

**FORTUNA SILVER MINES INC.**

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2007**

(Unaudited – Prepared by Management)

(Expressed in thousands of Canadian Dollars)

FORTUNA SILVER MINES INC.  
INTERIM CONSOLIDATED BALANCE SHEETS  
(Unaudited)  
(Expressed in thousands of Canadian Dollars)

|   | <b>September 30,<br/>2007<br/>(Unaudited)</b> | <b>December 31,<br/>2006<br/>(Audited)</b> |
|---|---|--|
| <b>ASSETS</b>   |   |  |
| <b>CURRENT</b>  |   |  |
| Cash and cash equivalents                                   | \$ 43,963                                     | \$ 1,641                                   |
| Accounts receivable and prepaid expenses (Note 4)           | 6,561   | 4,085                                      |
| Inventories (Note 5)  | 1,349   | 826  |
|   | 51,873  | 6,552                                      |
| LONG-TERM RECEIVABLES (Note 4)                              | 2,291   | 1,554                                      |
| LONG-TERM INVESTMENTS (Note 6)                              | 1,186   | 741  |
| PROPERTY, PLANT & EQUIPMENT (Note 7)                        | 12,710  | 7,807                                      |
| MINERAL PROPERTIES (Note 8)                                 | 47,948  | 42,540                                     |
|   | \$ 116,008                                    | \$ 59,194                                  |
| <b>LIABILITIES</b>  |   |  |
| <b>CURRENT</b>  |   |  |
| Accounts payable and accrued liabilities                    | \$ 4,527                                      | \$ 2,193                                   |
| Due to related parties, net (Note 9)                        | 40  | 27   |
| Current portion of obligation under capital lease (Note 10) | 174   | 45   |
| Forward contract (Note 11)                                  | 149   | -  |
| Loans (Note 10)   | -   | 5,730                                      |
|   | 4,890   | 7,995                                      |
| OBLIGATIONS UNDER CAPITAL LEASE (Note 10)                   | 381   | 97   |
| ASSET RETIREMENT OBLIGATION (Note 12)                       | 1,875   | 1,758                                      |
| FUTURE INCOME TAX LIABILITY                                 | 6,559   | 4,910                                      |
| NON-CONTROLLING INTEREST (Note 8)                           | 5,708   | 3,227                                      |
|   | 19,413  | 17,987                                     |
| <b>SHAREHOLDERS' EQUITY</b>                                 |   |  |
| SHARE CAPITAL (Note 13)                                     | 96,974  | 43,341                                     |
| CONTRIBUTED CAPITAL   | 11,664  | 6,085                                      |
| DEFICIT   | (12,419)                                      | (8,219)                                    |
| ACCUMULATED OTHER COMPREHENSIVE INCOME (Note 14)            | 376   | -  |
|   | 96,595  | 41,207                                     |
|   | \$ 116,008                                    | \$ 59,194                                  |

**Nature and continuance of operations** (Note 1)

**Commitments** (Note 17)

**Subsequent events** (Note 18)

APPROVED BY THE DIRECTORS:

\_\_\_\_\_  
*"signed"*, Director  
Jorge Ganoza Durant

\_\_\_\_\_  
*"signed"*, Director  
Simon Ridgway

(See accompanying Notes)

FORTUNA SILVER MINES INC.  
INTERIM CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006  
(Unaudited)  
(Expressed in thousands of Canadian Dollars, except for amounts of shares)

|  | Share Capital |           | Share Subscriptions | Contributed Surplus | (Deficit)  | Total Shareholders' Equity |
|--|---------------|-----------|---------------------|---------------------|------------|----------------------------|
|  | Shares        | Amount    |                     |                     |            |                            |
| Balance – December 31, 2005 (unaudited)                | 26,016,086    | \$ 17,745 | \$ -                | \$ 2,241            | \$ (4,487) | \$ 15,499                  |
| Exercise of options                                    | 590,000       | 379       | -                   | -                   | -          | 379                        |
| Exercise of warrants                                   | 4,818,950     | 4,244     | -                   | -                   | -          | 4,244                      |
| Private placement for cash                             | 12,700,000    | 19,050    | -                   | -                   | -          | 19,050                     |
| Private placement commission non-cash transaction      | 760,261       | 1,140     | -                   | -                   | -          | 1,140                      |
| Property finders fee non-cash transaction              | 50,000        | 68        | -                   | -                   | -          | 68                         |
| Shares subscribed                                      | -             | -         | 9                   | -                   | -          | 9                          |
| Transfer of contributed surplus on exercise of options | -             | 186       | -                   | (186)               | -          | -                          |
| Stock based compensation                               | -             | -         | -                   | 3,918               | -          | 3,918                      |
| Issue costs (non-cash amount \$1,140)                  | -             | (1,440)   | -                   | -                   | -          | (1,440)                    |
| (Loss) for the period                                  | -             | -         | -                   | -                   | (3,753)    | (3,753)                    |
| Balance – September 30, 2006 (unaudited)               | 44,935,297    | \$ 41,372 | \$ 9                | \$ 5,973            | \$ (8,240) | \$ 39,114                  |

