

**Transcript of
Fortuna Silver Mines
Second Quarter 2020 Financial and Operational Results
August 14, 2020**

Participants

Carlos Baca - Investor Relations Manager
Jorge Alberto Ganoza - President, Chief Executive Officer and Director
Luis Ganoza - Chief Financial Officer

Analysts

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Jacques Wortman - Laurentian Bank Securities
Justin Stevens - PI Financial Corp.
Ryan Thompson - BMO Capital Markets

Presentation

Operator

Good day, ladies and gentlemen, and welcome to your Fortuna Silver Mines Second Quarter 2020 Financial and Operational Results Call. All lines have been placed on a listen-only mode and the floor will be opened for your questions and comments following the presentation.

At this time, it is my pleasure to turn the floor over to your host, Carlos Baca, Investor Relations Manager. Sir, the floor is yours.

Carlos Baca - Investor Relations Manager

Thank you, Taryn. Good morning, ladies and gentlemen. I would like to welcome you to Fortuna Silver Mines and to our financial and operational results call for the second quarter of 2020.

Today, we will be using a webcast presentation, which will be controlled by us. To download the presentation, please go to our website at www.fortunasilver.com, click on the Investors tab then click on the Financials sub tab and under Q2 2020, click on the earnings call webcast link. Jorge Alberto Ganoza, President, CEO and Director; and Luis Dario Ganoza, CFO, will be hosting the call from their home offices in Lima, Peru.

Before I turn over the call to Jorge, I would like to indicate that this earnings call contains forward-looking information that is based on the company's current expectations, estimates and beliefs. This forward-looking information is subject to a number of risks, uncertainties and other factors. Actual results could differ materially from a conclusion, forecast or projection in the forward-looking information.

Certain material factors or assumptions were applied in drawing a conclusion or making a forecast or projection as reflected in the forward-looking information. Additional information about the material factors that could cause actual results to differ materially from the conclusion, forecast or projection in the forward-looking information and the material factors or assumptions that were applied in drawing a conclusion or making a forecast or projection as reflected in the forward-looking information, is contained in the company's annual information form and MD&A, which are publicly available on SEDAR. The company assumes no obligation to update such forward-looking information in the future, except as required by law.

I would now like to turn the call over to Jorge Alberto Ganoza, President, CEO and Co-Founder of Fortuna.

Jorge Alberto Ganoza - President, Chief Executive Officer and Director

Thank you, Carlos, and good morning to all. I'll be presenting an introduction to our second quarter results and discuss the status of our operations and development projects in this unprecedented COVID environment we're all living in, and then turn the call over to Luis, who will take you through the financial statements.

If we move on to slide 6 of the webcast presentation, in slide 6 of the presentation, the operational financial results of the company for the quarter are marked by the industry-wide suspension of activities dictated by the governments in Mexico, Argentina and Peru.

During the quarter, the suspension in Mexico impacted our San Jose Mine for a total of 53 days. And in Argentina, construction of the Lindero Project was halted for approximately 60 days. In Peru, we managed to continue carrying with mill processing at our Caylloma Mine, taking advantage of surface or stockpiles and produced at capacity. In spite of all of this, we reported neutral free cash from ongoing operations.

On May 20, we closed a successful \$69 million bought [ph] deal equity financing. As of the end of June, we have a total liquidity available of \$132 million. The company is adequately funded to meet its capital demands and maintain financial flexibility during these uncertain times.

As of the end of June, our Lindero construction is 97% complete. The project is largely now in the preproduction and commissioning phase, with relative minor construction activity ongoing on ADR and SART plants.

In March, we withdrew our consolidated metal production guidance for the year. The uncertain operational environment we face in the three countries, which hosts our operation does not support reinstating guidance at this time.

We have implemented strict sanitary protocols and COVID screening processes at all our operations. Up to this date, we have conducted over 9,000 serological and over 3,000 molecular tests. We have detected close to 200 confirmed COVID cases and had to report the sad passing of one confirmed case and one suspect case. As of today, all our operations are operating at capacity.

Moving on to slide 7, in slide 7, we shared with you our key safety performance indicators. We present the KPIs as a 12-month rolling average to better represent trends. And as you can appreciate, we are delivering solid and consistent improvement year-over-year.

Slide 8; as you can appreciate, in slide 8, our Q2 production for both gold and silver was dramatically impacted by the COVID industry-wide suspension in Mexico, in particular. Both silver and gold production is down 47% compared to a year ago. Byproduct lead and zinc production remained stable as the Caylloma Mine operated the mill at capacity during the quarter.

