



FORTUNA
SILVER MINES INC.

FINANCIAL REVIEW

Second Quarter Ended June 30, 2009

FORTUNA SILVER MINES INC.

UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Second Quarter Ended June 30, 2009

(Expressed in thousands of United States Dollars, unless otherwise stated)

**Notice to Reader of the Unaudited Interim Consolidated Financial Statements
For the three and six months ended June 30, 2009**

In accordance with National Instrument 51-102, of the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited interim consolidated financial statements.

The unaudited interim consolidated financial statements of Fortuna Silver Mines Inc. (the “Company”) for the three and six month periods ended June 30, 2009 (“Financial Statements”) have been prepared by management. The Financial Statements should be read in conjunction with the Company’s audited consolidated financial statements for the year ended December 31, 2008, which are available at the SEDAR website at www.sedar.com. The Financial Statements are stated in terms of thousands of United States dollars, unless otherwise indicated, and are prepared in accordance with Canadian generally accepted accounting principles.

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

	Notes	June 30, 2009 (Unaudited)	December 31, 2008 (Audited)
ASSETS			
CURRENT			
Cash and cash equivalents		\$ 31,165	\$ 29,454
Derivatives	4	-	1,418
Accounts receivable and prepaid expenses	5	8,315	1,865
GST and value added tax		1,473	5,127
Inventories	6	1,520	1,727
		42,473	39,591
LONG TERM RECEIVABLES		78	114
LONG TERM INVESTMENT AND RECEIVABLE	7	-	3,093
PROPERTY, PLANT & EQUIPMENT	8	15,445	13,285
MINERAL PROPERTIES	9	64,975	59,285
		\$ 122,971	\$ 115,368
LIABILITIES			
CURRENT			
Accounts payable and accrued liabilities		\$ 4,314	\$ 4,735
Due to related parties, net	10	24	38
Derivatives	4	1,100	-
Current portion of obligation under capital lease	11	1,024	682
Current portion of long term liability	11	-	80
		6,462	5,535
OBLIGATIONS UNDER CAPITAL LEASE	11	1,125	717
LONG TERM LIABILITY	11	616	665
ASSET RETIREMENT OBLIGATION	12	1,442	1,066
FUTURE INCOME TAX LIABILITY		11,213	9,410
NON-CONTROLLING INTEREST		-	9,007
		20,858	26,400
SHAREHOLDERS' EQUITY			
SHARE CAPITAL		103,613	98,206
CONTRIBUTED SURPLUS		12,076	11,798
DEFICIT		(9,838)	(9,980)
ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME		(3,738)	(11,056)
		102,113	88,968
		\$ 122,971	\$ 115,368
Nature and continuance of operations	1		
Commitments and contingencies	15		
Subsequent events	18		

APPROVED BY THE DIRECTORS:

"Jorge Ganoza Durant" , Director
Jorge Ganoza Durant

" Simon Ridgway " , Director
Simon Ridgway

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

FORTUNA SILVER MINES INC.
INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited - Expressed in thousands of US Dollars, except for share and per share amounts)

		<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	Notes	2009	2008	2009	2008
Sales		\$ 12,862	\$ 7,772	\$ 21,842	\$ 14,580
Cost of sales (including depletion, depreciation and accretion of \$2,979 (2008: \$2,155))		6,070	4,923	11,563	9,428
MINE OPERATING INCOME		6,792	2,849	10,279	5,152
Selling, general and administrative expenses (includes depreciation of \$31 (2008: \$21))	10	2,426	1,925	4,406	3,510
Stock-based compensation	13 d)	11	95	360	623
Write-off of deferred exploration costs		-	-	1,081	-
		2,437	2,020	5,847	4,133
OPERATING INCOME		4,355	829	4,432	1,019
Interest and other income and expenses		141	232	399	681
Interest and finance expenses		(42)	(28)	(72)	(45)
Net (loss) on commodity contracts		(1,356)	2,215	(1,772)	1,628
(Loss) on disposal of property, plant and equipment		(6)	(3)	(6)	(23)
(Loss) on disposal of investment		226	-	(236)	-
Foreign exchange (loss) gain		(399)	411	(372)	423
		(1,436)	2,827	(2,059)	2,664
INCOME BEFORE INCOME TAXES AND NON-CONTROLLING INTEREST		2,919	3,656	2,373	3,683
Income tax provision		1,723	1,144	2,411	1,754
Non-controlling interest		-	19	(180)	74
NET INCOME FOR THE PERIOD		\$ 1,196	\$ 2,493	\$ 142	\$ 1,855
Earnings per Share - Basic and Diluted		\$ 0.01	\$ 0.03	\$ 0.00	\$ 0.02
Weighted average number of shares outstanding - Basic		92,253,419	85,329,901	89,750,592	83,460,052
Weighted average number of shares outstanding - Fully Diluted		92,253,419	86,559,462	89,750,592	85,636,347

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

FORTUNA SILVER MINES INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited - Expressed in thousands of US Dollars)

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Net income (loss) for the period	\$ 1,196	\$ 2,493	\$ 142	\$ 1,855
Other comprehensive income (loss), net of taxes				
Unrealized gain (loss) on available for sale long-term investments	-	(254)	148	(621)
Transfer of unrealized loss to realized loss upon derecognition of available for sale long-term investment	-	-	462	-
Unrealized gain/(loss) on translation of functional currency to reporting currency	5,323	1,270	6,708	(3,018)
Other comprehensive income (loss)	5,323	1,016	7,318	(3,639)
Comprehensive income (loss)	\$ 6,519	\$ 3,509	\$ 7,460	\$ (1,784)

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

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

	Notes	Three months ended June 30,		Six months ended June 30,	
		2009	2008	2009	2008
OPERATING ACTIVITIES					
Net income for the period		\$ 1,196	\$ 2,493	\$ 142	\$ 1,855
Items not involving cash					
Depletion and depreciation		1,565	1,180	2,949	2,237
Accretion expense		31	26	61	52
Future income tax		2,146	1,423	2,411	1,590
Stock based compensation		11	95	360	623
Unrealized loss(gain)on commodity contracts		621	(2,053)	2,518	(1,316)
Non-controlling interest		-	19	(180)	74
Write-off of deferred exploration costs		-	-	1,081	-
Non-cash loss on disposal of equipment		6	3	6	23
Non-cash gain on disposal of investment		(226)	-	236	-
Other		10	-	18	-
Unrealized foreign exchange loss (gain)		331	(712)	319	(56)
		5,691	2,474	9,921	5,082
Changes in non-cash working capital items					
Accounts receivable and prepaid expenses		(845)	451	(4,335)	(2,149)
Inventories		9	63	381	(143)
Accounts payable		(162)	1,110	(815)	(407)
Payments from (to) related parties	10	6	4	(16)	16
Net cash from (used in) operating activities		4,699	4,102	5,136	2,399
FINANCING ACTIVITIES					
Net proceeds on issuance of common shares		141	4	141	8,004
Capital lease obligations		(180)	(15)	(360)	(129)
Net cash provided by (used in) financing activities		(39)	(11)	(219)	7,875
INVESTING ACTIVITIES					
Costs relating to the acquisition of Continuum		(43)	-	(163)	-
Mineral property expenditures		(2,643)	(6,479)	(4,814)	(8,994)
Value added taxes on purchase of property, plant & equipment		878	(447)	1,973	(606)
Property, plant & equipment		(41)	(921)	(940)	(1,295)
Long term receivable		241	-	269	-
Proceeds on disposal of equipment		-	2	-	10
Net cash (used in) provided by investing activities		(1,608)	(7,845)	(3,675)	(10,885)
Effect of exchange rate changes on cash and cash equivalents		1,091	591	469	(1,406)
INCREASE (DECREASE) IN CASH		3,052	(3,754)	1,242	(611)
Cash - beginning of period		27,022	49,302	29,454	48,156
CASH AND CASH EQUIVALENTS - END OF PERIOD		\$ 31,165	\$ 46,139	\$ 31,165	\$ 46,139
Supplementary disclosure of cash flow information:					
Cash received for interest		\$ 5	\$ (1,291)	\$ 67	\$ (803)
Cash paid for income taxes		\$ 50	\$ 128	\$ 143	\$ 276
Non-cash Transactions:					
Issue of shares on purchase of resource property	9	\$ -	\$ -	\$ 5,194	\$ -
Reassessment of asset retirement obligation	9, 12	\$ -	\$ -	\$ 288	\$ -
Cancellation of Minera Condor liability	11	\$ -	\$ -	\$ 156	\$ -
Equipment purchased through capital lease		\$ 1,026	\$ -	\$ 1,127	\$ -
Purchase of resource property on a deferred payment plan		\$ -	\$ -	\$ -	\$ -
Sale of equipment for a long-term receivable		\$ -	\$ -	\$ -	\$ -
Fair value of options exercised		\$ 61	\$ 1	\$ 71	\$ 27

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

FORTUNA SILVER MINES INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2009 AND 2008
(Unaudited - Expressed in thousands of US Dollars, except for share amounts)

