ 2,488	\$ 346	\$ 651
Ore stock piles	4,008	1,274	203
Materials and supplies	4,795	2,398	1,474
Total inventories	\$ 11,291	\$ 4,018	\$ 2,328

8. MINERAL PROPERTIES, PROPERTY, PLANT AND EQUIPMENT

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

* Commercial production began on September 1, 2011 for San Jose and included in mineral properties non-depletable as at December 31, 2010 and January 1, 2010.

In 2011, non-depletable mineral properties include the following properties: Mario, Don Mario, Tlacolula, and Taviche.

	Mineral Properties Non- Depletable	Mineral Properties Depletable (Caylloma)	Machinery and Equipment	Land Buildings, and Leasehold Improvements	Furniture and Other Equipment	Transport Units	Equipment under Finance Lease	Capital Work in Progress	Total
Year ended December 31, 2010									
Opening carrying amount	\$ 39,907	\$ 28,370	\$ 6,916	\$ 4,033	\$ 1,117	\$ 197	\$ 2,682	\$ 1,953	\$ 85,175
Additions	9,334	8,499	1,729	155	2,542	88	928	16,490	39,765
Disposals	(112)	(443)	(20)	(1)	(10)	(67)	-	-	(653)
Depreciation charge	-	(3,604)	(1,509)	(768)	(273)	(106)	(664)	-	(6,924)
Reclassification	-	786	(219)	3,594	(199)	-	(53)	(3,909)	-
Closing carrying amount	\$ 49,129	\$ 33,608	\$ 6,897	\$ 7,013	\$ 3,177	\$ 112	\$ 2,893	\$ 14,534	\$ 117,363
As at December 31, 2010									
Cost	49,129	47,500	\$ 11,060	\$ 9,076	\$ 3,985	\$ 436	\$ 4,174	\$ 14,534	\$ 139,894
Accumulated depreciation and impairment	-	(13,892)	(4,163)	(2,063)	(808)	(324)	(1,281)	-	(22,531)
Closing carrying amount	\$ 49,129	\$ 33,608	\$ 6,897	\$ 7,013	\$ 3,177	\$ 112	\$ 2,893	\$ 14,534	\$ 117,363

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	Mineral Properties Non- Depletable	Mineral Properties Depletable (Caylloma)	Machinery and Equipment	Land and Buildings	Furniture and Other Equipment	Transport Units	Equipment under Finance Lease	Capital Work in Progress	Total
As at January 1, 2010									
Opening carrying amount	\$ 35,755	\$ 25,947	\$ 6,661	\$ 3,365	\$ 1,025	\$ 392	\$ 1,629	\$ 1,493	\$ 76,267
Additions	5,402	5,019	418	138	229	-	1,425	2,652	15,283
Disposals	(1,250)	-	(77)	(1)	(26)	(80)	(23)	-	(1,457)
Depreciation charge	-	(2,596)	(1,250)	(392)	(216)	(115)	(349)	-	(4,918)
Reclassification	-	-	1,164	923	105	-	-	(2,192)	-
Closing carrying amount	\$ 39,907	\$ 28,370	\$ 6,916	\$ 4,033	\$ 1,117	\$ 197	\$ 2,682	\$ 1,953	\$ 85,175
As at January 1, 2010									
Cost	39,907	38,658	\$ 9,933	\$ 5,071	\$ 1,548	\$ 437	\$ 3,249	\$ 1,953	\$ 100,756
Accumulated depreciation and impairment	-	(10,288)	(3,017)	(1,038)	(431)	(240)	(567)	-	(15,581)
Closing carrying amount	\$ 39,907	\$ 28,370	\$ 6,916	\$ 4,033	\$ 1,117	\$ 197	\$ 2,682	\$ 1,953	\$ 85,175

Mineral properties includes bonuses paid of \$1,350 (2010: \$nil) (January 1, 2010: \$nil) which were paid upon commissioning of the San Jose mine to a director, a director and officer, and an officer. The bonus comprises of \$1,113 paid to key management and \$237 paid to a company controlled by a director. Refer to Note 10 Related Party Transactions.

a) Mario Property

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

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

The transfer of the property to the Company is subject to a 1% net smelter return ("NSR") royalty on production from the property payable to Crocodile Gold ("Crocodile"). The Company shall have the right to purchase the NSR royalty from Crocodile at any time during the five-year period following the final option payment for the sum of \$3,000. The property is also subject to a 2% NSR royalty on production payable to Teck Cominco and a 0.5% NSR royalty on production payable to Socrate Capital Inc., with each royalty in turn subject to certain buy-back provisions. As at December 31, 2011, \$1,000 has been paid under the agreement.

b) Don Mario Property

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

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

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

As at December 31, 2011, \$200 has been paid under the agreement.

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c) Tlacolula Property

In September 2009, the Company, through its wholly owned subsidiary, Cuzcatlan, was granted an option (the "Option") to acquire a 60% interest (the "Interest") in the Tlacolula silver project ("property") located in the State of Oaxaca, Mexico from Radius Gold Inc.'s wholly owned subsidiary, Radius (Cayman) Inc. ("Radius") (a related party by way of directors in common with the Company described further in Note 10).

The Company can earn the Interest by spending \$2,000, which includes a commitment to drill 1,500 meters within three years, and making staged annual payments of \$250 cash and \$250 in common stock of the Company to Radius according to the following schedule:

- \$20 cash and \$20 cash equivalent in shares upon stock exchange approval;
- \$30 cash and \$30 cash equivalent in shares by the first year anniversary;
- \$50 cash and \$50 cash equivalent in shares by the second year anniversary;
- \$50 cash and \$50 cash equivalent in shares by the third year anniversary; and,
- \$100 cash and \$100 cash equivalent in shares by the fourth year anniversary.