Slide 9; silver accounted of 49% of sales and gold for 28% for a combined 77% precious metals contribution. Quarter-over-quarter, we continued to realize higher silver and gold prices with \$17 and \$1,727 per ounce, respectively. We observed with expectation, the consolidation of what is configuring into a historic bull market for precious metals and mining equities.

Moving on to slide 10, our sales, EBITDA and net income were all negatively impacted by the shortfalls in production. For Q3, we expect a significantly improved quarter with a limited impact of three weeks of suspension of production at the Caylloma Mine during the month of July.

Moving on to slide 11, please; San Jose all-in sustaining cost was driven higher by lower metal production during the suspension period. And at Caylloma, higher all-in sustaining cost was driven by significant drops in zinc and lead prices of 29% and 12%, respectively.

Moving on to slide 12, following on with the same theme of suspended activities or rate of capital investment, execution was also impacted by the suspension during the period. More notorious is a small figure of \$5 million executed at Lindero, which again was suspended for a little over two months during the quarter.

Moving on to slide 13, slide 13 shows a glance of our project pipeline. And here, I can highlight, once again, the relevance of our Lindero Project. It will add to our low-cost gold production growth.

Slide 14 shows a simplified schedule for our Lindero Project. The industry-wide suspension in Argentina took effect on March 19, and our mobilization back to the project for the resumption of construction initiated during the second-half of May, effectively over two months of suspended construction. On July 16, we announced the successful commissioning of the primary and secondary crushing circuits and the start of ore stacking on the heap leach pad.

We're currently on the early stages of the ramp-up phase of mine production, crushing and leach pad operations. Our next milestone is the start of irrigation, which is planned for later in this month of August or early September at the latest. We plan to be in commercial operations in Q1 2020. For 2020, we expect gold dore [ph] production in the range of 25,000 to 28,000 ounces of gold.

From Slide 15 and onwards, we're going to share with you some updated photos of the Lindero construction and preproduction activities. Here, I can add that as of the end of June, our remaining project funding requirements for CapEx, preproduction, working capital and VAT stand at around \$55 million to \$60 million.

Slide 16; in the coming slides, we show preproduction activities. We have the initial mine benches prepared and in production. Our mine has already achieved the 40,000 tonne per day mining capacity prior to the suspension in March. Today, operating only under one shift [indiscernible]. Since the resumption, operating only under one shift with five trucks, we have already achieved 20,000 tonnes per day, so we're pretty satisfied with the performance of the mining team fleet and that is advancing well.

Next slide. These are views of the leach pad and ponds area. We started pre-commissioning of the pumping and solution management systems at the ponds in preparation for irrigation. So all of the pre-commissioning activities at the pumping are taking place and the leach pad is receiving crushed or everyday still under one shift up to now.

Next slide, please. These are some photos showing crushing operations.

Next slide, please. Primary and secondary crushers.

Next slide, please. I might have a delay on my end. Slide 15, slide 14, these are views in slide 14 of the tertiary and agglomeration circuits. We have some distortion of the webcast on my end. On the process area and solution funds, that's a view of the area that's under pre-commissioning currently.

Next slide, please. Slide 20, slide 21; here, we have a view of the ADR plant. ADR is in the final stages of piping and electrical, some pre-commissioning activities have initiated already on certain tanks and portions of the solution handled in circuit, but there is still some finishes on piping and electrical that we expect to conclude this month of August.

Next slide. This is a view of the SART plant. In the SART plant, it's not critical path for initial gold production, which is scheduled for September. We believe it needs to come into the circuit early, but it's not essential or critical path, as I said, for initial gold production. So we expect to be concluding with piping and electrical activities here as well in the month of September or, if it stretches, in October at the latest.

So with that, we are concluding with the photos we share on the webcast, and I will now let Luis take you through the financial results. Thank you.

Luis Ganoza - Chief Financial Officer

Thank you, Jorge. Slide 24; so sales for the second quarter were \$44.5 million, down 34% from 2019 due to lower metal production compared to the prior year, as Jorge explained, due mostly to COVID-19-related constraints. Our silver and gold production was impacted by the government mandated temporary suspension at our San Jose Mine. The stoppage impacted approximately 40% of the expected production for the quarter.

For the quarter, we reported \$1.3 million operating loss, compared to \$15.7 million of operating income in 2019. The operating loss was driven by the drop in sales and a significantly higher charge from stock-based compensation expense in Q2 of 2020. As I will show later in slide 27, the charge was \$5.7 million in the quarter compared to \$0.7 million in Q2 of 2019. This increase was due to the rise of our share price in the quarter.