|  | Share Capital |           | Contributed Surplus | (Deficit)   | Other Comprehensive Gain (Loss) | Total Shareholders' Equity |
|--|---------------|-----------|---------------------|-------------|---------------------------------|----------------------------|
|  | Shares        | Amount    |                     |             |                                 |                            |
| Balance – December 31, 2006 (audited)                                    | 46,587,728    | \$ 43,341 | \$ 6,085            | \$ (8,219)  | \$ -                            | \$ 41,207                  |
| Transitional adjustment on adoption of financial instruments, net of tax | -             | -         | -                   | -           | 438                             | 438                        |
| Exercise of options  | 1,077,500     | 1,515     | -                   | -           | -                               | 1,515                      |
| Exercise of warrants   | 13,285,761    | 18,640    | -                   | -           | -                               | 18,640                     |
| Private placement for cash   | 18,000,000    | 34,200    | -                   | -           | -                               | 34,200                     |
| Private placement commission non-cash transaction                        | 422,300       | 802       | -                   | -           | -                               | 802                        |
| Transfer of contributed surplus on exercise of options                   | -             | 963       | (963)               | -           | -                               | -                          |
| Stock based compensation   | -             | -         | 6,542               | -           | -                               | 6,542                      |
| Issue costs (non-cash amount \$802,370)                                  | -             | (2,487)   | -                   | -           | -                               | (2,487)                    |
| (Loss) for the period  | -             | -         | -                   | (4,200)     | -                               | (4,200)                    |
| Other comprehensive income/(loss), net of tax                            | -             | -         | -                   | -           | (62)                            | (62)                       |
| Balance – September 30, 2007 (unaudited)                                 | 79,373,289    | \$ 96,974 | \$ 11,664           | \$ (12,419) | \$ 376                          | \$ 96,595                  |

(See accompanying Notes)

FORTUNA SILVER MINES INC.  
INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS  
(Unaudited)

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

|  | Three months<br>ended<br>September<br>30,<br>2007 | Three months<br>ended<br>September<br>30,<br>2006 | Nine months<br>ended<br>September<br>30,<br>2007 | Nine months<br>ended<br>September<br>30,<br>2006 |
|--|---|---|--|--|
| Sales  | \$ 9,201  | \$ -  | \$ 23,737  | \$ -   |
| Cost of sales (including depletion,<br>depreciation and accretion of \$1,778 and<br>\$4,767)                         | 5,104   | -   | 13,914   | -  |
| <b>MINE OPERATING INCOME</b>   | <b>4,097</b>                                      | <b>-</b>  | <b>9,823</b>                                     | <b>-</b>   |
| Selling, general and administrative expenses<br>(includes depreciation of \$7 and \$18)                              | 1,413   | 221   | 4,159  | 547  |
| Stock-based compensation (Note 13)   | 4,120   | 1,807   | 6,542  | 3,918  |
|  | 5,533   | 2,028   | 10,701   | 4,465  |
| <b>OPERATING (LOSS)</b>  | <b>(1,436)</b>                                    | <b>(2,028)</b>                                    | <b>(878)</b>                                     | <b>(4,465)</b>                                   |
| Interest and other income and expenses   | 406   | 94  | 1,023  | 266  |
| Interest and finance expenses  | (2)   | -   | (18)   | (5)  |
| (Loss) on commodity contract   | (220)   | -   | (220)  | -  |
| (Loss) on disposal of capital assets   | (12)  | -   | (12)   | -  |
| Foreign exchange (loss) gain   | (937)   | 189   | (1,483)  | 451  |
|  | (765)   | 283   | (710)  | 712  |
| <b>(LOSS) BEFORE INCOME TAXES AND<br/>NON-CONTROLLING INTEREST</b>   | <b>(2,201)</b>                                    | <b>(1,745)</b>                                    | <b>(1,588)</b>                                   | <b>(3,753)</b>                                   |
| Income tax provision   | 1,251   | -   | 2,666  | -  |
| Non-controlling interest   | (62)  | -   | (54)   | -  |
| <b>NET (LOSS) FOR THE PERIOD</b>   | <b>\$ (3,390)</b>                                 | <b>\$ (1,745)</b>                                 | <b>\$ (4,200)</b>                                | <b>\$ (3,753)</b>                                |
| Other comprehensive (loss), net of tax<br>Unrealized (loss) on available for sale long-<br>term investment (Note 14) | (376)   | -   | (62)   | -  |
| <b>COMPREHENSIVE (LOSS) FOR THE<br/>PERIOD</b>   | <b>(3766)</b>                                     | <b>\$ (1,745)</b>                                 | <b>(4,262)</b>                                   | <b>(3,753)</b>                                   |
| (Loss) and comprehensive (loss) per share -<br>Basic and diluted   | \$ (0.05)   | \$ (0.04)   | \$ (0.06)  | \$ (0.10)  |
| Weighted average number of shares<br>outstanding   | 71,899,133  | 44,077,271  | 68,623,834                                       | 38,047,365                                       |