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

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

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

Subsequent to December 31, 2011, on January 13, 2012, the Company issued 8,605 common shares of the Company, at a fair market value of \$5.81 per share and paid \$50 cash according to the terms of the option agreement.

d) Taviche Property

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

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

9. TRADE AND OTHER PAYABLES

	December 31, 2011	December 31, 2010	January 1, 2010
Trade accounts payable	\$ 8,800	\$ 3,967	\$ 2,580
Payroll and other payables	7,152	5,249	2,556
Restricted share unit payable	1,204	87	–
	\$ 17,156	\$ 9,303	\$ 5,136

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

10. RELATED PARTY TRANSACTIONS

The consolidated financial statements include the financial statements of Fortuna Silver Mines Inc. and its subsidiaries listed in the following table:

Name	Country of Incorporation	Equity interest as at December 31,	
		2011	2010
Minera Bateas S.A.C.	Peru	100%	100%
Fortuna Silver Mines Peru S.A.C.	Peru	100%	100%
Compania Minera Cuzcatlan SA	Mexico	100%	100%
Fortuna Silver Mexico, S.A. de CV	Mexico	100%	n/a
Fortuna Silver (Barbados) Inc.	Barbados	100%	100%
Continuum Resources Ltd.	Canada	100%	100%

Fortuna Silver Mexico, S.A. de CV was incorporated in 2011.

a) Purchase of Goods and Services

The Company entered into the following related party transactions:

Transaction with related parties	Year ended December 31	
	2011	2010
Salaries and wages ^{1,2}	\$ 173	\$ 174
Other general and administrative expenses ²	292	185
Leasehold improvements ²	93	–
	\$ 558	\$ 359

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

² *Radius Gold Inc. ("Radius") has directors in common with the Company and shares office space, and is reimbursed for salaries and wages, general and administrative costs, and leasehold improvements incurred on behalf of the Company.*

During the year ended December 31, 2011, the Company transferred two mining concessions to Focus Ventures Ltd., a Company with directors in common, in exchange for a 1% net smelter return royalty.

During the year ended December 31, 2011, the Company issued 6,756 (2010: 7,813) common shares, at a fair market value of \$4.44 (2010: \$2.56) per share and paid \$30 cash (2010: \$20) to Radius, under the option to acquire a 60% interest in Tlacolula silver project located in the State of Oaxaca, Mexico.

Subsequent to the year ended December 31, 2011 to March 23, 2012, the Company issued 8,605 common shares, at a fair market value of \$5.81 per share and paid \$50 cash to Radius, under the option to acquire a 60% interest in Tlacolula silver project located in the State of Oaxaca, Mexico.

b) Key Management Compensation

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

	Year ended December 31	
	2011	2010
Salaries and other short term employee benefits	\$ 3,492	\$ 2,633
Directors fees	333	300
Consulting fees	416	174
Share-based payments	4,398	188
	\$ 8,639	3,295

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

Consulting fees includes fees paid to two non-executive directors in both 2011 and 2010.

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

Amounts due to/(from) related parties	December 31, 2011	December 31, 2010	January 1, 2010
Owing from a director and officer ³	\$ (36)	\$ (1)	\$ (1)
Owing to a company with common directors ²	205	41	50
	\$ 169	\$ 40	\$ 49

³ Owing from a director includes non-interest bearing advances to a director and officers at December 31, 2011 and one officer and director at December 31, 2010 and January 1, 2010.

11. LEASES AND LONG TERM LIABILITIES

Leases and long term liabilities are comprised of the following:

	December 31, 2011	December 31, 2010	January 1, 2010
Obligations under finance lease (a)	\$ 866	\$ 1,545	\$ 1,848
Long term liability (b)	771	705	644
Deferred share units (Note 14 c))	2,639	1,955	-
Restricted share units (Note 14 d))	1,204	131	-
	5,480	4,336	2,492
Less: current portion			
Obligations under finance lease	741	1,083	1,038
Long term liability	771	-	-
Current portion of long term liability	1,512	1,083	1,038
Restricted share unit payable, current (Note 9)	1,204	87	-
Leases and long term liability, non-current	\$ 2,764	\$ 3,166	\$ 1,454

a) Obligations under Finance Lease

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

Obligations under Finance Lease	December 31, 2011	December 31, 2010	January 1, 2010
Not later than 1 year	\$ 763	\$ 1,150	\$ 1,151
Less: future finance charges on finance lease	(22)	(67)	(113)
	741	1,083	1,038
Later than 1 year but less than 5 years	126	472	862
Less: future finance charges on finance lease	(1)	(10)	(52)
	125	462	810
Present value of finance lease payments	\$ 866	\$ 1,545	\$ 1,848

b) Long Term Liabilities

In May 2008, the Company acquired the Monte Alban II concession for which a payment of \$800 is due May 2012. This payment is non-interest bearing.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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12. PROVISIONS

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

	Decommissioning and Restoration Liability
Balance – January 1, 2010	\$ 2,917
New provisions	1,583
Increase to existing provisions	125
Accretion of provisions (Note 20)	163
Foreign exchange differences	93
Balance – December 31, 2010	\$ 4,881
Increase to existing provisions	126
Accretion of provisions (Note 20)	173
Foreign exchange differences	(5)
Cash payments	(201)
Total provisions – December 31, 2011	\$ 4,974
Less: current portion	(727)
Non current – December 31, 2011	\$ 4,247

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

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

13. INCOME TAX

a) Income tax expense differs from the amount that would be computed by applying the Canadian statutory income tax rate of 26.50% (2010: 28.50%) to income before income taxes. The reasons for the differences are as follows:

	December 31 2011	December 31 2010
Income before tax	\$ 38,335	\$ 27,513
Statutory income tax rate	26.50%	28.50%
Expected income tax	\$ 10,159	\$ 7,841
Items non-deductible for income tax purposes	1,401	292
Difference between Canadian and foreign tax rates	1,376	874
Effect of change in tax rates	620	431
Impact of foreign exchange on tax assets and liabilities	3,271	(133)
Impact of Mexican inflation on tax values	(16)	(130)
Under (over) provided in prior periods	704	(1,495)
Unused tax losses and tax offsets not recognized in tax asset	1,287	3,830
Total income taxes	\$ 18,802	\$ 11,510
Represented by:		
Current income tax	\$ 14,607	\$ 8,620
Deferred income tax	4,195	2,890
	\$ 18,802	\$ 11,510

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The effective tax rate for the years ended December 31, 2011 and 2010 was 49.05% and 41.8%, respectively. The change in the effective tax rate was primarily attributable to the geographical mix of income, fluctuations in exchange rates for foreign currency, the impact of foreign exchange on the tax basis on non-monetary assets, and the non-recognition of tax benefits.