	Notes	Share Capital		Contributed Surplus	(Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
		Shares	Amount				
Balance - December 31, 2008		85,331,659	\$ 98,206	\$ 11,798	\$ (9,980)	\$ (610)	\$ 99,414
Translation adjustment due to change of Minera Bateas from integrated to self-sustaining foreign subsidiary		-	-	-	-	(3,941)	(3,941)
Translation adjustment due to change in reporting currency		-	-	-	-	(6,505)	(6,505)
		85,331,659	98,206	11,798	(9,980)	(11,056)	\$ 88,968
Exercise of options		200,000	144	-	-	-	144
Issuance of shares for property		6,786,706	5,192	-	-	-	5,192
Cancellation of fractional shares		(36)	-	-	-	-	-
Transfer of contributed surplus on exercise of options		-	71	(71)	-	-	-
Stock based compensation		-	-	349	-	-	349
Loss for the period		-	-	-	142	-	142
Unrealized gain on available for sale long term investments		-	-	-	-	148	148
Transfer of unrealized loss to realized loss upon derecognition of available for sale long-term investment		-	-	-	-	462	462
Unrealized gain/(loss) on translation of functional currency to reporting currency		-	-	-	-	6,708	6,708
Balance June 30, 2009		92,318,329	\$ 103,613	\$ 12,076	\$ (9,838)	\$ (3,738)	\$ 102,113

	Notes	Share Capital		Contributed Surplus	(Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
		Shares	Amount				
Balance - December 31, 2007		80,977,663	\$ 90,176	\$ 10,533	\$ (9,070)	\$ 135	\$ 91,774
Effect of change in reporting currency		-	-	-	-	11,252	11,252
Exercise of options		31,400	38	-	-	-	38
Exercise of warrants		4,322,596	7,966	-	-	-	7,966
Transfer of contributed surplus on exercise of options		-	27	(27)	-	-	-
Stock based compensation		-	-	623	-	-	623
Loss for the period		-	-	-	1,855	-	1,855
Unrealized loss of AFS shares		-	-	-	-	(621)	(621)
Unrealized gain/(loss) on translation of functional currency to reporting currency		-	-	-	-	(3,018)	(3,018)
Balance June 30, 2008		85,331,659	\$ 98,207	\$ 11,129	\$ (7,215)	\$ 7,748	\$ 109,869

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

FORTUNA SILVER MINES INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2009 AND 2008

(All amounts expressed in thousands of US 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.

These unaudited interim consolidated financial statements have been prepared using Canadian generally accepted accounting standards (“Canadian GAAP”) applicable to going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. During the three and six months ended June 30, 2009 and 2008, the Company had a net income of \$1,196 (2008: \$2,493) and \$142 (2008: \$1,855), respectively, and as at June 30, 2009, had an accumulated deficit of \$9,838. The Company’s continuing operations as a going concern 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.

2. Summary of Significant Accounting Policies

a) Basis of presentation and principles of consolidation

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”), and presented in US dollars, but they do not contain all disclosures required by Canadian GAAP for annual financial statements and, accordingly, they should be read in conjunction with the most recently prepared annual financial statements for the year ended December 31, 2008. They include the accounts of the Company and its significantly wholly owned subsidiaries: Minera Bateas SAC (“Bateas”); Fortuna Silver (Barbados) Inc.; Compania Minera Cuzcatlan SA (“Cuzcatlan”); Continuum Resources Ltd. (“Continuum”); and Fortuna Silver Mines Peru SAC.

These unaudited interim consolidated financial statements reflect, in the opinion of management, all adjustments necessary to present fairly the consolidated financial position as at June 30, 2009 and the consolidated statement of income and consolidated cash flows for the three and six month periods presented. Operating results of the interim period are not necessarily indicative of the result that may be expected for the full fiscal year ending December 31, 2009.

All significant inter-company transactions and accounts have been eliminated upon consolidation.

b) Change in Reporting Currency

Effective January 1, 2009, the Company changed its reporting currency to the US dollar. The change in reporting currency better reflects the Company’s business activities and improves investors’ ability to compare the Company’s financial results with other publicly traded businesses in the mining industry. Prior to January 1, 2009, the Company reported its annual and quarterly consolidated balance sheets and the related consolidated statements of operations and cash flows in Canadian dollars (CAD).

FORTUNA SILVER MINES INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2009 AND 2008

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

2. Summary of Significant Accounting Policies (continued)

b) Change in Reporting Currency (continued)

In making this change in reporting currency, the Company followed the recommendations of the Emerging Issues Committee (EIC) of the Canadian Institute of Chartered Accountants (CICA), set out in EIC-130, "Translation Method when the Reporting Currency Differs from the Measurement Currency or there is a Change in the Reporting Currency". In accordance with EIC-130, the financial statements for all years and periods presented have been translated into the new reporting currency using the current rate method. Under this method, the statements of operations and cash flows statements items for each year and period have been translated into the reporting currency using the average exchange rates prevailing during each reporting period. All assets and liabilities have been translated using the exchange rate prevailing at the consolidated balance sheets dates. Shareholders' equity transactions since October 1, 1998 have been translated using the rates of exchange in effect as of the dates of the various capital transactions, while shareholders' equity balances on September 30, 1998 have been translated at the exchange rate on that date. All resulting exchange differences arising from the translation are included as a separate component of other comprehensive income. All comparative financial information has been restated to reflect the Company's results as if they had been historically reported in US dollars.

c) Adoption of New Accounting Standards

Goodwill and Intangible Assets (Section 3064)

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Intangible Assets," and CICA Section 3450, "Research and Development Costs", and CICA Section 1000, "Financial Statement Concepts". The standard intends to reduce the differences with International Financial Reporting Standards ("IFRS") in the accounting for intangible assets and results in closer alignment with U.S. GAAP. Under current Canadian standards, more items are recognized as assets than under IFRS or U.S. GAAP. The objectives of CICA Section 3064 are to reinforce the principle-based approach to the recognition of assets only in accordance with the definition of an asset and the criteria for asset recognition; and clarify the application of the concept of matching revenues and expenses such that the current practice of recognizing assets that do not meet the definition and recognition criteria are eliminated. The standard will also provide guidance for the recognition of internally developed intangible assets (including research and development activities), ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. This standard will be effective for fiscal years beginning on or after October 1, 2008. The Company has evaluated the new section and determined that adoption of these new requirements will have no impact on the Company's consolidated financial statements.

FORTUNA SILVER MINES INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2009 AND 2008

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

2. Summary of Significant Accounting Policies (continued)

c) Adoption of New Accounting Standards (continued)

Credit risk and fair value of financial assets and financial liabilities

In January 2009, the Emerging Issues Committee of the CICA issued EIC-173 "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". This guidance clarified that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments, for presentation and disclosure purposes.

The guidance should be applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after the date of issuance of this Abstract. Retrospective application with restatement of prior periods is permitted but not required. Early adoption is encouraged.

The Company has evaluated the new section and determined that adoption of these new requirements will have no impact on the Company's consolidated financial statements.

Mining Exploration Costs

On March 27, 2009, the Emerging Issues Committee of the CICA issued EIC-174 "Mining Exploration Costs" which applies to interim and annual financial statements for periods ending on or after January 20, 2009. This guidance clarified that an entity that has initially capitalized exploration costs has an obligation in the current and subsequent accounting periods to test such costs for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

This standard will be effective for the Company beginning on April 1, 2009. The Company has evaluated the new section and determined that adoption of these new requirements will have no impact on the Company's consolidated financial statements.

d) Foreign currency translation

The Company's functional currency is the Canadian dollar. Effective January 1, 2009, the Company changed its reporting currency to the US dollar.

All subsidiaries, except its wholly owned subsidiary Minera Bateas S.A.C. ("Bateas"), are considered to be integrated foreign operations and their financial statements are translated to Canadian dollars under the temporal method. Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities at historical exchange rates. Revenues and expenses are translated at the average exchange rate in effect during the period. Realized and unrealized foreign exchange gains and losses are included in earnings.

FORTUNA SILVER MINES INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2009 AND 2008

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

2. Summary of Significant Accounting Policies (continued)

d) Foreign currency translation (continued)

Commencing January 1, 2009, Bateas was reclassified as a self-sustaining operation from an integrated foreign operation because of the significant changes in the economic facts and circumstances of Bateas. Bateas's commercial mine production and cash generated from sales is sufficient to cover further exploration expenditure and other operation costs. Therefore, its financial statements are translated using the current rate method. Assets and liabilities of Bateas, which are denominated in US dollars, are translated into Canadian dollars using the current rate method at period-end exchange rates and resulting translation adjustments are reflected in comprehensive income. Revenues and expenses of Bateas are translated at average exchange rates for the period.

3. Recently released Canadian Accounting Standards

The Company has assessed new and revised accounting pronouncements that have been issued that are not yet effective and determined that the following may have an impact on the Company:

Convergence with International Financial Reporting Standards ("IFRS")

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canadian GAAP. This date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company will begin reporting its financial statements in accordance with IFRS on January 1, 2011, with comparative figures for 2010.

The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Company for its year ended December 31, 2010, and of the opening balance sheet as at January 1, 2010.

The Company has begun planning its transition to IFRS but the impact on its consolidated financial position and results of operations has not yet been determined. The process will consist of three phases: Scoping and Diagnostics, Analysis and Development, and Implementation and Review. The Company has begun the first phase which includes a diagnostic assessment of its current accounting policies systems and processes in order to identify differences between current Canadian GAAP and IFRS treatment. The Company will continue to monitor changes in IFRS during implementation process and intends to update the critical accounting policies and procedures to incorporate the changes required by converting to IFRS and the impact of these changes on its financial reporting.