The operating loss was offset by \$2.2 million of Argentine peso-denominated investment gains from cross-border trade, resulting in positive income before income taxes of \$0.6 million. The net loss for the quarter was \$5.7 million, after deducting \$6.2 million of income tax provision for Q2.

Adjusted EBITDA was \$9.4 million, 65% below the \$27.4 million recorded in 2019. It is relevant to note, our adjusted EBITDA includes the full stock-based compensation charge. Excluding this item, the fall in EBITDA is 54%.

And also as Jorge expressed in his prepared remarks in spite of a complicated quarter, for all the reasons previously discussed, we managed to maintain slightly positive or neutral free cash flow from ongoing operations. Year-to-date, free cash flow from ongoing operations was \$14.3 million.

Now to the next slide please, slide 25. When breaking down our sales performance for the quarter, we can appreciate that the largest impact came from lower silver and gold production, explaining the bulk of the decrease quarter-over-quarter of \$23.4 million.

Next slide, slide 26; here at the top of the slide, we show adjusted operating income for the quarter of \$1.5 million. We have a full reconciliation of our adjusted figures at the end of the presentation and at the end of the news release. The main item of adjustment above operating income is a \$2.7 million foreign exchange loss stemming from the balance sheet of our Argentina subsidiary.

At San Jose, the impact of the temporary shutdown on EBITDA was partially offset by higher prices compared to 2019. At Caylloma, significantly lower base metal crisis drove the sharp falls in EBITDA in the quarter. And both operations, unit cash costs remain below our original guidance for the year and below the prior year.

In the case of San Jose, in particular, the unit cash cost figure of \$66 per tonne, excludes \$1.7 million of cost during the temporary suspension, which are treated for accounting purposes as care and maintenance included under the line item denominated other expenses in our income statement.

Slide 27, the slide reflects or shows the lower execution in our G&A, as part of the announced cost and expense reductions in our Q1 earnings call. As I mentioned before, the large charge on the stock-based compensation expense is related to the appreciation of Fortuna share price of over 100% in the quarter.

The calculation of the effective tax rate yields an abnormally high percentage due to our depressed consolidated earnings base in the quarter. This was further accentuated by the negative impact that the devaluation of the Mexican peso had on our income tax provision in the quarter of approximately \$2 million, and of which \$1.2 million was a deferred tax effect.

Next slide, slide 28; here, we were highlighting two items that have been previously disclosed, the amendment of our debt covenants, granting additional flexibility up to Q1 2021 and the \$69 million equity financing for which the closing was announced on May 20.

As Jorge mentioned, our total liquidity position as of the end of June is \$132 million. We have disclosed, we expect to provide additional funding of between \$55 million and \$60 million up to the point where we start generating revenue at Lindero in Q4. So we believe our liquidity position today gives us an adequate margin of safety, considering the uncertainties that remain from operating in the current environment.

On the balance sheet, I would also like to provide a comment on our VAT receivable at Lindero included in the long-term receivables line item. We carry a balance as of the end of June of \$36.5 million, where the total incurred VAT on a cumulative basis, since we start spending in 2017, has been \$56 million. The difference of \$20 million is a cumulative loss we have recorded over this three-year period. It is worth noting that half of that loss [audio drops].

Operator

Pardon the interruption. This is the operator. Mr. Baca, it looks like we've lost our other speaker line.

Carlos Baca - Investor Relations Manager

Yes, one second, please. [Foreign language]. What do you suggest?

Operator

I can try to dial back out to the number that came in on if you'd like?

Carlos Baca - Investor Relations Manager

[Foreign language]. Okay, they're going to dial back in.

Operator

Thank you. Everyone, please hold for just one moment while we reconnect our speakers.

Luis Ganoza - Chief Financial Officer

Thank you. [Foreign language]. Hello?

Carlos Baca - Investor Relations Manager

Can you hear now?

Luis Ganoza - Chief Financial Officer

Yes. This is Luis Ganoza. We got disconnected from the call. We're back here. So back to you, Carlos.

Carlos Baca - Investor Relations Manager

Okay. We would now like to turn the call over to any questions that you may have.

Operator

Ladies and gentlemen, the floor is now open for questions. [Operator instructions]. We'll take our first question from Trevor Turnbull with Scotiabank. Please go ahead, sir.

Q: Yes. Thank you, guys. Jorge, I had two quick questions. I guess, maybe I'll start with the one for Luis. He got cut off when he was talking about the VAT receivables. Has there been an interruption in your ability to get VAT receivables in Argentina because of the coronavirus, or is that kind of business as usual in terms of getting those?