(See accompanying Notes)

FORTUNA SILVER MINES INC.  
INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
(Expressed in thousands of Canadian Dollars)

|   | Three months<br>ended<br>September<br>30,<br>2007 | Three months<br>ended<br>September<br>30,<br>2006 | Nine months<br>ended<br>September<br>30,<br>2007 | Nine months<br>ended<br>September<br>30,<br>2006 |
|---|---|---|--|--|
| <b>OPERATING ACTIVITIES</b>                               |   |   |  |  |
| Net (loss) for the period                                 | \$ (3,390)  | \$ (1,745)  | \$ (4,200)                                       | \$ (3,753)                                       |
| Items not involving cash                                  |   |   |  |  |
| Depletion and depreciation                                | 1,742   | 2   | 4,667  | 5  |
| Accretion expense   | 43  | -   | 118  | -  |
| Future income tax   | 526   | -   | 1,940  | -  |
| Stock based compensation charge                           | 4,120   | 1,807   | 6,542  | 3,918  |
| Unrealized loss on commodity contract                     | 149   | -   | 149  | -  |
| Foreign exchange (loss)                                   | (2)   | -   | (365)  | -  |
| Changes in non-cash working capital items                 |   |   |  |  |
| Accounts receivable and prepaid expenses                  | 329   | (1,593)   | (2,477)  | (3,690)  |
| Inventories   | (386)   | (575)   | (474)  | (968)  |
| Accounts payable  | 707   | 944   | 1,477  | 1,074  |
| Net cash provided by (used in) operating activities       | <u>3,838</u>                                      | <u>(1,160)</u>                                    | <u>7,377</u>                                     | <u>(3,414)</u>                                   |
| <b>FINANCING ACTIVITIES</b>                               |   |   |  |  |
| Proceeds on issuance of common shares                     | 10,737  | 759   | 52,670   | 23,382   |
| Capital lease obligations                                 | (51)  | -   | (84)   | -  |
| Payments from (to) related parties (Note 9)               | 14  | 57  | 13   | 39   |
| Repayment of debt (Note 10)                               | -   | -   | (5,730)  | (5,271)  |
|   | <u>10,700</u>                                     | <u>816</u>  | <u>46,869</u>                                    | <u>18,150</u>                                    |
| <b>INVESTING ACTIVITIES</b>                               |   |   |  |  |
| Long-term receivables                                     | (209)   | -   | (737)  | -  |
| Mineral property expenditures                             | (3,552)   | (3,127)   | (6,530)  | (7,560)  |
| Temporary investment                                      | -   | (99)  | -  | (4,831)  |
| Plant & equipment expenditures                            | (2,094)   | (2,202)   | (4,657)  | (3,592)  |
|   | <u>(5,855)</u>                                    | <u>(5,428)</u>                                    | <u>(11,924)</u>                                  | <u>(15,983)</u>                                  |
| <b>INCREASE (DECREASE) IN CASH</b>                        | 8,683   | (5,772)   | 42,322   | (1,247)  |
| Cash – beginning of period                                | <u>35,280</u>                                     | <u>8,691</u>                                      | <u>1,641</u>                                     | <u>4,166</u>                                     |
| <b>CASH – END OF PERIOD</b>                               | <u>\$ 43,963</u>                                  | <u>\$ 2,919</u>                                   | <u>\$ 43,963</u>                                 | <u>\$ 2,919</u>                                  |
| <b>Supplementary disclosure of cash flow information:</b> |   |   |  |  |
| Cash (received) for interest                              | <u>\$ (368)</u>                                   | <u>\$ (93)</u>                                    | <u>\$ (983)</u>                                  | <u>\$ (265)</u>                                  |
| Cash paid for income taxes                                | <u>\$ -</u>                                       | <u>\$ -</u>                                       | <u>\$ -</u>                                      | <u>\$ -</u>                                      |