FORTUNA SILVER MINES INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2009 AND 2008

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

3. Recently released Canadian Accounting Standards (continued)

Business Combinations

In January 2009, the CICA issued Section 1582, "Business Combinations", Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests". These new standards are harmonized with International Financial Reporting Standards (IFRS). Section 1582 specifies a number of changes, including: an expanded definition of a business, a requirement to measure all business acquisitions at fair value, a requirement to measure non-controlling interests at fair value, and a requirement to recognize acquisition-related costs as expenses. Section 1601 establishes the standards for preparing consolidated financial statements. Section 1602 specifies that non-controlling interests be treated as a separate component of equity, not as a liability or other item outside of equity. The new standards will become effective in 2011 but early adoption is permitted. The Company is evaluating the attributes of early adoption of this standard and its potential effects if events or transactions occurred that this standard applies to.

4. Derivatives

Forward Sales Contracts - Swap Basis

During January 2009, the Company entered into commodity forward contracts to secure a minimum price level on part of its zinc and lead metal production throughout the period February 2009 to July 2009. The contracts are spread evenly over the same period with settlement occurring on a monthly basis. No initial premium associated with these trades has been paid. The counterparties are Standard Bank PLC, and Banco Bilbao Vizcaya Argentaria, S.A.

The following forward sale contracts were entered into, on a SWAP basis, as defined below:

Lead forward contracts:	\$1,109/t, for the total of 3,150 tons
Zinc forward contracts:	\$1,240/t, for the total of 3,850 tons

The SWAP basis contract is settled against the arithmetic average of zinc and lead spot prices over the month in which the contract matures.

As at June 30, 2009, the Company had two open positions on each of these arrangements. Additionally, the Company will occasionally enter into forward lead and zinc contracts with banks 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 estimated fair value of the outstanding derivative contracts of (\$1,100) was determined with reference to the published market prices for underlying commodities quoted at the London Metal Exchange.

Subsequent to June 30, 2009, the Company entered into the following contracts on a SWAP: lead forward contracts of \$1,645/t for a total of 2,675 tons; and zinc forward contracts \$1,561/t for a total of 3,000 tons.

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

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2009 AND 2008

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

5. Accounts receivable and prepaid expenses

	June 30, 2009	December 31, 2008
Trade accounts receivable	\$ 7,113	\$ -
Advances and other receivables	925	1,701
Prepaid expenses and deposits	277	164
	\$ 8,315	\$ 1,865

Advances and other receivables include prepaid income tax of \$9 and the \$116 short term portion of the long term receivable.

6. Inventories

Inventories consist of the following:

	June 30, 2009	December 31, 2008
Stockpile ore	\$ 238	\$ 322
Concentrate inventory	24	90
Materials and supplies	1,258	1,315
	\$ 1,520	\$ 1,727

7. Long term investment and receivable

As at December 31, 2008, the Company had an investment in 3,706,250 shares of Continuum Resources Ltd. ("Continuum"). The Company measures these investments at fair value and this was determined based on published share prices of underlying securities on the active market. In addition, the Company had granted a loan to Continuum under the terms of the agreement by which Fortuna acquired all of the issued and outstanding shares of Continuum. This amount was used by Continuum to meet its share of the San Jose project capital contributions as well as general corporate expenditures.

As at March 6, 2009, the Company closed the acquisition of Continuum as discussed in Note 9.

	June 30, 2009	December 31, 2008
Investment in shares in Continuum	\$ -	\$ 91
Loan to Continuum	-	3,002
	\$ -	\$ 3,093

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

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2009 AND 2008

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

8. Property, Plant & Equipment

Property, plant and equipment are comprised of the following:

	June 30, 2009			December 31, 2008		
	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value
Land	\$ 244	\$ -	\$ 244	\$ 231	\$ -	\$ 231
Machinery & equipment	8,695	2,322	6,373	7,867	1,704	6,163
Buildings	3,698	856	2,842	3,410	602	2,808
Furniture & other equipment	1,410	330	1,080	1,193	218	975
Transport units	451	197	254	526	171	355
Equipment under capital lease	2,992	368	2,624	1,615	216	1,399
Work in progress	2,028	-	2,028	1,354	-	1,354
	\$ 19,518	\$ 4,073	\$ 15,445	\$ 16,196	\$ 2,911	\$ 13,285

9. Mineral Properties

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

	June 30, 2009				December 31, 2008			
	Cost	Depletion	Write-off	Net Book Value	Cost	Depletion	Write-off	Net Book Value
Caylloma, Peru	\$ 38,187	\$ 9,589	\$ 318	\$ 28,280	\$ 32,915	\$ 7,154	\$ -	\$ 25,761
San Jose, Mexico	37,648	63	990	36,595	33,843	34	285	33,524
Predilecta, Mexico	100	-	-	100	-	-	-	-
	\$ 75,935	\$ 9,652	\$ 1,308	\$ 64,975	\$ 66,758	\$ 7,188	\$ 285	\$ 59,285

Caylloma Project, Peru

For the six months ending June 30, 2009, additions to the Caylloma mineral property includes development and exploration costs of \$2,482 and an increase of \$288 resulting from a revision to the estimate for the asset retirement obligation.

San Jose Project, Mexico

For the six months ending June 30, 2009, additions to the San Jose mineral property consist of development and exploration costs capitalized of \$1,288. Included in the additions for the San Jose property is \$27 relating to the accretion of the payable for the Monte Alban II concession. This property was acquired for a total of \$1,900 and consists of a payment of \$1,100 made in May 2008 and a future payment of \$800 is to be made in May 2012 (Note 11). The present value of the \$800 was \$589 and this is being accreted monthly with the accretion amount being capitalized to the mineral property.

FORTUNA SILVER MINES INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2009 AND 2008

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

9. Mineral Properties (continued)

San Jose Project, Mexico (continued)

Also included in additions to the San Jose mineral property is depreciation of equipment involved in construction work of \$82 (2008: \$181), and general and administrative costs to develop the mine of \$719 (2008: \$1,087), and \$121 received as interest on VAT recovered. There was also a decrease of \$307 resulting from the purchase price discrepancy upon the acquisition of Continuum. The San Jose Project is owned and operated by Compañía Minera Cuzcatlan (“Cuzcatlan”), a company wholly owned by the Company.

In February 2009, the Company made effective a reduction of 8,344 ha out of the approximately 49,000 ha surrounding the San Jose project for which it holds exploration and mining rights. This is equivalent to a write-down of \$990. This decision was based on existing geological information and is part of an effort to prioritize capital expenditures.

Acquisition of Continuum Resources Ltd. (“Continuum”)

On March 6, 2009, the Company closed the acquisition of all the issued and outstanding shares of Continuum Resources Ltd. Continuum had 124,037,920 shares outstanding as of March 6, 2009 and the Company has issued to the Continuum shareholders a total of 6,995,738 shares, which is an exchange ratio of approximately 0.0564 of a share of the Company for every one Continuum share held. As Fortuna held 3,706,250 common shares of the issued and outstanding share capital of Continuum as at March 6, 2009, those shares were cancelled and Fortuna issued a total of 6,786,706 shares to the Continuum shareholders other than Fortuna. As a result of the acquisition of Continuum, Fortuna now owns 100% of the San Jose Project in Oaxaca, Mexico.

The acquisition is being accounted for as a purchase of assets. The following calculations include the fair value of Fortuna shares issued, based on the issuance of 6,786,706 Fortuna shares at CAD\$0.98 per share for consideration of \$5,194 (CAD\$6,651). A valuation date of March 6, 2009 was determined for the share value.

The difference between the purchase consideration and the adjusted book values of Continuum’s assets and liabilities has been allocated to “Mineral properties”. The fair value of all identifiable assets and liabilities acquired was determined by a valuation effective March 6, 2009. No future tax asset or liability has been recorded as the price paid was less than the book value of the assets and the tax basis and book value of the assets purchased was equivalent. The resulting “negative” purchase price discrepancy would have resulted in a future tax asset but as it is more likely than not that this will not be recovered, it has not been recorded.

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

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2009 AND 2008

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

9. Mineral Properties (continued)***Acquisition of Continuum Resources Ltd. (“Continuum”)(continued)***

The purchase price allocation is as follows:

Purchase price

6,786,706 common shares of Fortuna	\$	5,194
Acquisition costs		113
Loan to Continuum		3,182
Cost of shares previously acquired		130
Total purchase price	\$	8,619

Purchase price allocation

Net assets acquired:

Cash received	\$	5
Property, plant & equipment		6
Mineral property interests		8,747
Accounts payable and accrued liabilities		(139)
Net identifiable assets of Continuum	\$	8,619

Included as part of the mineral property interests purchased was the Predilecta project in Mexico with a value of \$87 at acquisition date.

10. Related Party Transactions

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

Transactions with related parties	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Consulting fees ¹	\$ 34	\$ 7	\$ 65	\$ 15
Salaries and wages ²	37	-	60	13
Other ³	45	-	66	-
	\$ 116	\$ 7	\$ 191	\$ 28

¹ Consulting fees includes fees paid to two directors, Simon Ridgway and Mario Szotlender.

^{2,3} Radius Gold Inc. (“RDU”) has directors in common with the Company and shares office space, and is reimbursed for various general and administrative costs incurred on behalf of the Company.

² Salaries and wages includes employees' salaries and benefits charged to the Company based on an estimated percentage of the actual hours worked for the Company.

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

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2009 AND 2008

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

10. Related Party Transactions (continued)

Amounts due to/(from) related parties	June 30, 2009	December 31, 2008
Owing to a company with common directors ³	\$ 24	\$ 38

The transactions with related parties are measured at the exchange amount, which is the amount of consideration established and agreed upon by the parties. The balances with related parties are unsecured, non-interest bearing, and payable in the normal course of business.