Effective January 1, 2011, the Canadian Federal corporate tax rate decreased from 18% to 16.5% and the British Columbia provincial tax decreased from 10.5% to 10%. The overall reduction in tax rates has resulted in a decrease in the Company's statutory tax rate from 28.50% to 26.50%.

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

Income taxes payable of \$3,923 (December 31, 2010: \$4,192, January 1, 2010 \$2,949) relates to current taxes.

b) The tax effected items that give rise to significant portions of the deferred income tax assets and deferred income tax liabilities at December 31, 2011 and 2010 are presented below:

	December 31 2011	December 31 2010
Deferred income tax assets:		
Non-capital losses	\$ 12,544	\$ 2,939
Provisions and other	2,059	1,095
Financial derivatives	5	42
Mineral properties, property, plant and equipment	296	186
Net deferred income tax assets	14,904	4,262
Deferred income tax liabilities:		
Mineral properties – Peru	\$ (11,790)	\$ (9,912)
Mineral properties – Mexico	(5,640)	(2,832)
Equipment	(10,148)	–
Total deferred income tax liabilities	\$ (27,578)	\$ (12,744)
Net deferred income tax liabilities	\$ (12,674)	\$ (8,482)
Classification		
Non-current assets	\$ 36	\$ –
Non-current liabilities	(12,710)	(8,482)
Net deferred income tax liabilities	\$ (12,674)	\$ (8,482)

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

	December 31 2011	December 31 2010
Non-capital losses	\$ 38,503	\$ 29,689
Provisions and other	3,841	3,563
Share issue cost	2,913	4,146
Mineral properties, property, plant and equipment	1,532	3,966
Unrecognized deductible temporary differences	\$ 46,789	\$ 41,364

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The Company's unrecognized deferred tax assets related to unused tax losses have the following expiry dates:

		Expiry Date
Non-capital losses, expiring as follows:		
Canada	\$ 35,346	2013 - 2031
Mexico	2,850	2016 - 2031
Barbados	172	2017 - 2020
	\$ 38,368	

14. SHARE CAPITAL

a) Unlimited Common Shares Without Par Value

During the year ended December 31, 2010, the Company issued an aggregate of 26,507,500 common shares, under two bought deal financings, for gross proceeds of \$78,528. Net proceeds of \$73,919 after share issuance costs of \$4,609 were raised from the bought deal financings comprised of: 15,007,500 common shares at CAD\$2.30 per share, for net proceeds of \$31,135; and 11,500,000 common shares at CAD\$4.00 per share, for net proceeds of \$42,784.

During the year ended December 31, 2011, the Company issued 6,756 (2010: 7,813) common shares, at a fair market value of \$4.44 (2010: \$2.56) per share to Radius Gold, under the option to acquire a 60% interest in Tlacolula silver project located in the State of Oaxaca, Mexico.

Subsequent to the year ended December 31, 2011 to March 23, 2012, the Company issued 8,605 common shares, at a fair market value of \$5.81 per share to Radius Gold, under the option to acquire a 60% interest in Tlacolula silver project located in the State of Oaxaca, Mexico.

b) Share Options

The Company's stock option plan, approved by the shareholders on August 30, 2006 and accepted by the TSX Venture Exchange on October 16, 2006 provides a rolling maximum of the issuance of common treasury shares equal to up to ten percent of the issued and outstanding common shares with no vesting provisions. The exercise price of the optioned shares are no less than the market price, with a maximum term of ten years from grant. Shareholder approval of the Company's stock option plan was not obtained at the Company's annual general meeting held on June 23, 2010.

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

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

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The following is a summary of option transactions:

	December 31, 2011		December 31, 2010	
	Shares (in 000's)	Weighted average exercise price (CAD\$)	Shares (in 000's)	Weighted average exercise Price (CAD\$)
Outstanding at beginning of the year	4,551	\$ 1.51	8,215	\$ 1.50
Granted	1,792	4.46	-	-
Exercised	(2,442)	1.55	(999)	1.03
Cancelled	-	-	(2,665)	1.62
Forfeited	(25)	4.46	-	-
Outstanding at end of the year	3,876	\$ 2.83	4,551	\$ 1.51
Vested and exercisable at end of the year	2,557	\$ 1.99	4,551	\$ 1.51

The non-cash compensation recovery of \$2,440 recognized for the year ended December 31, 2010 is associated with the 2,665,000 share purchase options granted in the fourth quarter of 2009 and cancelled as shareholder approval was not obtained at the Company's annual general meeting held on June 23, 2010.

During the year ended December 31, 2011, 1,792,289 share purchase options were granted with an exercise price of CAD\$4.46 per share with a term of three years and vesting 25% within six months of grant date, 50% within 12 months of grant date, 75% within 18 months of grant date, and fully vested after 24 months of grant date. As at December 31, 2011, 24,814 share purchase options were forfeited and 8,271 share purchase options were accelerated to expire March 8, 2012. The share based compensation charge of \$1,830 covering option grants, forfeitures, and accelerated vesting, was recognized for the year ended December 31, 2011 has been determined under the fair value method using the Black-Scholes option pricing model with the following assumptions:

	Year ended December 31	
	2011	2010
Risk-free interest rate	1.91%	n/a
Expected stock price volatility	56.48%	n/a
Expected term in years	3	n/a
Expected dividend yield	0%	n/a
Expected forfeiture rate	1.38%	n/a

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

The following table summarizes information related to stock options outstanding and exercisable at December 31, 2011:

Exercise price in CAD\$	Number of outstanding share purchase options (in 000's)	Weighted average remaining contractual life of outstanding share purchase options (years)	Weighted average exercise price on outstanding share purchase options CAD\$	Exercisable share purchase options (in 000's)	Weighted average exercise price on exercisable share purchase options CAD\$
\$0.80 to \$0.99	816	6.8	\$ 0.85	816	\$ 0.85
\$1.00 to \$1.99	693	4.4	1.53	693	1.53
\$2.00 to \$4.46	2,367	3.0	3.90	1,048	3.19
\$0.80 to \$4.46	3,876	4.1	\$ 2.83	2,557	\$ 1.99

Subsequent to December 31, 2011 to March 23, 2012, 184,138 share purchase options were granted with an exercise price of CAD\$6.67 per share with a term of five years and vesting 33.33% within twelve months of grant date, 33.33% within 24 months of grant date, and 33.34% within thirty six months of grant date.