Non-cash transactions – Note 16

(See accompanying Notes)

## **FORTUNA SILVER MINES INC.**

NOTES TO THE UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS  
AS AT AND FOR THE THREE AND NINE MONTH PERIOD ENDED SEPTEMBER 30, 2007  
(Tabular amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

### **1. Nature and Continuance of Operations**

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

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

### **2. Basis of Presentation**

In 2006, the Company changed its year end from September 30 to December 31.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles using the same accounting policies and methods as our most recent annual financial statements except as indicated in note 3 below. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements as at December 31, 2006.

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

### **3. Change in Accounting Policies**

On January 1, 2007, the Company adopted the provisions of the Canadian Institute of Chartered Accountants Handbook (“CICA HB”) Sections 1530 “Comprehensive Income”, 3251 “Equity”, 3855 “Financial Instruments – Recognition and Measurement”, 3861 “Financial Instruments – Presentation and Disclosure”, and 3865 “Hedges”. These sections address the classification, recognition and measurement of financial instruments and hedges in the financial statements and inclusion of other comprehensive income. These standards have been applied prospectively and therefore comparative amounts for prior periods have not been restated.

**FORTUNA SILVER MINES INC.**

**NOTES TO THE UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**AS AT AND FOR THE THREE AND NINE MONTH PERIOD ENDED SEPTEMBER 30, 2007**

(Tabular amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**3. Change in Accounting Policies (continued)**

a) Comprehensive income

Section 1530 introduces comprehensive income, which consists of net income and other comprehensive income. Other comprehensive income represents changes in shareholders' equity during a period arising from transactions and other events and circumstances from non-owner sources and includes unrealized gains and losses on financial assets classified as available-for-sale. The components of comprehensive income are disclosed on the interim consolidated statements of operations.

b) Financial instruments

Section 3861 establishes standards for the presentation and disclosure of financial instruments. Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. It requires that financial assets and financial liabilities, including derivatives, be measured at fair value on initial recognition and recorded on the balance sheet. Measurement in subsequent period depends on whether the financial instrument has been classified as held-for-trading, available-for-sale, held-to-maturity, loans and receivables or other financial liabilities.

Financial assets and liabilities held-for-trading are measured at fair value with changes in those fair values recognized in net income. Financial assets and financial liabilities considered held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized costs using the effective interest method of amortization. Available-for-sale financial assets are measured at fair value with unrealized gains and losses recognized in other comprehensive income. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost.

Derivative instruments, including embedded derivatives, are recorded on the balance sheet at fair value. Changes in the fair values of derivative instruments are recognized in net income with the exception of derivatives designated as effective cash flow hedges. Section 3865 establishes the standards for hedge accounting.

c) Impact upon adoption of CICA HB Section 1530, 3251, 3855, 3861 and 3865

As a result of adopting these new standards at January 1, 2007, the Company recorded an unrealized gain of \$438,430 for the change in accounting for financial assets classified as "available-for-sale" and measured at fair value instead of cost. This increase is reported as a one-time cumulative effect to other comprehensive income (Note 14).

**FORTUNA SILVER MINES INC.**

NOTES TO THE UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS  
AS AT AND FOR THE THREE AND NINE MONTH PERIOD ENDED SEPTEMBER 30, 2007  
(Tabular amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**4. Accounts receivable and prepaid expenses**

|                                | September 30,<br>2007<br>(Unaudited) | December 31,<br>2006<br>(Audited) |
|--------------------------------|--------------------------------------|-----------------------------------|
| GST and value added taxes *    | \$ 1,862                             | \$ 2,184                          |
| Trade accounts receivable      | 3,567                                | 1,562                             |
| Advances and other receivables | 991                                  | 279                               |
| Prepaid expenses and deposits  | 141                                  | 60                                |
|                                | <u>\$ 6,561</u>                      | <u>\$ 4,085</u>                   |

\* The Mexico portion of the VAT receivable of \$2,290,666 (December 31, 2006 - \$1,554,002) has been reclassified to long-term receivable from accounts receivable as it is not expected to be recovered in the next twelve months.