11. Leases and Long Term Liabilities*Obligations under capital lease*

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

	Interest Rate	Maturity Date	June 30, 2009	December 31, 2008
Scotia Bank	9.29%	2009	\$ 6	\$ 14
Interamericano de Finanzas	8.50%	2009	15	38
Scotia Bank	8.20%	2009	68	134
Scotia Bank	8.66%	2010	165	226
Scotia Bank	8.20%	2010	396	26
Scotia Bank	8.49%	2010	84	534
Scotia Bank	8.34%	2010	20	110
Scotia Bank	8.49%	2011	133	248
Interbank	9.12%	2011	210	69
Interbank	9.75%	2012	108	-
Interbank	9.75%	2012	944	-
Lease payments			\$ 2,149	\$ 1,399
Less current amount			(1,024)	(682)
			\$ 1,125	\$ 717

Long term liability

In November 2007, Bateas acquired the Minera Condor II and the Minera Condor III concessions for \$250. A payment of \$50 was done at the signing of the contract, payments of \$30 are required to be paid every six months for a total of five payments, and \$50 is required to be paid November 2010. This contract was cancelled in March 2009 and the obligation of \$156 recorded has been written down.

In May 2008, Cuzcatlan acquired the Monte Alban II concession (Note 9) for which a payment of \$800 is due May 2012. This payment is non-interest bearing and all debt relating to the acquisition of the mineral resource property has been recognized as at June 30, 2009.

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

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11. Leases and Long Term Liabilities (continued)*Long term liability (continued)*

	June 30,	December 31,
	2009	2008
Face value of long term liability	\$ 970	\$ 1,000
Less: adjustment to amortized cost	(225)	(271)
Opening fair value of liability measured at amortized cost	745	729
Cancellation of contract	(156)	-
Add: accretion to period end	27	46
Less: payments	-	(30)
Liability at period end	616	745
Less: current portion of long term liability	-	(80)
	\$ 616	\$ 665

Principal minimum repayment terms will be :

2009	\$ -
2010	-
2011	-
2012	800
\$	800

Contingent liability

Interbank bank, 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 approval procedures of Bateas' mine closure plan, for the sum of \$600. This letter is available against first and simple demand and will expire on July 27, 2009. At this point it will be renewed until the end of 2009 when a new guarantee will be set up according to an approved mine closure plan for an amount corresponding to the work to be executed during 2010. This amount is yet to be established but it is expected to be less than the current guarantee.

12. Asset Retirement Obligation

The Company has recorded an asset retirement obligation of \$1,442 as of June 30, 2009 consisting of accretion of the previously recorded asset retirement obligation of \$1,066 as of December 31, 2008 by \$61, an increase in the estimated amount of the asset retirement obligation of \$288, and a translation adjustment of \$26. The accretion expense was calculated over the year using a rate of 9%. The Company has reviewed its reclamation obligations at the property in light of changing regulations and on the basis of further data in respect of the mine life and has made an increase to the estimated amount of the asset retirement obligation of \$288.

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

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

12. Asset Retirement Obligation (continued)

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, 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 property, plant and equipment balance.

13. Share Capital

a) Authorized: Unlimited common shares without par value

On June 17, 2009, an aggregate of 36 common shares resulting from rounding of previous capital consolidations were returned to treasury to reduce the accumulated fractional shares held in the Company's trustee account.

b) Stock Options

The following is a summary of option transactions:

	Number of Shares	Weighted Average Exercised Price Per Share in CAD\$
Balance, December 31, 2007	6,686,400	\$ 2.24
Granted	2,655,000	1.03
Exercised	(31,400)	1.22
Expired	-	-
Forfeited	(1,576,000)	2.77
Balance, December 31, 2008	7,734,000	\$ 1.79
Granted	-	-
Exercised	(200,000)	0.85
Expired	(920,000)	2.38
Forfeited	-	-
Balance, June 30, 2009	6,614,000	\$ 1.74

During the period, 920,000 share purchase options with exercise prices ranging from CAD\$0.85 to CAD\$3.22 per share expired unexercised and 200,000 share purchase options were exercised at an exercise price of CAD\$0.85 per share.

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

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

13. Share Capital (continued)

b) Stock Options (continued)

The following stock options were outstanding at June 30, 2009:

Number of shares	Exercise Price CAD\$	Expiry Date	Weighted Average Remaining Contractual Life - Years
29,000	\$ 0.37	December 2, 2009	0.4
30,000	\$ 0.80	July 24, 2010	1.1
270,000	\$ 1.35	February 5, 2016	6.6
250,000	\$ 2.29	March 30, 2016	6.8
60,000	\$ 1.75	May 8, 2016	6.9
200,000	\$ 1.75	May 22, 2016	6.9
35,000	\$ 0.85	July 5, 2016	7.0
245,000	\$ 1.55	July 5, 2016	7.0
860,000	\$ 1.66	July 10, 2016	7.0
225,000	\$ 1.61	September 13, 2016	7.2
110,000	\$ 0.85	January 11, 2017	7.5
730,000	\$ 2.22	January 11, 2017	7.5
50,000	\$ 2.75	February 6, 2017	7.6
15,000	\$ 0.85	April 22, 2017	7.8
50,000	\$ 0.85	May 31, 2017	7.9
50,000	\$ 0.85	June 27, 2017	8.0
50,000	\$ 0.85	July 2, 2017	8.0
1,075,000	\$ 3.22	July 2, 2017	8.0
25,000	\$ 0.85	October 24, 2017	8.3
250,000	\$ 2.52	February 5, 2018	8.6
150,000	\$ 1.25	August 25, 2018	9.2
1,205,000	\$ 0.85	October 5, 2018	9.3
650,000	\$ 0.85	November 5, 2018	9.4
6,614,000			7.95

6,614,000 options have vested as at June 30, 2009.

Subsequent to June 30, 2009, the Company granted to an officer and an employee an aggregate of 250,000 incentive stock options with an exercise price of CAD\$0.83 per share, exercisable for ten years, and vesting October 1, 2009.

FORTUNA SILVER MINES INC.
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13. Share Capital (continued)

c) Warrants

The following is a summary of share purchase warrant transactions:

	Number of Share Purchase Warrants	Weighted Average Exercise Price Per Share Purchase Warrant in CAD\$
Balance, December 31, 2007	16,479,375	\$ 1.89
Issued	-	-
Exercised	(4,322,596)	1.85
Expired	(1,093,424)	2.30
Balance, December 31, 2008	11,063,355	\$ 1.86
Issued	-	-
Exercised	-	-
Expired	-	-
Balance, June 30, 2009	11,063,355	\$ 1.86

The following share purchase warrants were outstanding at June 30, 2009:

Number of warrants	Exercise Price per Share Purchase Warrant in CAD\$	Expiry Date
862,117	\$ 0.345	June 27, 2010
1,613,238	\$ 0.345	November 17, 2010
8,588,000	\$ 2.300	July 11, 2009
11,063,355		

Subsequent to June 30, 2009, 8,588,000 share purchase warrants with a strike price of CAD\$2.30 per share purchase warrant, expired unexercised.

d) Stock-Based Compensation

The Company has established a formal stock option plan in accordance with the policies of the TSX Venture Exchange under which it is authorized to grant options up to 10% of its outstanding shares to officers, directors, employees, and consultants. The exercise price of each option must not be less than the closing market price of the Company's shares on the trading day immediately prior to the date of grant. The options are for a maximum term of ten years.

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 \$360 recognized for the six months ended June 30, 2009 (June 30, 2008: \$623) 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:

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

13. Share Capital (continued)

d) Stock-Based Compensation (continued)

	Six months ended June 30,	
	2009	2008
Risk-free interest rate	2.74% - 3.45%	3.78% - 4.58%
Expected stock price volatility	70% - 78%	59.0% - 72.8 %
Expected term in years	5 & 10	3, 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, risk-free interest rate and expected life of the options. 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. Segmented Information

The Company is currently engaged in mining and the development of mineral properties. Details on a geographical basis are as follows:

	Canada	Peru	Mexico	Other	Total
Three months ended June 30, 2009					
Revenues	\$ -	\$ 12,862	\$ -	\$ -	\$ 12,862
Operating (loss) income	\$ (660)	\$ 5,063	\$ -	\$ (48)	\$ 4,355
Three months ended June 30, 2008					
Revenues	\$ -	\$ 7,772	\$ -	\$ -	\$ 7,772
Operating (loss) income	\$ (1,936)	\$ 2,763	\$ -	\$ 2	\$ 829
Six months ended June 30, 2009					
Revenues	\$ -	\$ 21,842	\$ -	\$ -	\$ 21,842
Operating income (loss)	\$ (1,666)	\$ 7,072	\$ (921)	\$ (53)	\$ 4,432
Six months ended June 30, 2008					
Revenues	\$ -	\$ 14,580	\$ -	\$ -	\$ 14,580
Operating (loss) income	\$ (3,082)	\$ 4,104	\$ -	\$ (3)	\$ 1,019
As at June 30, 2009					
Property, plant & equipment	\$ 9	\$ 10,934	\$ 4,499	\$ 3	\$ 15,445
Total assets	\$ 24,756	\$ 56,137	\$ 42,063	\$ 15	\$ 122,971
As at December 31, 2008					
Property, plant & equipment	\$ 4	\$ 9,105	\$ 4,174	\$ 2	\$ 13,285
Total assets	\$ 25,071	\$ 46,124	\$ 41,348	\$ 2,825	\$ 115,368

FORTUNA SILVER MINES INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

15. Commitments and Contingencies

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 2,800 Kw) and Bateas 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. Renewal can be avoided without penalties by notifying 10 months in advance of renewal date. Tariffs are established yearly by the energy market regulator in accordance with applicable regulations in Peru.