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Subsequent to December 31, 2011, 49,628 share purchase options were forfeited and 41,542 share purchase options were accelerated to expire March 30, 2012.

Subsequent to December 31, 2011 to March 23, 2012, 314,225 share purchase options were exercised at prices ranging from CAD\$0.85 to CAD\$4.46 per share, resulting in issued and outstanding shares of 125,268,751.

c) Deferred Share Units (“DSU”) Cost

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

During the year ended December 31, 2011, 70,000 DSU were settled in cash for \$5.36 per unit for a total payment of \$375.

During the year ended December 31, 2011, the Company granted 48,824 DSU with a market value of CAD\$232, at the date of grant, to a director, and 93,544 DSU with a market value of CAD\$473, at the date of grant, to a director, with vesting subject to the commissioning of the San Jose mine, which occurred on September 1, 2011.

During the year ended December 31, 2010, the Company granted 409,097 DSU with a market value of CAD\$1,358, at the date of grant, to directors.

As at December 31, 2011, there are 481,465 (2010: 409,097) DSU outstanding with a fair value of \$2,639 (2010: \$1,955).

d) Restricted Share Units (“RSU”) Cost

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

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

During the year ended December 31, 2011, the Company paid \$736 (2010: \$nil) on 109,557 (2010: nil) RSU to directors, a former director, and officers of the Company.

As at December 31, 2011, there are 265,231 (2010: 219,114) RSU outstanding with a fair value of \$1,204 (2010: \$131).

e) Earnings per Share

i. Basic

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

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

	Year ended December 31	
	2011	2010
Income available to equity owners	\$ 19,533	\$ 16,003
Weighted average number of shares (in '000's)	123,295	108,120
Earnings per share – basic	\$ 0.16	\$ 0.15

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ii. Diluted

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

	Year ended December 31	
	2011	2010
Income available to equity owners	\$ 19,533	\$ 16,003
Weighted average number of shares ('000's)	123,295	108,120
Incremental shares from share options	1,417	2,445
Weighted average diluted shares outstanding	124,712	110,565
Earnings per share – diluted	\$ 0.16	\$ 0.14

15. SUPPLEMENTAL CASH FLOW INFORMATION

	Note	Years ended December 31	
		2011	2010
Non-cash Investing and Financing Activities:			
Issuance of shares on purchase of mineral properties, property, plant and equipment	8	\$ 30	\$ 20

16. CAPITAL DISCLOSURE

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

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

The management of the Company believes that the capital resources of the Company as at December 31, 2011, are sufficient for its present needs for at least the next 12 months. The Company is not subject to externally imposed capital requirements.

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

17. MANAGEMENT OF FINANCIAL RISK

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

a) Fair Value of Financial Instruments

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

The amortized value of long term receivables approximates their fair value as these are measured at the amortized cost using the effective interest method. The fair value of the lease and long term liabilities is \$5,531 as at December 31, 2011.

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

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

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

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

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

Financial assets (liabilities) at fair value as at December 31, 2010				
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 70,298	\$ –	\$ –	\$ 70,298
Short term investments	20,509	–	–	20,509
Trade receivable from concentrate sales	–	12,551	–	12,551
Derivatives	–	(133)	–	(133)
	\$ 90,807	\$ 12,418	\$ –	\$ 103,225

There were no changes in the levels during the year ended December 31, 2010.

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

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

During the year ended December 31, 2011, there have been no changes in the classification of financial assets and liabilities in levels 1, 2, and 3 of the hierarchy.

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b) Currency Risk

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

As at December 31, 2011, the Company is exposed to currency risk through the following assets and liabilities denominated in Canadian dollars, Nuevo Soles and Mexican Pesos (all amounts are expressed in thousands of Canadian dollars, thousands of Nuevo Soles or thousands of Mexican Pesos):

	December 31, 2011			December 31, 2010		
	Canadian Dollars	Nuevo Soles	Mexican Pesos	Canadian Dollars	Nuevo Soles	Mexican Pesos
Cash and cash equivalents	\$ 18,457	S/. 1,396	\$ 1,758	\$ 54,782	S/. 741	\$ 2,201
Accounts receivable and other assets	42	5,657	58,939	71	1,304	42,452
Deposits on long term assets	-	-	-	-	-	24,209
Trade and other payables	(1,580)	(17,993)	(24,310)	(625)	(15,493)	(6,390)
Provisions, current	-	(1,351)	(3,163)	-	-	-
Income tax payable	-	(10,581)	-	-	(11,775)	-
Leases and long term liabilities	(2,691)	-	-	(1,999)	-	-
Provisions	-	(8,079)	(17,494)	-	(9,169)	(19,959)
Total	14,228	(30,951)	15,730	52,229	(34,392)	42,513
Total US\$ equivalent	13,950	(11,476)	1,125	52,219	(12,244)	3,440

Based on the above net exposure as at December 31, 2011, and assuming that all other variables remain constant, a 10% depreciation or appreciation of the US dollar against the above currencies would result in an increase or decrease, as follows: impact to other comprehensive income of \$1,550 (2010: \$5,802) and a net loss of \$1,150 (2010: \$978).

c) Credit Risk

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

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

The Company's maximum exposure to credit risk at December 31, 2011 is as follows:

	December 31 2011	December 31 2010
Cash and cash equivalents	\$ 38,730	\$ 70,298
Short term investments	17,000	20,509
Accounts receivable	14,391	12,551
Derivative assets	70	-
Due from related parties	36	-
GST/HST and value added tax receivable	4,777	3,542
Total	\$ 75,004	\$ 106,900

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

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d) Liquidity Risk

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

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

	Expected payments due by period as at December 31, 2011				Total
	Less than 1 year	1-3 years	4-5 years	After 5 years	
Trade and other payables	\$ 17,156	\$ -	\$ -	\$ -	\$ 17,156
Due to related parties	205	-	-	-	205
Derivative liabilities	87	-	-	-	87
Income tax payable	3,923	-	-	-	3,923
Long term liabilities	1,534	2,765	-	-	4,299
Operating leases	696	1,410	1,177	531	3,814
Provisions	734	849	774	3,725	6,082
	\$ 24,335	\$ 5,024	\$ 1,951	\$ 4,256	\$ 35,566

Operating leases includes leases for office premises, computer and other equipment used in the normal course of business. Refer to Note 19 c) for details of operating leases.