**5. Inventories**

Inventories consist of the following:

|                         | September 30,<br>2007<br>(Unaudited) | December 31,<br>2006<br>(Audited) |
|-------------------------|--------------------------------------|-----------------------------------|
| Ore stock piles         | \$ 396                               | \$ 78                             |
| Concentrate stock piles | 105                                  | 165                               |
| Materials and supplies  | 848                                  | 583                               |
|                         | <u>\$ 1,349</u>                      | <u>\$ 826</u>                     |

**6. Long term investments**

At September 30, 2007 and December 31, 2006 the Company owned 3,706,250 shares of Continuum Resources Ltd. The fair market value and the cost are as follows:

|                              | September 30,<br>2007<br>(Unaudited) | December 31,<br>2006<br>(Audited) |
|------------------------------|--------------------------------------|-----------------------------------|
| Fair market value            | \$ 1,186                             | \$ 1,260                          |
| Cost                         | 741                                  | 741                               |
| Unrealized gain (cumulative) | <u>\$ 445</u>                        | <u>\$ 519</u>                     |

On January 1, 2007, the Company adopted CICA HB 3861 and 3855 (Note 3), which is a change in accounting policy with respect to financial instruments. Section 3855 requires that financial assets be measured at fair value on initial recognition and recorded on the balance sheet. As a result, a transition adjustment of \$518,875 has been recorded in opening accumulated other comprehensive loss as at January 1, 2007 and long term investments were increased to their fair market value of \$1,260,125 (\$0.34 per share). The current fair market value of the shares is \$1,186,000 (\$0.32 per share). The Company has classified its long term investments as available-for-sale and, therefore, the decrease in fair value of \$74,125 arising during the 9 months ended September 30, 2007 has been recognized in other comprehensive loss for the period.



**FORTUNA SILVER MINES INC.**

NOTES TO THE UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS  
AS AT AND FOR THE THREE AND NINE MONTH PERIOD ENDED SEPTEMBER 30, 2007  
(Tabular amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**7. Property, Plant & Equipment**

Property, Plant and Equipment are comprised of the following:

|                                  | September 30,<br>2007 |  | December 31,<br>2006             |                                |
|----------------------------------|-----------------------|--|----------------------------------|--------------------------------|
|                                  | Cost<br>(Unaudited)   | Accumulated<br>Depreciation<br>(Unaudited) | Net book<br>value<br>(Unaudited) | Net book<br>value<br>(Audited) |
| Land                             | \$ 297                | \$ -                                       | \$ 297                           | \$ -                           |
| Machinery & equipment            | 7,479                 | 817  | 6,662                            | 4,527                          |
| Buildings                        | 2,583                 | 311  | 2,272                            | 2,457                          |
| Furniture & other<br>equipment   | 505                   | 73   | 432                              | 174                            |
| Transport units                  | 229                   | 35   | 194                              | 372                            |
| Equipment under capital<br>lease | 668                   | 42   | 626                              | 169                            |
| Work in progress                 | 2,227                 | -  | 2,227                            | 108                            |
|                                  | <u>\$ 13,988</u>      | <u>\$ 1,278</u>                            | <u>\$ 12,710</u>                 | <u>\$ 7,807</u>                |

**8. Mineral Properties**

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

|                   | September 30,<br>2007 |                          | December 31,<br>2006 |                  |
|-------------------|-----------------------|--------------------------|----------------------|------------------|
|                   | Cost<br>(Unaudited)   | Depletion<br>(Unaudited) | Net<br>(Unaudited)   | Net<br>(Audited) |
| Peru - Caylloma   | \$ 28,519             | \$ 4,175                 | \$ 24,344            | \$ 23,965        |
| Mexico – San Jose | 23,594                | -                        | 23,594               | 18,565           |
| Other             | 10                    | -                        | 10                   | 10               |
|                   | <u>\$ 52,123</u>      | <u>\$ 4,175</u>          | <u>\$ 47,948</u>     | <u>\$ 42,540</u> |

The carrying amount for San Jose includes \$336,493 of capitalized interest on loans (Note 10). Additions for development and capitalized exploration for the 9 month period ended September 30, 2007 consist of \$3,982,020 at Caylloma and \$5,029,344 at San Jose.

**San Jose Project, Mexico**

The San Jose Project is owned and operated by Compañía Minera Cuzcatlan (“Cuzcatlan”), a company owned 76% by the Company and 24% by Continuum Resources Ltd (“Continuum”). The Company is the operator of the work programs and the Company and Continuum must contribute to the costs thereof in proportion to its ownership percentage in Cuzcatlan.