The Company acts as guarantor to capital lease obligations held by two of its mining contractors. These capital lease contracts are related to the acquisition of mining equipment deployed at the Caylloma mine. As at June 30, 2009, these obligations amounted to \$1,396 and mature in 2010.

Environmental Matters

The Company's mining and exploration activities are subject to various laws and regulations governing the protection of the environment. These laws and regulations are continually changing and are generally becoming more restrictive. The Company conducts its operations so as to protect the public health and environment and believes its operations are in compliance with applicable laws and regulations in all material respects. The Company has made, and expects to make in the future, expenditures to comply with such laws and regulations, but cannot predict the full amount of such future expenditures.

Estimated future reclamation costs are based principally on legal and regulatory requirements. As of June 30, 2009 and December 31, 2008, \$1,442 and \$1,066, respectively, were accrued for reclamation costs relating to mineral properties in accordance with Section 3110, "Asset Retirement Obligations". See Note 12.

Income Taxes

The Company operates in numerous countries around the world and accordingly it is subject to, and pays annual income taxes under the various income tax regimes in the countries in which it operates. Some of these tax regimes are defined by contractual agreements with the local government, and others are defined by the general corporate income tax laws of the country. The Company has historically filed, and continues to file, all required income tax returns and to pay the taxes reasonably determined to be due. The tax rules and regulations in many countries are highly complex and subject to interpretation. From time to time, the Company is subject to a review of its historic income tax filings and in connection with such reviews, disputes can arise with the taxing authorities over the interpretation or application of certain rules to the Company's business conducted within the country involved.

Title Risk

Although the Company has taken steps to verify title to properties in which it has an interest, these procedures do not guarantee the Company's title. Property title may be subject to, among other things, unregistered prior agreements or transfers and may be affected by undetected defects.

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

16. Management of capital risk

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 Company is not subject to externally imposed capital requirements.

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.

a) Currency risk

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada, Peru, Mexico and Barbados 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 results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

At June 30, 2009, 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):

	June 30, 2009			December 31, 2008		
	Canadian Dollars	Nuevo Soles	Mexican Pesos	Canadian Dollars	Nuevo Soles	Mexican Pesos
Cash and cash equivalents	\$ 24,740	S/. 4,551	\$20,405	\$29,748	S/. 629	\$ 3,864
Accounts receivable	10	879	20,221	13	10,400	46,460
Accounts payable and accrued liabilities	(149)	(5,861)	(638)	(172)	(5,281)	(10,259)

Based on the above net exposure as at June 30, 2009, 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, expressed in US dollars, as follows:

Impact to other comprehensive income (loss)	\$	2,365				
Impact to net income (loss)			\$	(16)	\$	389

FORTUNA SILVER MINES INC.

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17. Management of financial risk (continued)

b) 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 equivalents are held through large Canadian and international financial institutions. These investments mature at various dates over the current operating period. All of the Company's trade accounts receivables are held with large international metals trading companies. As at June 30, 2009, the Company has a Mexican value added tax of \$1,345 and Peruvian value added tax of \$118. The Company expects to recover the full amounts from the Mexican and Peruvian Governments.

c) 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 and cash equivalents, and its committed liabilities.

Accounts payable and accrued liabilities, amounts due to related parties and the current portion of obligations under capital lease are due within the current operating period.

d) 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 of the amounts in investments with maturities of 90 days or less included in cash and cash equivalents is limited because these investments, although available for sale, are generally held to maturity.

e) Price risk

The Company is exposed to metals price risk with respect to silver, gold, zinc, and lead 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.

18. Subsequent Events

There are no further subsequent events not reported above.



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MANAGEMENT'S DISCUSSION AND ANALYSIS Second Quarter Ended June 30, 2009

General

This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the unaudited consolidated financial statements of the Company for the three and six months ended June 30, 2009 prepared in accordance with Canadian generally accepted accounting principles. This MD&A is prepared as of August 7, 2009. **All amounts are expressed in US dollars unless otherwise indicated. See page 13 for details regarding the change in reporting currency effective January 1, 2009.**

Forward Looking Information

Certain statements contained in this MD&A and elsewhere constitute forward-looking statements. Such forward-looking statements involve a number of known and unknown risks, uncertainties and other factors which may cause the actual results, and performance of achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, changes in project parameters to deal with unanticipated economic factors, risks related to technological and operational nature of the Company's business, the speculative nature of exploration and development, and changes in local and national government legislation.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statements were made, and readers are advised to consider such forward-looking statements in light of the risks set forth in the section Risks and Uncertainties.

In particular, forward-looking information and statements include:

- "The copper circuit is scheduled to be restarted in the month of August." (page 4);
- Conclusion of the San Jose resource estimation;
- "The Company has awarded all the components of the project engineering which it expects to conclude to a feasibility level of detail in the coming months." (page 7) "Management believes that the Company's cash position as well as its ongoing operation in Caylloma is sufficient to support the Company's operating and capital requirements on an ongoing basis." (page 8)

Business of the Company

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

Recent Developments and Highlights

Financial and Operating Results

In the second quarter of 2009, the Company generated net income of \$1.20 million compared \$2.49 million for the same period of 2008. Cash generated by operating activities before changes in working capital for the period was \$5.69 million compared to \$2.47 million in the same period of 2008.

In the second quarter of 2009, silver production amounted to 468,822 ounces and represented 47% of revenue, with a negative cash cost per ounce of payable silver of \$2.98. The Company's Caylloma mine maintains the growth trend in metal production it has been showing for the past 11 consecutive quarters. In the second quarter, 100,881 tonnes of ore were treated compared to 80,121 tonnes in the same period of 2008 and the cash cost per tonne of treated ore was \$43.39 (Cash cost is a non-GAAP measure. See page 8 for reconciliation of cash cost to the cost of sales in the consolidated statement of operations).

New Reserves Estimate at Caylloma

On July 16, 2009, the Company released an updated NI 43-101 resource estimation for Caylloma, with the full NI 43-101 to be released within 45 days, as follows:

- Proven and Probable Mineral Reserves are estimated at 4.03 million tonnes averaging 156 g/t Ag, 0.55 g/t Au, 1.70% Pb and 2.58% Zn;
- Contained silver is estimated at 20.3 million ounces, representing a 304% increase in silver ounces in the Proven and Probable reserve categories over the previous resource and reserve estimate (NI 43-101 Technical Report published October 3, 2006);
- Inferred Mineral Resources are estimated at 1.3 million tonnes averaging 187 g/t Ag, 0.29 g/t Au, 1.92% Pb and 3.25% Zn;
- Contained silver in the Inferred Resource category is estimated at 7.7 million ounces.

Quarterly Information

The following table provides information for the eight fiscal quarters ended June 30, 2009:

Expressed in \$000's, except per share data

	Quarters Ended							
	30-Jun-09	31-Mar-09	31-Dec-08	30-Sep-08	30-Jun-08	31-Mar-08	31-Dec-07	30-Sep-07
Revenues	12,862	8,980	2,795	7,492	7,772	6,808	8,097	8,794
Mine operating income (loss) *	6,792	3,487	(2,986)	1,734	2,848	2,303	3,469	3,916
Net Income (loss)	1,196	(1,054)	(2,468)	(297)	2,493	(638)	1,440	(3,240)
Net Income (loss) per share								
- basic	0.01	(0.02)	(0.03)	0.00	0.03	(0.01)	0.02	(0.05)
- diluted	0.01	(0.02)	(0.03)	0.00	0.03	(0.01)	0.02	(0.05)

* Mine operating income (loss) is a non-GAAP measure used by the Company as a measure of operating performance

Financial Results

During the second quarter of 2009, the Company generated record quarterly sales of \$12.86 million compared to \$7.77 million in the same period of 2008. This represents an increase of 65%. When broken down by type of concentrate: silver-lead concentrate sales increased in tonnage by 85%, while the unit value of concentrate

decreased by 17%. The latter decrease is the combined result of a decrease in lead price and silver price of 35% and 20%, respectively, and lower smelter treatment charges of \$200 per ton of concentrate. Zinc concentrate sales increased in tonnage by 31% while the unit value of concentrate decreased by 25%. The latter decrease is a result of a decrease in the metal price of 30% and lower smelter treatment charges of \$160 per ton of concentrate.

The significant increase in concentrate sold is the result of the Company's continuous investments over the last two years in mine development, processing plant expansion, and infrastructure.

During the second quarter of 2009 mine operating income was \$6.79 million, 138% above the \$2.85 million achieved in the same period of 2008. This improvement in spite of significantly lower metal prices is a reflection of improved head grades, higher throughput, and lower operating costs. Contributing to the net income for the second quarter of \$1.20 million is the: operating income of \$4.36 million, interest and other income and expenses of \$0.14 million, gain on disposal of investments of \$0.23 million, offset by the non operating loss in commodity contracts of \$1.36 million, foreign exchange loss of \$0.40 million, and income tax provision of \$1.72 million.