In 2010, the Company entered into a credit agreement with the Bank of Nova Scotia for a \$20 million senior secured revolving credit facility ("credit facility") to be refinanced or repaid on or within two and one-half years or before December 2012. The credit facility is secured by a first ranking lien on Bateas and its assets and bears interest and fees at prevailing market rates. In the event that utilization under the credit facility is less than \$10 million, a commitment fee of 1.50% per annum is payable quarterly on the unutilized portion of the available credit facility. No funds were drawn from this credit facility during the year.

e) Interest Rate Risk

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

A 10% change in interest rates would cause a \$12 change in income on an annualized basis.

f) Metal Price Risk

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

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18. SEGMENTED INFORMATION

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

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

The Company's operating segments are based on the reports reviewed by the senior management group that are used to make strategic decisions. The Chief Executive Officer considers the business from a geographic perspective considering the performance of the Company's business units.

The segment information provided to the Board of Directors for the reportable segments for the year ended December 31, 2011 and 2010 are as follows:

Reportable Segments	Corporate	Bateas	Cuzcatlan	Total
Year ended December 31, 2011				
Sales to external customers	\$ –	\$ 97,740	\$ 12,264	\$ 110,004
Silver concentrates	–	–	7,586	7,586
Gold concentrates	–	–	4,678	4,678
Lead concentrates	–	80,689	–	80,689
Zinc concentrates	–	15,290	–	15,290
Copper concentrates	–	1,761	–	1,761
Sales to internal customers	5,961	–	–	5,961
Cost of sales	–	42,236	6,794	49,030
Depreciation, depletion, and amortization	100	7,053	2,268	9,421
Selling, general and administrative expenses	14,352	3,920	1,568	19,840
Exploration and evaluation costs	1,715	–	–	1,715
Impairment of mineral properties, property, plant and equipment	–	–	1,894	1,894
Interest income	494	297	39	830
Interest expense	306	219	35	560
Income (loss) before tax	(15,881)	52,133	2,083	38,335
Income taxes	183	15,804	2,815	18,802
Income (loss) for the year	(16,064)	36,329	(732)	19,533
Capital expenditures	814	25,066	53,127	79,007

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Reportable Segments	Corporate	Bateas	Cuzcatlan	Total
Year ended December 31, 2010				
Sales to external customers	\$ -	\$ 74,056	\$ -	\$ 74,056
Lead concentrates	-	31,180	-	31,180
Zinc concentrates	-	15,883	-	15,883
Copper concentrates	-	26,993	-	26,993
Sales to internal customers	2,464	-	-	2,464
Cost of sales	-	34,844	-	34,844
Depreciation, depletion, and amortization	202	6,347	-	6,549
Selling, general and administrative expenses	6,941	4,043	-	10,984
Exploration and evaluation costs	547	-	-	547
Interest income	44	449	-	493
Interest expense	417	291	-	708
Income (loss) before tax	(6,491)	34,004	-	27,513
Income taxes	(47)	11,557	-	11,510
Income (loss) for the year	(6,444)	22,447	-	16,003
Capital expenditures	1,190	14,614	23,961	39,765

Reportable Segments	Corporate	Bateas	Cuzcatlan	Total
As at December 31, 2011				
Total assets	\$ 27,843	\$ 112,746	\$ 131,017	\$ 271,606
Total liabilities	\$ 5,694	\$ 29,793	\$ 7,808	\$ 43,295
As at December 31, 2010				
Total assets	\$ 81,900	\$ 74,950	\$ 77,020	\$ 233,870
Total liabilities	\$ 3,404	\$ 24,794	\$ 3,082	\$ 31,280
As at January 1, 2010				
Total assets	\$ 25,330	\$ 65,439	\$ 42,820	\$ 133,589
Total liabilities	\$ 321	\$ 21,037	\$ 870	\$ 22,228

For the years ended December 31, 2011 three (2010: two) customers, respectively, represented 100% of total sales to external customers.

External Sales by Customer and Region	Years ended December 31,			
	2011		2010	
Customer 1	\$ 95,978	98%	\$ 47,062	64%
Customer 2	1,762	2%	26,994	36%
Bateas/Peru	\$ 97,740	100%	\$ 74,056	100%
% of total sales	89%		100%	
Customer 1	\$ 12,264	100%	\$ -	0%
Cuzcatlan/Mexico	\$ 12,264	100%	\$ -	0%
% of total sales	11%		0%	
Consolidated	\$ 110,004	100%	\$ 74,056	100%
% of total sales	100%		100%	

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19. CONTINGENCIES AND CAPITAL COMMITMENTS

a) Bank Letter of Guarantee

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

Banco Bilbao Vizcaya Argentaria, S.A., a third party, has established a bank letter of guarantee on behalf of Bateas in favor of the Peruvian mining regulatory agency in compliance with local regulation associated with the approved Bateas' mine closure plan, for the sum of \$439. This bank letter of guarantee expires 360 days from December 2011.

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

b) Capital Commitments

As at December 31, 2011, \$8,122 of capital commitments not disclosed elsewhere in the consolidated financial statements, and forecasted to be expended within one year, includes the following: \$5,800 for the ramp development at the San Jose property located in Mexico; \$2,247 for the tailing dam, concentrator plant and electrical infrastructure renewal, and mine camp development at the Caylloma Property; and \$75 for software development.

c) Other Commitments

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

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

The Company acts as guarantor to finance lease obligations held by two of its mining contractors. These finance lease contracts are related to the acquisition of mining equipment deployed at the Caylloma mine. As at December 31, 2011, these obligations amounted to \$231 with \$74 maturing in 2012 and \$157 maturing in 2013.