Cuzcatlan has been accounted for as a variable interest entity, as defined in CICA Accounting Guideline 15 Consolidation of Variable Interest Entities and has been consolidated from the date of acquisition. A non-controlling interest of \$5,708,065 has been recorded as at September 30, 2007 (December 31, 2006 - \$3,226,631).

**FORTUNA SILVER MINES INC.****NOTES TO THE UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

AS AT AND FOR THE THREE AND NINE MONTH PERIOD ENDED SEPTEMBER 30, 2007

(Tabular amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**9. Related Party Transactions**

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

|  | Nine months ended<br>September 30,<br>2007<br>(Unaudited) | Nine months ended<br>September 30,<br>2006<br>(Audited) |
|--|---|---|
| Mineral property costs – geological fees | \$ 45   | \$ 99   |
| Consulting fees                          | 91  | 45  |
| Salaries and wages                       | 71  | 6   |
| Management fees                          | 183   | 41  |

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

At September 30, 2007, due to related parties consists of \$40,359 (December 31, 2006 - \$27,278) owing to an officer and to companies with a common director. These amounts were incurred as a result of shared administrative costs. These amounts are unsecured, non-interest bearing and payable in the normal course of business.

**10. Loans**

On November 21, 2006 the Company borrowed \$4,600,000 at an interest rate of 12% from Quest Capital Corporation in connection with the acquisition of the San Jose property. The loan was due on May 30, 2007 but was paid back on January 15, 2007. As additional consideration for the facility, 153,333 shares of the Company were issued to the lender in the prior year as payment of a bonus in the amount of \$275,999.

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

At September 30, 2007 the Company has capital lease obligations of \$554,623 (December 31, 2006 - \$142,045) with a current portion of \$174,235 (December 31, 2006 - \$44,945). These are related to the acquisition of mining equipment and transport units. These obligations have terms of 25 months and 36 months and bear interest at rates ranging from 8.16% to 8.92%.

**FORTUNA SILVER MINES INC.**

**NOTES TO THE UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**AS AT AND FOR THE THREE AND NINE MONTH PERIOD ENDED SEPTEMBER 30, 2007**

(Tabular amounts expressed in thousands of Canadian Dollars, except for share and per share amounts)

**11. Forward Contracts**

During September 2007 the Company entered into a forward sale contract maturing in December 2007 for the sale of 450 tonnes of zinc at US\$2,925 per tonne and 325 tonnes of lead at US\$2,963 per tonne that is measured at fair market value at each period end. The Company has recorded a loss of \$154,074 on this contract as loss on commodity contract for the period ending September 30, 2007.

**12. Asset Retirement Obligation**

The Company has recorded an Asset Retirement Obligation of \$1,875,347 as of September 30, 2007. This is the result of having accreted the previously reported Asset Retirement Obligation of \$1,757,970 as of December 31, 2006 by \$117,377. The accretion expense was calculated over the nine month period using a rate of 9%. The initial amount was based on an estimate prepared by an independent third party at the time of acquisition as to the cost of reclamation associated with the Caylloma property. The Company is currently reviewing its reclamation obligations at the property in light of changing regulations and on the basis of further data in respect of the mine life.

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

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

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**13. Share Capital**

Authorized: Unlimited common shares without par value

|  | Number of<br>shares | Amount           |
|--|---------------------|------------------|
| Balance, September 30, 2005 (unaudited)                        | 20,083,465          | \$ 12,164        |
| Exercise of options  | 650,000             | 424              |
| Exercise of warrants   | 6,124,631           | 5,600            |
| Private placement for cash                                     | 16,700,000          | 22,050           |
| Private placement commission non-cash transaction<br>(Note 16) | 760,261             | 1,140            |
| Property acquisition non-cash transaction                      | 1,897,621           | 2,714            |
| Property finders fee non-cash transaction (Note 16)            | 50,000              | 68               |
| Property acquisition non-cash transaction                      | 168,417             | 285              |
| Loan fee   | 153,333             | 276              |
| Transfer of contributed surplus on exercise of options         | -                   | 215              |
| Less issue costs (non-cash amount \$1,140,392)                 | -                   | (1,595)          |
| Balance, December 31, 2006 (audited)                           | 46,587,728          | 43,341           |
| Exercise of options  | 1,077,500           | 1,515            |
| Exercise of warrants   | 13,285,761          | 18,640           |
| Private placement for cash                                     | 18,000,000          | 34,200           |
| Private placement commission non-cash transaction<br>(Note 16) | 422,300             | 802              |
| Transfer of contributed surplus on exercise of options         | -                   | 963              |
| Less issue costs (non-cash amount \$802,370)                   | -                   | (2,487)          |
| Balance, September 30, 2007 (unaudited)                        | <u>79,373,289</u>   | <u>\$ 96,974</u> |