Total **cost of sales** for the second quarter of 2009 was \$6.07 million compared to \$4.92 million for the same period of 2008. While tonnage of concentrate sold in the second quarter of 2009 increased 51% with respect to the corresponding quarter in 2008, cost of sales increased only by 23% due to the significant increase achieved in head grades and a reduction of 8% in unit cash costs. Other things being equal, an increase in head grades will deliver higher concentrate production for equal or similar production costs.

Selling and administrative expenses for the second quarter of 2009 totalled \$2.43 million compared to \$1.93 million for the same period of 2008. The increase is due mainly to higher selling expenses associated with higher tonnage of concentrate sold. The amount is comprised of \$0.94 million of corporate general and administrative expenses, and \$1.49 million of general and administrative expenses at the subsidiary level which includes \$0.64 million of selling expenses, and \$0.12 million of government royalty paid by Minera Bateas.

Stock based compensation charge totalled \$0.01 million for the second quarter of 2009, compared to \$0.10 million for the same period of 2008.

Interest and other income and expenses in the second quarter of 2009 amounted to net income of \$0.14 million compared to net income of \$0.23 million for the same period of 2008. The decrease is attributable to the Company holding a comparatively smaller average cash balance as well as reduced interest rates.

Interest and finance expenses for the second quarter 2009 were \$0.04 million compared to \$0.03 million in the same period of 2008. Interest expenses relate primarily to capital lease operations at our operating subsidiary.

Net loss on commodity contract for the second quarter of 2009 was \$1.36 million compared to a net gain of \$2.22 million for the same period of 2008. This amount reflects the change in fair value of derivative contracts between the opening of the reporting period and either the expiry of the contracts or the closing of the period, whichever happened first. As a result of this only contracts that opened and expired within the reporting period will see their change in fair value as reported in the statement of operations match the actual settlement at expiry. Actual settlements for the period were negative \$0.73 million. The Company has entered into short term commodity forward contracts to secure a minimum price level on part of Caylloma's zinc and lead metal production, and enters regularly into forward lead and zinc contracts with banks 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 Company does not use hedge accounting.

In the second quarter of 2009, the Company recognized a **gain on disposal of investments** of \$0.23 million in connection with the shares of a junior exploration company.

The \$1.72 million **Income tax provision** recorded in the second quarter of 2009 (2008: \$1.14 million) consisted of current and future income tax expense. Current income tax for the period, including the worker profit sharing plan regulated by Peruvian law was \$0.51 million (2008: recovery \$0.28 million). Future income tax expense, amounting to \$1.21 million (2008: \$1.42 million) is mainly related to temporary differences arising on amounts of mineral properties at Peruvian operations where exploration and development are expensed for tax purposes.

Results of Operations

Peru – Caylloma Ag-Pb-Zn Mine

Caylloma Mine	Quarters ended							
	30-Jun-09	31-Mar-09	31-Dec-08	30-Sep-08	30-Jun-08	31-Mar-08	31-Dec-07	30-Sep-07
Tonnes milled	100,881	91,449	91,025	89,827	80,121	70,408	68,615	65,806
Average tons milled per day	1,146	1,051	1,023	1,009	910	800	754	715
Grade per tonne								
Silver (oz)	5.16	4.75	3.69	3.14	2.75	2.64	2.43	2.45
Lead (%)	3.20	3.11	2.97	2.58	2.29	1.94	1.87	1.80
Zinc (%)	3.82	3.83	3.75	3.64	3.75	3.42	3.09	3.01
Copper (%)	0.26							
Recoveries								
Silver (%)*	86.48	84.58	82.43	80.07	78.12	76.42	77.74	75.75
Lead (%)	92.56	92.97	93.41	92.19	88.94	87.26	87.51	88.50
Zinc (%)	88.60	90.02	87.25	88.11	87.58	86.45	85.09	86.51
Copper (%)	8.60							
Production (metal contained)								
Silver (oz)**	468,822	384,339	291,381	243,280	186,276	140,239	139,433	132,450
Lead (tonnes)	2,988	2,645	2,524	2,139	1,633	1,189	1,124	1,049
Zinc (tonnes)	3,414	3,152	2,976	2,877	2,629	2,079	1,805	1,712
Copper (tonnes)	23							
Unit cash cost (US\$/oz ag)	(2.98)	0.10						
Unit cash cost (US\$/tonne)	43.39	44.37	44.60	44.43	46.92	49.97	52.41	49.15
Unit Net Smelter Return (US\$/tonne)	114.00	91.00	60.00	80.40	97.79	97.70	118.41	133.70

In the second quarter of 2009, the Caylloma mine achieved significant increments in metal output with respect to both the previous quarter and the corresponding quarter of 2008. Silver production reached 468,822 ounces; 22% increase over the first quarter of 2009 and 152% increase over the second quarter of 2008. Lead production reached 2,988 tonnes; 13% increase over the first quarter of 2009 and 83% increase over the second quarter of 2008. Zinc production reached 3,414 tonnes; 8% increase over the first quarter of 2009 and 30% increase over the second quarter of 2008.

These increments were achieved through a combination of higher grades, improved metallurgical recoveries, and a higher throughput which reached an average of 1146 tpd for the second quarter of 2009 and 1209 tpd for the month of June 2009, 9% and 15% above the average throughput rate for the first quarter of the year correspondingly.

The copper circuit is still in the commissioning phase. It was launched in the last week of April and was subsequently halted to undergo several design adjustments. The copper circuit is now scheduled to be restarted in the month of August 2009.

Ore processed was sourced mainly from the polymetallic Animas vein (91%) with the balance provided by the high grade silver veins Soledad and Bateas, which are blended into the mill feed to achieve higher average silver

head grades. Exploration and development on the silver rich Bateas vein continues with the objective of further delineating the extension of high grade mineralization.

With silver now comprising close to 50% of revenue, the Company is reporting cash cost per ounce of payable silver at Caylloma, which was \$0.10 and negative \$2.98 for the first and second quarters of 2009, respectively. Cash cost per tonne of treated ore for the second quarter of 2009 was \$43.39 compared to \$46.92 for the corresponding quarter of 2008. This cost reduction has been achieved through a combination of increased tonnage and further mechanization of mining operations. (See page 8 for reconciliation of cash production cost to the cost of sales in the consolidated statement of operations).

On July 16, 2009, the Company released an updated NI 43-101 resource estimation for Caylloma. The NI 43-101 Technical Report will be filed within the following 45 days. Highlights of the resource & reserve estimation include:

- Proven and Probable Mineral Reserves are estimated at 4.03 million tonnes averaging 156 g/t Ag, 0.55 g/t Au, 1.70% Pb and 2.58% Zn;
- Contained silver is estimated at 20.3 million ounces, representing a 304% increase in silver ounces in the Proven and Probable reserve categories over the previous resource and reserve estimate (NI 43-101 Technical Report published October 3, 2006);
- Inferred Mineral Resources are estimated at 1.3 million tonnes averaging 187 g/t Ag, 0.29 g/t Au, 1.92% Pb and 3.25% Zn;
- Contained silver in the Inferred Resource category is estimated at 7.7 million ounces.

Price protection program

During January 2009, the Company entered into commodity forward contracts to secure a minimum price level on part of Caylloma's zinc and lead metal production throughout the period February 2009 to July 2009. The decision to hedge was aimed at securing our minimum cash flow requirements during the construction phase of the plant expansion and copper circuit projects.

The contracts are spread evenly over the same period with settlement occurring on a monthly basis and consist of the following:

Lead Forward contracts:	\$1,109/t, for the total of 3,150 tons
Zinc Forward contracts:	\$1,240/t, for the total of 3,850 tons

Subsequent to June 30, 2009, the Company entered into additional commodity forward contracts for the period August 2009 to December 2009 as follows: lead forward contracts of \$1,645/t for a total of 2,675 tons; and zinc forward contracts \$1,561/t for a total of 3,000 tons.

Mexico – San Jose Silver-Gold Project

Trinidad Resource Estimation

On January 2009, the Company completed the 33,000 meter in-fill drilling program initiated in June of 2008. This program was designed to convert inferred resources to the indicated category in the upper 250m of the deposit, where mining is initially expected to take place. Highlights of the drill program have been released and are available on the Company's website at www.fortunasilver.com. A new resource estimation is expected to be completed by September 2009.

Metallurgical Studies

Metallurgical tests have now been completed by Metcon Research of Tucson Arizona, and based on these results a definitive process flow sheet has been developed by the Company's metallurgical consultants.

Metallurgical results indicate that commercial grade silver and gold concentrates can be achieved with recoveries over 90% for both metals through a conventional flotation. The use of cyanide is not required as part of this process.

Community Relations and Land Agreements

The road blockade reported in a Company news release dated April 16, 2009, was brought to an end on May 6, 2009 by Federal and State police, as a result of a call to action by local Municipal and Ejido authorities. The Company and local authorities are engaged in dialogue with the fringe group of demonstrators in order to ensure an equitable long term solution to their concerns. A detachment of fifteen policemen remains on-site. No further disruptions on the access road to the town or Project have been reported. The Company has resumed all its activities with normality.

Over forty hectares of land that encompass the Trinidad mineralized zone and future infrastructure sites have been secured with renewable thirty year land tenure agreements with parcel owners in accordance with Mexican laws and Ejido authorities.

The Company is currently engaged in the process of negotiating a collaborative agreement with the San Jose del Progreso community.

Industrial Water Supply

The Company is concluding the detail engineering on the treatment of "grey water" from an existing plant facility in a nearby town to source the industrial process requirements of the project.