Luis Ganoza - Chief Financial Officer

Yes. Hi, Trevor. Yes, I'm sorry, I wasn't able to gauge where exactly that I get cut off. But just to conclude, so I was highlighting the fact that our current balance today is \$36.5 million. We have seen a recorded accumulative loss on this item since 2017 of \$20 million, which has been offset to an extent by our cumulative gains on our cross-border trade of \$14.3 million.

Now, going to your question, we will not be able to collect VAT up until the time we start generating revenue. There was an expectation initially that we could do so throughout the construction phase. But as we know that was dependent or contingent on the procedure being issued by the government.

There is a law that sticks [ph] to favor investments, foreign investments in country. But it hasn't been applicable since there hasn't been the formality required to put it in place. So our expectation today is that we start collecting upon the start of revenue generation and the project growth [ph].

Q: Okay. Thank you for that, Luis. So my other question was for Jorge, and relates to the commissioning and getting everything up to speed. I remember that there was some commissioning concerns with people needing to come into Argentina, but because of travel restrictions that was getting delayed.

I couldn't remember if that was related to the HPGRs, but it doesn't sound like that's a problem. But you mentioned the SART plant, it's not on the critical path, but is that still something that's contingent on being able to get people in for the commissioning phase?

Jorge Alberto Ganoza - President, Chief Executive Officer and Director

Okay. With respect to the foreign technicians required for commissioning, we have identified the HPGR as the critical equipment that requires more vendor support in the commissioning phase. The HPGR has been pre-commissioned, is installed and pre-commissioned, but we still have to run it with load.

So we decided, and this was explained on our May 8 news release, to take out of the critical path and place on standby that entire circuit. So we're currently running the mine, the crushing and placing ore in the leach pad bypassing HPGR.

What's the plan with HPGR? We're not counting on having the foreign technicians on site. What we have developed is a plan to have remote assistance through the commissioning. But because of that, we have given ourselves plenty of time for the commissioning period.

So a commissioning phase that, under normal conditions, would take three weeks, we're giving ourselves almost three months. And that's how we're mitigating the risk of commissioning without onsite vendor technicians. So we're basically allowing plenty of time to work with remote assistance.

With respect to the SART, the SART is – it has never been in the critical path for gold production. There is a debate between our metallurgists on how soon do we need it. As you know, the purpose of the SART plant is to help us keep copper in pregnant solution at or below 500 ppm. So the question is how fast is the copper going to build? And even if it builds above 500 ppm, there are other alternative ways to manage copper in solution through higher cyanide addition.

So we don't know if it's going to take a month, three weeks or two months for the copper to build to that critical level of 500 ppm. That is why we believe we need it early, but not on day one. And once again, what we are doing is developing a plan with our process engineers to commission this remotely with remote assistance.

We have our operators. We have a couple of operators with SART experience, and then we're preparing to work through with remote assistance through the commissioning phase of SART. I don't know if that addresses your question, Trevor.

Q: No, it does, Jorge. I knew that originally, you were going to bypass your HPGR circuit, and I guess you are, because you're already crushing on the primary and secondary circuits. And then I didn't realize that the extra time for remote commissioning is what gets us to that being used towards the end of Q4. So yes, that cleared it up. Thank you, Jorge. That's all I had.

Jorge Alberto Ganoza - President, Chief Executive Officer and Director

No, thank you.

Operator

We'll take our next question from Jacques Wortman with Laurentian Bank. Please go ahead.

Q: Yes, thanks very much. My question regarding VAT has been answered. Thank you.

Operator

[Operator instructions]. We'll take our next question from Justin Stevens with PI Financial. Please go ahead.

Q: Hi, guys. Most of what I was going to ask has already been answered both by the presentation and previous callers, but just a couple of ones. Do you have everyone then onsite that you'll need to complete commissioning of the lead circuit, or is there anything that you're still sort of waiting on before that happens?

Jorge Alberto Ganoza - President, Chief Executive Officer and Director

We have the entire plan team on site, yes. Everybody who is under our plan and is required to be on site under our May 8th plan is on site in Argentina at this time.

Q: Great. And so yes, I guess, then the next critical path item we'll be finishing that EIP work to get the leach plant up and running and then sort of start irrigating the heap and circulating the PLS?