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**13. Share Capital (cont'd)**

## Stock Options

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

|                                     | Nine months ended<br>September 30, 2007<br>(Unaudited) |  | Fifteen months ended<br>December 31, 2006<br>(Audited) |  |
|-------------------------------------|--|--|--|--|
|                                     | Number of<br>Options                                   | Weighted<br>Average<br>Exercised Price | Number of<br>Options                                   | Weighted<br>Average<br>Exercised Price |
| Outstanding, beginning<br>of period | 3,765,000  | \$ 1.62                                | 860,000  | \$ 0.56                                |
| Granted                             | 4,080,000  | 2.82                                   | 3,555,000  | 1.70                                   |
| Exercised                           | (1,077,500)  | 1.40                                   | (650,000)  | 0.65                                   |
| Expired/cancelled                   | (112,500)  | 2.56                                   | -  | -                                      |
| Outstanding, end of<br>period       | <u>6,655,000</u>                                       | <u>\$ 2.27</u>                         | <u>3,765,000</u>                                       | <u>\$ 1.62</u>                         |

The following stock options were outstanding and exercisable at September 30, 2007:

| Number of<br>shares | Exercise Price \$ | Expiry Date        |
|---------------------|-------------------|--------------------|
| 39,000              | 0.37              | December 2, 2009   |
| 30,000              | 0.80              | July 24, 2010      |
| 345,000             | 1.35              | February 5, 2016   |
| 451,000             | 2.29              | March 30, 2016     |
| 90,000              | 1.75              | May 8, 2016        |
| 200,000             | 1.75              | May 22, 2016       |
| 315,000             | 1.55              | July 5, 2016       |
| 860,000             | 1.66              | July 10, 2016      |
| 225,000             | 1.61              | September 13, 2016 |
| 50,000              | 1.90              | November 20, 2016  |
| 50,000              | 1.96              | November 23, 2016  |
| 1,480,000           | 2.22              | January 11, 2017   |
| 80,000              | 2.75              | February 6, 2017   |
| 15,000              | 3.09              | April 22, 2017     |
| 50,000              | 3.10              | May 31, 2017       |
| 50,000              | 3.10              | June 17, 2017      |
| 50,000              | 3.05              | June 27, 2017      |
| 2,025,000           | 3.22              | July 2, 2017       |
| 250,000             | 2.97              | September 23, 2017 |
| <u>6,655,000</u>    |                   |                    |

6,442,500 options have vested as at September 30, 2007.

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**13. Share Capital (cont'd)**

## Warrants

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

|                                     | Nine months ended<br>September 30, 2007<br>(Unaudited) |                                       | Fifteen months ended<br>December 31, 2006<br>(Audited) |                                       |
|-------------------------------------|--|---------------------------------------|--|---------------------------------------|
|                                     | Number of<br>Warrants                                  | Weighted<br>Average<br>Exercise Price | Number of<br>Warrants                                  | Weighted<br>Average<br>Exercise Price |
| Outstanding, beginning<br>of period | 20,566,185   | \$ 1.23                               | 13,114,117   | \$ 0.91                               |
| Issued                              | 10,559,725   | 2.30                                  | 13,576,699   | 1.40                                  |
| Exercised                           | (13,285,761)   | 1.40                                  | (6,124,631)  | 0.91                                  |
| Outstanding, end of<br>period       | <u>17,840,149</u>                                      | <u>\$ 1.88</u>                        | <u>20,566,185</u>                                      | <u>\$ 1.23</u>                        |

The following share purchase warrants were outstanding at September 30, 2007:

| Number of warrants | Exercise Price \$ | Expiry Date       |
|--------------------|-------------------|-------------------|
| 374,500            | 1.250             | October 6, 2007   |
| 58,556             | 0.800             | October 6, 2007   |
| 4,838,546          | 1.850             | March 23, 2008    |
| 862,117            | 0.345             | June 27, 2010     |
| 1,613,238          | 0.345             | November 17, 2010 |
| 970,482            | 2.300             | July 11, 2008     |
| 9,122,710          | 2.300             | July 11, 2008     |
| <u>17,840,149</u>  |                   |                   |

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**13. Share Capital (cont'd)**