Water sourcing alternatives for the project have been developed around the treatment and use of sewage from neighboring towns. The San Jose mine will draw much of its water from treated sewage, rather than from ground water sources, in day-to-day mining and processing operations.

Management is currently engaged in negotiations with the municipality to establish a long term agreement for the use of the sewage treatment plant.

Power Supply

On April 28, 2009, the "Comisión Federal de Electricidad" (Mexican Federal Energy Commission) approved the feasibility study for power consumption at the San Jose Project, allowing for connection to the national power grid for up to five megawatts which is more than will be required in the first stage of the life of the mine.

Underground Development

The 1,100 meter long decline to the Trinidad mineralized zone reached the deepest level of the old mine workings, 150 meters below surface, in July of 2008 and was subsequently stopped. Management has achieved the objective of gaining access to the upper portion of the Trinidad zone resource. The decline development to date will allow testing of trial mining methods, gain better geologic control of mineralization and cut down a year's worth of mine preparation time.

Project Engineering

The Company has awarded all the components of the project engineering which it expects to conclude to a feasibility level of detail in the coming months. The main components and their delivery times are as follows:

- Plant design and engineering; awarded to Promimet SA de CV – feasibility level studies expected by the end of August 2009;
- Mine design; awarded to Proyectos y Estudios Mineros SAC - to be updated to feasibility level as the new block model is ready by September 2009;
- Geotechnical studies and tailings design; awarded to SVS Ingenieros SAC - expected by the end of August 2009;
- Energy project; awarded to Soto Ortega Ingenieros SA de CV - detail engineering to be concluded by October 2009;
- Water project; awarded to ICAYS SA de CV – detail engineering to be concluded by the end of August 2009.

The Company has engaged North American engineering firm CAM to provide Qualified Person supervision for the project engineering and to author required Technical Reports.

Permitting

The Company submitted the “Manifiesto de Impacto Ambiental” to the Mexican environmental authorities on April 3, 2009. The company is working closely with the Semarnat (Mexican Environmental Agency) authorities to resolve technical observations and assure an expedited approval. The “Estudio Tecnico Justificativo” (ETJ) will be submitted to the Semarnat authority by mid August.

Exploration

In February 2009, the Company made effective a reduction of 8,344 ha out of the approximately 49,000 ha surrounding the San Jose project for which it holds exploration and mining rights. This decision was based on existing geological information and is part of an effort to prioritize capital expenditures.

Cash cost per silver ounce and cash cost per tonne (non-GAAP measures)

Cash cost per ounce and cash cost per tonne are key performance measures that management uses to monitor performance. These performance measures have no meaning within Canadian Generally Accepted Accounting Principles (“Canadian GAAP”), and, therefore, amounts presented may not be comparable to similar data presented by other mining companies.

The following table presents a reconciliation of cash costs per tonne of processed ore and cash cost per ounce of payable silver to the cost of sales in the consolidated statement of operations:

	\$'000's
Cost of sales	6,070
Add / (Subtract)	
Change in inventory (ore and concentrate stock piles)	(113)
Depletion, depreciation, and accretion	(1,580)
Cash cost	4,377
Total processed ore (tonnes)	100,881
Cash cost per tonne of processed ore (\$/t)	43.39
Cash cost	4,377
Add / (Subtract)	
By-product credits	(6,015)
Refining charges	384
Cash cost applicable per payable ounce	(1,254)
Payable silver ounces	421,006
Cash cost per ounce (\$/oz)	(2.98)

Liquidity and Capital Resources

The Company's cash resources and liquid investments as at June 30, 2009 were \$31.17 million compared to \$29.45 million as at December 31, 2008.

During the second quarter of 2009 cash generated by operating activities before changes in working capital was \$5.69 million. Further liquidity consumed by changes in working capital amounted to \$0.99 million, for total cash generated by operating activities of \$4.70 million.

During the second quarter of 2009 the Company invested a total amount of \$2.64 million in mineral properties and \$0.04 million in plant and equipment. Additionally, the Company collected a net amount of value added tax refundable credit from the Mexican Government of \$0.88 million. This is net of value added tax disbursements on local expenses during the period.

As at June 30, 2009, the Company had working capital of \$36.01 million compared to working capital of \$34.06 million at December 31, 2008.

Management believes the Company's cash position as well as its ongoing operation in Caylloma 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 recognizes the uncertainty attached thereto.

Related Party Transactions (expressed in \$'000's)

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

Transactions with related parties	Expressed in \$'000's			
	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Consulting fees ¹	\$ 34	\$ 7	\$ 65	\$ 15
Salaries and wages ²	37	-	60	13
Other ³	45	-	66	-
	\$ 116	\$ 7	\$ 191	\$ 28

¹ Consulting fees includes fees paid to two directors, Simon Ridgway and Mario Szotlender.

^{2, 3} Radius Gold Inc. ("RDU") has directors in common with the Company and shares office space, and is reimbursed for various general and administrative costs incurred on behalf of the Company.

² Salaries and wages includes employees' salaries and benefits charged to the Company based on an estimated percentage of the actual hours worked for the Company.

Amounts due to/(from) related parties	Expressed in \$'000's	
	June 30, 2009	December 31, 2008
Owing to a company with common directors ³	\$ 24	\$ 38

The transactions with related parties are measured at the exchange amount, which is the amount of consideration established and agreed upon by the parties. The balances with related parties are unsecured, non-interest bearing, and payable in the normal course of business.

Critical Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. These estimates and assumptions are based on established industry standards, historical experience, and are reviewed on an ongoing basis to confirm their continued applicability.

Amortization and Mineral Property Costs

Mineral property costs are comprised of acquisition costs and capitalized exploration, construction and development costs. Upon initiating production, the asset is amortized over its estimated useful life on a units-of-production basis. The Company estimates reserves and resources and the economic life of its mines and utilizes this information to calculate depletion and amortization expense. Depreciation and depletion charges are adjusted prospectively based on periodic re-assessments of the Company's mineral reserves.

The estimate of mineral reserves is prepared by Qualified Persons in accordance with industry standards defined under NI 43-101 of the Canadian Securities regulatory authorities. Mineral reserve estimates can change over time as a result of numerous factors, including changes in metal prices, production costs, or the re-evaluation of geological, engineering and economic data of a deposit. A significant reduction in mineral reserves would have a negative impact on the calculation of the amortization of this asset.

Asset Retirement Obligations

Fortuna's determination for asset retirement obligations involves estimation of timing and amounts of future costs relating to ongoing environmental and mine closure activities required under applicable law or the Company's own remediation plans. These estimates are subject to significant uncertainties because many of these costs will not be incurred for a number of years, the nature of the reclamation activities might change and the assumptions regarding the rate of inflation and credit risk-adjusted interest rate used in the calculation may vary over time. Therefore, actual costs and their timing might differ from current estimates.

Impairment of Long-lived Assets

Management reviews and evaluates its long-lived assets for impairment when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Examples of such events or circumstances are changes in metal prices, sudden physical deterioration of the asset, legal circumstances or political risks in the countries Fortuna operates, or other external factors which could have a significant impact on the operations of the Company. Impairment is considered to exist if total estimated future cash flows or probability-weighted cash flows on an undiscounted basis are less than the carrying amount of the assets, including mineral property, plant and equipment and non-producing property. An impairment loss is measured and recorded based on discounted estimated future cash flows or the application of an expected present value technique to estimate fair value in the absence of a market price. Future cash flows include recoverable proven and probable reserves and a portion of recoverable resources, silver, zinc, copper, lead and gold prices (considering current and historical prices, price trends and related factors), production levels, capital and reclamation costs, all based on detailed engineering life-of-mine plans. Assumptions underlying future cash flow estimates are subject to risks and uncertainties. Any differences between significant assumptions and market conditions and/or the Company's performance could have a material effect on any impairment provision, and on the Company's financial position and results of operations.

Income Taxes

The estimation of the Company's future tax liabilities and assets involves significant judgment around a number of assumptions. Judgement must be used to determine the Company's future earning potential, and the expected timing of the reversal of future tax assets and liabilities. Further uncertainties are the result of interpretation of tax legislation in a number of jurisdictions which might differ from the ultimate assessment of the tax authorities. These differences may affect the final amount or the timing of the payment of taxes.

Stock-based Compensation

The determination of the value of stock-based compensation is estimated using the Black-Scholes option pricing model. Option pricing models require the input of highly subjective assumptions, particularly as to the expected price volatility of the stock. Other assumptions include the expected life of the options and the risk-free interest rate at the time of the grant. Changes in these assumptions can materially affect the fair value estimated.

Financial Instruments

The carrying value of receivables, due from/to related parties and accounts payable and accrued liabilities approximate their fair value because of the short-term maturity of those instruments.

The Company enters into derivative contracts to manage its exposure to fluctuations in base metal prices. These contracts are marked-to-market at the end of each period, and the changes in estimated fair value are recorded as an unrealized gain (loss) on commodity contracts in the statement of operations. As at June 30, 2009 the Company estimated the fair value of the outstanding contracts to constitute a liability of \$1.10 million, and recorded a loss in the consolidated statements of operations for the second quarter of 2009 of \$1.36 million.

The estimated fair value was determined based on using applicable valuation techniques for commodity options with reference to the published market prices for underlying commodities quoted at London Metal Exchange.