The Company, jointly with Radius Gold Inc., has entered into an office premise lease located in Canada, effective on November 28, 2011, the date the Company commenced carrying on business in the premises. The shared office with Radius has been finalized with the Company obligated to pay 50% of the total rent payable. The lease term is eight years with the Company's annual net rent payable, on 3,195 rentable square feet, as follows:

- years one to two \$111;
- years three to five \$115; and,
- years six to eight \$118.

In addition, estimated operating costs, utilities, and realty taxes is \$71 in the first year of occupancy. During 2011, the Company has advanced 50% of the three month security deposit in the amount of \$47.

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

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

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

As at December 31, 2011, the Company has advanced rent \$159 (2010:\$426) and provided a security deposit of \$44.

On March 15, 2011, the Company entered into a one year office premise lease located in Mexico with an annual lease obligation of \$37. The office premise leases are included as operating leases in Note 17 d).

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	Expected payments due by period as at December 31, 2011				Total
	Less than 1 year	1-3 years	4-5 years	After 5 years	
Office premises – Canada	\$ 181	\$ 549	\$ 372	\$ 359	\$ 1,461
Office premises – Peru	363	758	805	172	2,098
Office premises – Mexico	8	–	–	–	8
Total office premises	\$ 552	\$ 1,307	\$ 1,177	\$ 531	\$ 3,567
Computer equipment – Peru	128	75	–	–	203
Computer equipment – Mexico	16	28	–	–	44
Total computer equipment	\$ 144	\$ 103	\$ –	\$ –	\$ 247
Total operating leases	\$ 696	\$ 1,410	\$ 1,177	\$ 531	\$ 3,814

d) Other Contingencies

In February 2009, the Environmental Assessment and Oversight Agency (“OEFA”) in Peru, alleged the Company had five violations: two were for breaches of recommendations; two for excess of total suspended solids in water over the maximum allowable; and an alleged unauthorized discharge of effluent. The Ministry of Energy and Mines in Peru (“OSINERGMIN”) decided to close the two alleged violations for failure to adopt recommendations and punish the Company for the three alleged violations and imposed a fine of \$200 in 2010. The Company appealed on June 23, 2010. Subsequent to December 31, 2011 and on February 22, 2012, the alleged unauthorized discharge of effluent was dismissed and confirmed a fine of \$133 for the two alleged violations of excess of total suspended solids in water over the maximum allowable. The Company is proceeding with an administrative appeal to the Ministry of Energy and Mines in Peru (“OSINERGMIN”) for the remaining two alleged offenses. The Company believes it is more likely than not that it will defend itself successfully in the claims and therefore has not recorded a provision for the potential exposure relating to these alleged violations.

20. NET FINANCE INCOME (EXPENSE)

	Years ended December 31	
	2011	2010
Finance income		
Interest income on FVTPL financial assets	\$ 830	\$ 493
Total finance income	830	493
Finance expenses		
Interest expense	81	128
Standby and commitment fees	306	417
Accretion of provisions (Note 12)	173	163
Total finance expense	560	708
Net finance income (expense)	\$ 270	\$ (215)

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21. EXPENSES BY NATURE

	Years ended December 31	
Cost of Sales	2011	2010
Direct mining costs ¹	\$ 38,649	\$ 27,729
Depreciation and depletion	9,059	6,327
Royalty expenses	1,322	788
Total cost of sales	\$ 49,030	\$ 34,844

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

	Years ended December 31	
Selling, general and administrative expenses	2011	2010
Salaries and benefits	\$ 12,168	\$ 5,312
Corporate administration	3,409	2,253
Audit, legal and professional fees	2,915	2,414
Filing and listing fees	467	311
Director's fees	519	472
Depreciation	362	222
Total selling, general and administrative expenses	\$ 19,840	\$ 10,984

	Years ended December 31	
Exploration and evaluation costs	2011	2010
Brownfields exploration	\$ 206	\$ 160
Greenfields exploration	344	253
	550	413
Evaluation costs	1,165	134
Total exploration and evaluation costs	\$ 1,715	\$ 547

22. SUBSEQUENT EVENTS UP TO MARCH 23, 2012

Subsequent to December 31, 2011 and at March 23, 2012 the value of the DSU and RSU liabilities have increased by \$278 and \$211, respectively.

On February 17, 2012, the Company entered into a one year office premise lease, effective March 1, 2012, located in Mexico with an annual lease obligation of \$18.

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23. FIRST-TIME ADOPTION OF IFRS

IFRS 1 First-time Adoption of International Financial Reporting Standards, which governs the first time adoption of IFRS, in general requires accounting policies to be applied retrospectively to determine the opening financial position at the Company's transition date of January 1, 2010, and allows certain exemptions on the transition to IFRS. The elections the Company has decided to apply and that are considered significant to the Company include:

- **Business Combinations Exemption**
 - IFRS 1 allows a first-time adopter to not apply of IFRS 3 retrospectively to business combinations that occur before either the date of transition to IFRS or an alternative pre-transition date.
 - The Company elected the business combinations exemption in IFRS 1 to not apply IFRS 3 retrospectively to past business combinations. Accordingly, the Company has not restated business combinations that took place prior to the transition date.
- **Share-Based Payment Exemption**
 - IFRS 1 gives a first-time adopter the option to not apply IFRS 2 Share-Based Payment to (i) equity instruments that were granted for the periods on or before November 7, 2002 or after November 7, 2002 but that vested before the date of transition to IFRS and (ii) liabilities arising from cash-settled share-based payment transactions if those liabilities were settled before January 1, 2005 or before the date of transition to IFRS.
 - The Company elected to apply this exemption at the transition date.
- **Cumulative Translation differences**
 - IFRS 1 gives a first-time adopter through IAS 21 The Effects of Changes in Foreign Exchange Rates which allows for the cumulative translation differences that existed at the date of transition to IFRS to be reset to zero.
 - The Company elected to set the previously accumulated cumulative translation amount, which was included in accumulated other comprehensive income ("AOCI"), to zero as at the date of transition with the balance being reclassified to retained earnings.
- **Borrowing Costs Exemption**
 - This exemption in IFRS 1 allows a first-time adopter to apply the transitional provisions set out in IAS 23 Borrowing Costs at January 1, 2009 or the date of transition to IFRS, whichever is later. IAS 23 requires the capitalization of borrowing costs related to all qualifying assets.
 - The Company elected to apply IAS 23 to borrowing costs relating to all qualifying assets for which the commencement date for capitalization is on or after the transition date.
- **Decommissioning Liability Exemption**
 - IFRS 1 indicates that a first-time adopter may elect not to apply IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities retrospectively.
 - The Company elected to take a simplified approach to calculate and record the asset related to the decommissioning and restoration liability on our opening IFRS consolidated statement of financial position. The decommissioning and restoration liability calculated on the transition date in accordance with IFRS 37 Provisions, Contingent Liabilities and Contingent Assets was discounted back to the date when the provision first arose on the mineral property, at which date the corresponding asset and liability was set up and then depreciated to its carrying amount at the transition date.

The IFRS 1 mandatory exceptions applied by the Company in the conversion from Canadian Generally Accepted Accounting Principles ("CAD GAAP") to IFRS included estimates. In accordance with IFRS 1, an entity's estimates under IFRS at the date of transition to IFRS must be consistent with estimates made for the same date under previous GAAP unless those estimates were in error. The Company's IFRS estimates as at the Transition Date are consistent with its CAD GAAP estimates as at that date.

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Adjustments on transition to IFRS

Adoption of IFRS resulted in changes to the Company's Statements of Financial Position, Statements of Income, Statements of Comprehensive Income (Loss), Statements of Cash Flows, and Statements of Changes in Equity as set out below:

a) Foreign Exchange

Under IAS 21, each entity in a group must be analyzed, through application of primary and secondary factors, to determine its functional currency. Based on this assessment, the functional currency of each of the entities in the group is the US\$, with the exception of the parent entity and certain holding companies which have a Canadian dollar functional currency. Under CAD GAAP, the parent entity had a Canadian dollar presentation currency and all subsidiaries were integrated with the exception of Bateas which was self-sustaining. The presentation currency will continue to be US\$.

The parent entity and the holding companies which have a CAD\$ functional currency will be translated to US\$ using the closing rate method with the differences to the cumulative translation adjustment account, on consolidation. Those entities with a US\$ functional currency do not require translation on consolidation. Under CAD GAAP, the Company used the indirect consolidation method whereby all entities were first translated to CAD\$ and then the entire consolidation translated to US\$ for presentation purposes.

b) Deferred Income Tax

Under IFRS, income taxes include all domestic and foreign taxes based on taxable profits. The Company accounted for Peruvian statutory workers participation under CAD GAAP as an income tax. Under IFRS the statutory workers participation is accounted for as an employee benefit under IAS 19. Accordingly, future Peruvian Workers Participation balances have been derecognized and current Peruvian Workers Participation expense has been reclassified from income tax expense to operating expenses.

Under IFRS, deferred tax is recognized on the difference between the accounting basis and tax basis of all items. Under CAD GAAP income tax assets or liabilities were not recognized for differences arising between the historical exchange rate and the current exchange rate translation of the cost of non-monetary assets or liabilities of integrated foreign operations.

For foreign currency non-monetary assets or liabilities where the tax basis currency differs from the functional currency of the entity, foreign exchange differences will result in tax assets or liabilities which were not previously recognized under CAD GAAP. This difference will result in added volatility in the tax expense as foreign exchange rate changes will have an impact on the tax expense.

IAS 12 does not permit recognition of temporary differences on the initial acquisition of assets that do not constitute a business combination. There is no similar prohibition under CAD GAAP. Deferred tax arising from temporary differences on initial recognition have been reversed against mineral properties, property, plant and equipment and retained earnings.

c) Reset Accumulated Other Comprehensive Income to Zero

The Company has taken the exemption under IFRS 1 which allows for the cumulative translation differences that existed at the date of transition to IFRS to be reset to zero.

d) Provisions

Where a provision is recognized, IFRS requires the estimate to be discounted at a risk-free pre-tax rate, typically that of a government bond that is matched to the expected risk adjusted cash flows. On transition, the Company used a risk free rate to discount their decommissioning liabilities and this results in an increased decommissioning liability being recognized under IFRS as compared to CAD GAAP.

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e) Reclassification of items in the Consolidated Statements of Income

The Company has reclassified the following income and expense items in the consolidated statements of income:

- government royalties to cost of sales from selling, general and administrative expenses;
- distribution costs to cost of sales from selling, general and administrative expenses;
- community relation costs to cost of sales from selling, general and administrative expenses;
- other income and expenses from interest and other income and expenses to selling, general and administrative expenses;
- interest expense includes interest on debt financing and accretion of provisions;
- current workers participation from income tax to cost of sales and selling, general and administrative expenses; and,
- depletion and depreciation combined with cost of sales.

In addition, exploration and evaluation costs moved from selling, general and administrative expenses.

The above changes are reclassifications within our statement of income so there is no net impact to our income as a result of these changes.

f) Reconciliation of Consolidated Statements of Changes in Equity

The reconciliations between the CAD GAAP and IFRS consolidated Equity, for January 1, 2010 and December 31, 2010 are provided below:

Expressed in \$'000's	Notes	January 1, 2010	December 31, 2010
Equity, CAD GAAP		\$ 112,557	\$ 206,008
Adjustments:			
Effect of foreign exchange on inventory, deposits on long term assets, and mineral properties, property, plant and equipment	23 a)	(2,538)	(5,339)
Deferred income tax adjustments	23 b)	1,475	1,944
Transfer of accumulated other comprehensive income to retained earnings	23 c)	2,898	2,898
Reset accumulated other comprehensive income to zero	23 c)	(2,898)	(2,898)
Adjustment to revise provisions	23 d)	(311)	(254)
Adjustment for depletion on mineral properties related to provisions	23 d)	178	231
Total IFRS adjustments to Equity		(1,196)	(3,418)
Equity, IFRS		\$ 111,361	\$ 202,590

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g) Reconciliation of Consolidated Statement of Financial Position

The reconciliations between the CAD GAAP and IFRS consolidated statement of financial position at December 31, 2010 (date of transition to IFRS) are provided below.