Jorge Alberto Ganoza - President, Chief Executive Officer and Director

Yes. We are pre-commissioning with water as we speak the solution handling systems. At the ponds, we're doing tests with water on the heap, recirculating, [indiscernible], handling solutions from pond to pond. So all of that work is taking place, so I have really nothing to report outside of our plan on that matter. We have a high expectation that we will be able to meet our milestone for irrigation, if not by the end of this month, in about 10, 15 days, early next, at the very latest.

Q: Great. I think that's all I had then. And that sounds good and best of luck with the commissioning.

Jorge Alberto Ganoza - President, Chief Executive Officer and Director

Thank you.

Operator

Our next question will return to Trevor Turnbull with Scotiabank.

Q: Sorry, I had just one other follow-up, Jorge. I was wondering, with things starting to wrap up on the construction and commissioning front, when will you be able to start spending time evaluating some of the brownfields opportunities at Lindero? Is that something that—is exploration able to resume, and is that work something you're planning to be able to do early in 2021?

Jorge Alberto Ganoza - President, Chief Executive Officer and Director

It is for certain a 2021 activity, Trevor. Right now, we have 1,200-man camp and we are only hosting about half of that population because of the social distancing measures we have implemented at the project. So every bed is taken by either construction personnel or operations personnel at this stage. And we expect that will continue to be the case until the end of the year. Every time we conclude a construction task and we demobilize construction people, those beds are taken by mine operations personnel.

We're pushing for the initiation of night shift. We're currently working only with day shift. So we want to be able to get our night shifts going. And as soon as someone from construction leaves, the bed is taken by an operator. So that will continue to be the case likely until the end of the year, so exploration will resume 2021.

Q: Okay. Yes, look forward to it. Thanks, Jorge

Operator

We'll take our next question from Garrett Goggin with Gold Stock Analyst. Please go ahead. And it appears he no longer has a question. [Operator instructions]. We'll take our next question from Ryan Thompson with BMO. Please go ahead.

Q: Hi, Jorge. If I could just follow-up on Trevor's question, can you maybe just touch a little bit on exploration at the other two assets?

Jorge Alberto Ganoza - President, Chief Executive Officer and Director

Yes. Exploration at our San Jose Mine has resumed. It is a priority for us. Over the last year-and-a-half, two years, we've been doing data mining and revisiting the intensive work that we have done throughout the years generating new ideas. So we're currently drilling from underground and from surface, testing new ideas on both the underground and surface.

So we have one rig drilling underground, looking to build it into two rigs, and we have one rig on surface testing new lineaments and structures. So we know that we enjoyed a significant exploration success at San Jose up until 2016, and since then, we've been on sort of a dry spell at San Jose.

So we're doing different things. We're trying different ideas. We have been looking at the project with different eyes. And one of the first things we have done is resume exploration activities at San Jose. At Caylloma, we have suspended exploration. We have a substantial resource base at Caylloma, and resumption of exploration at that asset will likely take place in the first-half of 2021.

Q: That's helpful. And maybe just a quick follow-up on Caylloma; I know that you have some silver-rich sorts of areas in in that mine and with silver prices sort of doing what they're doing, what is the thinking there, and how long do you think silver prices sort of need to stay here before you could actually make a concrete decision to maybe chase after some of those areas?

Jorge Alberto Ganoza - President, Chief Executive Officer and Director

Yes. We decommissioned—just to put it into perspective, when we had those zones in production, those areas sourced 5% of throughput at the mill and contributed 50% of the silver we produce. So there are significant contributors to silver and we decommissioned those areas when silver dropped below \$20 back in—when was that? It's long ago, too long ago.

But when silver pierced through the \$20 mark is that we started decommissioning those zones. So we would need to see sustained prices above \$20 for us to incorporate or reincorporate those areas into our mine plans. Those are narrow veins that require conventional labor-intensive mining, and it's not only the limitation of prices, but also the fact that they are labor-intensive, so those narrow veins don't support high degrees of mechanization at Caylloma. So we would also need to see a [indiscernible] of COVID restrictions, probably to think about bringing those veins into production. So it's a combination of price and the COVID environment for sure for those veins.

Q: Okay, thanks. That's very helpful, and good to hear that you have the drills turning at San Jose again. Thanks for the update.

Operator

[Operator instructions]. And sir, there appear to be no further questions at this time.

Jorge Alberto Ganoza - President, Chief Executive Officer and Director

Thank you, Taryn. I would like to thank everyone for listening to today's earnings call, and we look forward to you joining us next quarter. Have a good day.

Operator

Ladies and gentlemen, this does conclude today's teleconference. We thank you for your participation. You may disconnect your lines at this time, and have a great day.