## Stock-Based Compensation

The Company uses the fair value based method of accounting for share options granted to consultants, directors, officers and employees. The non-cash compensation charge of \$6,542,262 recognized for the nine months ended September 30, 2007 is associated with the granting of options to a consultant, directors and employees. These compensation charges have been determined under the fair value method using the Black-Scholes option pricing model with the following assumptions:

|                                 | Nine months ended<br>September 30, 2007<br>(Unaudited) | Nine months ended<br>September 30, 2006<br>(Unaudited) |
|---------------------------------|--|--|
| Risk-free interest rate         | 4.04% - 4.67%  | 4.01% - 4.59%  |
| Expected stock price volatility | 59% - 68%  | 72% - 104%   |
| Expected term in years          | 0.3, 5 & 10  | 1, 5 & 10  |
| Expected dividend yield         | 0%   | 0%   |

Option pricing models require the input of highly subjective assumptions including the estimate of the share price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options.

**14. Accumulated other comprehensive income**

|   | September<br>30, 2007 |
|---|-----------------------|
| Balance at December 31, 2006 (audited)  | \$ -                  |
| Cumulative impact of accounting changes, net of tax (Note 3)                      | 438                   |
| Adjusted balance January 1, 2007  | 438                   |
| Unrealized (loss) on available-for-sale long term investment, net of tax (Note 6) | (62)                  |
| Balance at September 30, 2007 (unaudited)   | \$ 376                |

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**15. Segmented Information**

Details of identifiable assets by geographic segments are as follows:

|                      | September 30,<br>2007<br>(Unaudited) | December 31,<br>2006<br>(Audited) |
|----------------------|--------------------------------------|-----------------------------------|
| Canada               |                                      |                                   |
| Current assets       | \$ 38,256                            | \$ 1,839                          |
| Investments          | 1,186                                | 741                               |
| Equipment            | 7                                    | 9                                 |
|                      | <u>\$ 39,449</u>                     | <u>\$ 2,589</u>                   |
| Peru                 |                                      |                                   |
| Current assets       | \$ 11,151                            | \$ 5,021                          |
| Long-term receivable | 2,291                                | 1,554                             |
| Plant and equipment  | 8,612                                | 7,793                             |
| Mineral properties   | 22,053                               | 22,411                            |
|                      | <u>\$ 44,107</u>                     | <u>\$ 36,779</u>                  |
| Mexico               |                                      |                                   |
| Current assets       | \$ 729                               | \$ 1,247                          |
| Plant and equipment  | 4,088                                | 2                                 |
| Mineral properties   | 25,884                               | 18,564                            |
|                      | <u>\$ 30,701</u>                     | <u>\$ 19,813</u>                  |
| Other                |                                      |                                   |
| Current assets       | \$ 1,738                             | \$ -                              |
| Equipment            | 3                                    | 3                                 |
| Mineral properties   | 10                                   | 10                                |
|                      | <u>\$ 1,751</u>                      | <u>\$ 13</u>                      |
|                      | <u>\$ 116,008</u>                    | <u>\$ 59,194</u>                  |

All revenues are generated in Peru.



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**16. Supplementary Disclosure of Non-cash Transactions**

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

The following non-cash transactions occurred:

|   | Nine months ended<br>September 30, 2007<br>(Unaudited) |        |
|---|--|--------|
|   | Number of shares                                       | Amount |
| Shares issued for commission on private placement | 422,300  | \$ 802 |
| Purchase of equipment on a deferred payment plan  | -  | \$ 856 |
| Fair market value of options exercised            | -  | \$ 963 |

  

|   | Nine months ended<br>September 30, 2006<br>(Unaudited) |          |
|---|--|----------|
|   | Number of shares                                       | Amount   |
| Shares issued for property finders fees           | 50,000   | \$ 68    |
| Shares issued for commission on private placement | 760,261  | \$ 1,140 |
| Fair market value of options exercised            | -  | \$ 186   |

**17. Commitments**

A processing plant was purchased in the first quarter of 2007 for US\$2,250,000 to be paid in three installments of US\$750,000. The first installment was made on February 1, 2007 and the second installment was paid on August 1, 2007. The final installment is required to be paid on February 1, 2008. The final installment amount is included in accounts payable and accrued liabilities as at September 30, 2007.

**18. Subsequent Events**

Subsequent to September 30, 2007 the Company received \$162,750 from the exercise of 90,000 options and \$514,970 from the exercise of 433,056 warrants.

During October 2007 the Company executed a series of put and call option strategies involving 3,150 tonnes of zinc and 1,750 tonnes of lead and maturing throughout the period starting November 2007 and ending December 2008. No initial premium associated with these trades has been paid.

**19. Comparative Figures**

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