		December 31, 2010		
	Notes	Canadian GAAP	Effect of Transition to IFRS	IFRS
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents		\$ 70,298	\$ -	\$ 70,298
Short term investments		20,509	-	20,509
Accounts receivable and other assets		13,454	-	13,454
GST/HST and value added tax receivable		3,542	-	3,542
Inventories	23 a)	4,034	(16)	4,018
		111,837	(16)	111,821
NON-CURRENT ASSETS				
Deposits on long term assets	23 a)	4,533	153	4,686
Mineral properties, property, plant and equipment	23 a) b) d)	126,813	(9,450)	117,363
Total assets		\$ 243,183	\$ (9,313)	\$ 233,870
LIABILITIES AND EQUITY				
CURRENT LIABILITIES				
Trade and other payables		\$ 9,303	\$ -	\$ 9,303
Due to related parties		40	-	40
Derivative liabilities		133	-	133
Income tax payable		4,192	-	4,192
Current portion of long term liability		1,083	-	1,083
		14,751	-	14,751
NON-CURRENT LIABILITIES				
Leases and long term liabilities		3,166	-	3,166
Provisions	23 d)	4,924	(43)	4,881
Deferred income tax liabilities	23 b) d)	14,334	(5,852)	8,482
		37,175	(5,895)	31,280
EQUITY				
Share capital		180,403	-	180,403
Share option and warrant reserve		11,116	-	11,116
Retained earnings (deficit)	23 a) b) c) d)	3,597	4,751	8,348
Accumulated other comprehensive income	23 c)	10,892	(8,169)	2,723
		14,489	(3,418)	11,071
		206,008	(3,418)	202,590
		\$ 243,183	\$ (9,313)	\$ 233,870

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

h) Reconciliations of Consolidated Statement of Income

The reconciliation between the CAD GAAP and IFRS consolidated statement of income for the year ended December 31, 2010 are provided below:

	Notes	Year ended December 31, 2010		
		Canadian GAAP	Effect of Transition to IFRS	IFRS
Sales	23 e)	\$ 74,056	\$ –	\$ 74,056
Cost of sales	23 d) e)	29,129	5,715	34,844
Mine operating income (loss)		44,927	(5,715)	39,212
Other expenses				
Selling, general and administrative expenses	23 a) e)	16,529	(5,545)	10,984
Exploration and evaluation costs	23 e)	547	–	547
Net (gain) on commodity contracts		(736)	–	(736)
Loss on disposal of mineral properties, property, plant and equipment		127	–	127
Loss on disposal of investment		119	–	119
Write-off of deferred exploration costs		443	–	443
Operating income (loss)		27,898	(170)	27,728
Finance items				
Interest income	23 d) e)	(379)	872	493
Interest expense	23 e)	(544)	(164)	(708)
Net finance income (expense)		(923)	708	(215)
Income before tax		26,975	538	27,513
Income taxes	23 b) d) e)	14,020	(2,510)	11,510
Income for the year		\$ 12,955	\$ 3,048	\$ 16,003

i) Reconciliation of Consolidated Statement of Comprehensive Income

The reconciliation between the CAD GAAP and IFRS consolidated statement of comprehensive income for the year ended December 31, 2010 are provided below:

	Notes	Year ended December 31, 2010		
		Canadian GAAP	Effect of Transition to IFRS	IFRS
Income for the year		\$ 12,955	\$ 3,048	\$ 16,003
Other comprehensive income (loss)				
Transfer of unrealized loss to realized loss upon reduction of net investment, net of taxes	23 c)	2,100	(2,100)	–
Unrealized (loss) gain on translation to presentation currency on foreign operations	23 a)	5,895	(3,172)	2,723
Other comprehensive (loss) income		7,994	(5,271)	2,723
Total comprehensive (loss) income for the year		\$ 20,949	\$ (2,223)	\$ 18,726

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

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

j) Reconciliation of Consolidated Statement of Cash Flows

The adoption of IFRS has had no material impact on the net cash flows of the Company. The changes made to the Consolidated Statement of Financial Position and Consolidated Statement of Comprehensive Income has resulted in reclassifications of various amounts on the Consolidated Statement of Cash Flows, however as there have been no material changes to the net cash flows, summarized reconciliation has been presented below.

		Year ended December 31, 2010		
	Notes	Canadian GAAP	Effect of Transition to IFRS	IFRS
Effect of exchange rate changes on cash and cash equivalents	23 a)	2,128	23	2,151
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	23 a)	37,407	(23)	37,384
Cash and cash equivalents – beginning of year		30,763	–	30,763
CASH AND CASH EQUIVALENTS – END OF YEAR		\$ 70,298	\$ –	\$ 70,298



Trading on the NYSE as of September 19, 2011

CORPORATE DATA

Corporate Office

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Investor Relations

Management Head Office
Carlos Baca,
Investor Relations Manager

Corporate Office
Holly Hendershot,
Investor Relations

info@fortunasilver.com

Stock Exchanges

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

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Chartered Accountants
2800 – 1055 Dunsmuir Street
Vancouver, BC Canada V7X 1P4

Share Transfer Agent

Olympia Trust Company
750 West Pender Street, Suite 1003
Vancouver, BC Canada V6C 2T8

Qualified Person

Thomas I. Vehrs, Ph.D., Vice President of Exploration, is the Qualified Person for Fortuna Silver Mines Inc. as defined by National Instrument 43-101.

Dr. Vehrs is a Founding Registered Member of The Society for Mining, Metallurgy, and Exploration, Inc. (SME Registered Member Number 3323430RM) and is responsible for ensuring that the information contained in this annual report is an accurate summary of the original reports and data provided to or developed by Fortuna Silver Mines.



FORTUNA

SILVER MINES INC.



Caylloma Mine, Peru



Frankfurt: F4S.F