The long-term investments in marketable securities are classified as available-for-sale and are measured at fair value at the end of each period. Fair value of these investments is determined based on published market prices of underlying securities. Change in fair values of available-for-sale marketable securities is recognized in other comprehensive income. At December 31, 2008 the Company had an investment in 3,706,250 shares of Continuum. These shares were de-recognized upon the Company's acquisition of Continuum on March 6, 2009 and a loss of \$0.46 million was recorded in the statement of operations to reflect the realization of the loss.

The Company's financial instruments are exposed to certain financial risks, including currency risk, credit risk, liquidity risk, interest risk, and price risk.

(a) Currency risk

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada, Peru, Mexico, and Barbados 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 results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

At June 30, 2009, 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					
	June 30, 2009			December 31, 2008		
	Canadian Dollars	Nuevo Soles	Mexican Pesos	Canadian Dollars	Nuevo Soles	Mexican Pesos
Cash and cash equivalents	\$ 24,740	S/. 4,551	\$20,405	\$29,748	S/. 629	\$ 3,864
Accounts receivable	10	879	20,221	13	10,400	46,460
Accounts payable and accrued liabilities	(149)	(5,861)	(638)	(172)	(5,281)	(10,259)

Based on the above net exposure as at June 30, 2009, 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, expressed in US dollars, as follows:

Impact to other comprehensive income (loss)	\$	2,365			
Impact to net income (loss)			\$	(16)	\$ 389

(b) 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 equivalents are held through large Canadian and international financial institutions. These investments mature at various dates over the current operating period. All of the Company's trade accounts receivables are held with large international metals trading companies. As at June 30, 2009, the Company has a Mexican value added tax of \$1,345 and Peruvian value added tax of \$118. The Company expects to recover the full amounts from the Mexican and Peruvian Governments.

(c) 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 and cash equivalents and its committed liabilities.

Accounts payable and accrued liabilities, amounts due to related parties and the current portion of obligations under capital lease are due within the current operating period.

(d) 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 of the amounts in investments with maturities of 90 days or less included in cash and cash equivalents is limited because these investments, although available for sale, are generally held to maturity.

(e) Price risk

The Company is exposed to metals price risk with respect to silver, gold, zinc, and lead 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 derivative instruments. As a matter of policy, the Company does not hedge its silver production.

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.

Share Position and Outstanding Warrants and Options

The Company's outstanding share position at August 7, 2009 is 92,318,329 common shares. In addition, a total of 9,339,355 share purchase warrants and incentive stock options are currently outstanding as follows:

<u>Type of Security</u>	<u>No. of Shares</u>	<u>Exercise Price CAD\$</u>	<u>Expiry Date</u>
Warrants	862,117	\$0.345	June 27, 2010
	<u>1,613,238</u>	\$0.345	Nov. 17, 2010
	2,475,355		
Director/Employee Stock Options:	29,000	\$0.37	Dec. 2, 2009
	30,000	\$0.80	July 24, 2010
	270,000	\$1.35	Feb. 5, 2016
	250,000	\$2.29	Mar. 30, 2016
	60,000	\$1.75	May 8, 2016
	200,000	\$1.75	May 22, 2016
	35,000	\$0.85	July 5, 2016
	245,000	\$1.55	July 5, 2016
	860,000	\$1.66	July 10, 2016
	225,000	\$1.61	Sept. 13, 2016
	110,000	\$0.85	Jan. 11, 2017
	730,000	\$2.22	Jan. 11, 2017
	50,000	\$2.75	Feb. 6, 2017
	15,000	\$0.85	April 22, 2017
	50,000	\$0.85	May 31, 2017
	50,000	\$0.85	June 27, 2017
	50,000	\$0.85	July 2, 2017
	1,075,000	\$3.22	July 2, 2017
	25,000	\$0.85	Oct. 24, 2017
	250,000	\$2.52	Feb. 5, 2018
	150,000	\$1.25	Aug. 25, 2018
	1,205,000	\$0.85	Oct. 5, 2018
	650,000	\$0.85	Nov. 5, 2018
	<u>250,000</u>	\$0.83	July 6, 2019
	6,864,000		
TOTAL OUTSTANDING OPTIONS AND WARRANTS:	<u>9,339,355</u>		

Change in Accounting Policy

Change in Reporting Currency

Effective January 1, 2009, the Company changed its reporting currency to the US dollar. The change in reporting currency is to better reflect the Company's business activities and to improve investors' ability to compare the Company's financial results with other publicly traded businesses in the mining industry. Prior to January 1, 2009, the Company reported its annual and quarterly consolidated balance sheets and the related consolidated statements of operations and cash flows in Canadian dollar (CAD).

In making this change in reporting currency, the Company followed the recommendations of the Emerging Issues Committee (EIC) of the Canadian Institute of Chartered Accountants (CICA), set out in EIC-130, "Translation Method when the Reporting Currency Differs from the Measurement Currency or there is a Change in the Reporting Currency". In accordance with EIC-130, the financial statements for all years and periods presented have been translated in to the new reporting currency using the current rate method. Under this

method, the statements of operations and cash flows statements items for each year and period have been translated into the reporting currency using the average exchange rates prevailing during each reporting period. All assets and liabilities have been translated using the exchange rate prevailing at the consolidated balance sheets dates. Shareholders' equity transactions since October 1, 1998 have been translated using the rates of exchange in effect as of the dates of the various capital transactions, while shareholders' equity balances on September 30, 1998 have been translated at the exchange rate on that date. All resulting exchange differences arising from the translation are included as a separate component of other comprehensive income. All comparative financial information has been restated to reflect the Company's results as if they had been historically reported in US dollars.

Adoption of New Accounting Standards

Goodwill and Intangible Assets (Section 3064)

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Intangible Assets", and CICA Section 3450, "Research and Development Costs", and CICA Section 1000, "Financial Statement Concepts". The standard intends to reduce the differences with International Financial Reporting Standards ("IFRS") in the accounting for intangible assets and results in closer alignment with U.S. GAAP. Under current Canadian standards, more items are recognized as assets than under IFRS or U.S. GAAP. The objectives of CICA Section 3064 are to reinforce the principle-based approach to the recognition of assets only in accordance with the definition of an asset and the criteria for asset recognition; and clarify the application of the concept of matching revenues and expenses such that the current practice of recognizing assets that do not meet the definition and recognition criteria are eliminated. The standard will also provide guidance for the recognition of internally developed intangible assets (including research and development activities), ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. This standard will be effective for fiscal years beginning on or after October 1, 2008. The Company has evaluated the new section and determined that adoption of these new requirements will have no impact on the Company's consolidated financial statements.

Credit risk and fair value of financial assets and financial liabilities

In January 2009, the Emerging Issues Committee of the CICA issued EIC-173 "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". This guidance clarified that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments, for presentation and disclosure purposes.

The guidance should be applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after the date of issuance of this Abstract. Retrospective application with restatement of prior periods is permitted but not required. Early adoption is encouraged.

The Company has evaluated the new section and determined that adoption of these new requirements will have no impact on the Company's consolidated financial statements.

Mining Exploration Costs

On March 27, 2009, the Emerging Issues Committee of the CICA issued EIC-174 "Mining Exploration Costs" which applies to interim and annual financial statements for periods ending on or after January 20, 2009. This guidance clarified that an entity that has initially capitalized exploration costs has an obligation in the current and subsequent accounting periods to test such costs for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

This standard will be effective for the Company beginning on April 1, 2009. The Company has evaluated the new section and determined that adoption of these new requirements will have no impact on the Company's consolidated financial statements.

Foreign currency translation

The Company's functional currency is the Canadian dollar. Effective January 1, 2009, the Company changed its reporting currency to the US dollar.

All subsidiaries, except its wholly owned subsidiary Minera Bateas S.A.C. ("Bateas"), are considered to be integrated foreign operations and their financial statements are translated to Canadian dollars under the temporal method. Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities at historical exchange rates. Revenues and expenses are translated at the average exchange rate in effect during the period. Realized and unrealized foreign exchange gains and losses are included in earnings.

Commencing January 1, 2009, Bateas was reclassified as a self-sustaining operation from an integrated foreign operation because of the significant changes in the economic facts and circumstances of Bateas. Bateas's commercial mine production and cash generated from sales is sufficient to cover further exploration expenditure and other operation costs. Therefore, its financial statements are translated using the current rate method. Assets and liabilities of Bateas, which are denominated in US dollars, are translated into Canadian dollars using the current rate method at period-end exchange rates and resulting translation adjustments are reflected in comprehensive income. Revenues and expenses of Bateas are translated at average exchange rates for the period.

Recent released Canadian Accounting Standards

The Company has assessed new and revised accounting pronouncements that have been issued that are not yet effective and determined that the following may have an impact on the Company:

Convergence with International Financial Reporting Standards ("IFRS")

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canadian GAAP. This date is for interim and annual financial statements relating to fiscal years beginning on or after 1 January 2011. The Company will begin reporting its financial statements in accordance with IFRS on January 1, 2011, with comparative figures for 2010.

The adoption date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Company for its year ended December 31, 2010, and of the opening balance sheet as at January 1, 2010.

The Company has begun planning its transition to IFRS but the impact on its consolidated financial position and results of operations has not yet been determined. The process will consist of three phases: Scoping and Diagnostics, Analysis and Development, and Implementation and Review. The Company has begun the first phase which includes a diagnostic assessment of its current accounting policies systems and processes in order to identify differences between current Canadian GAAP and IFRS treatment. The Company will continue to monitor changes in IFRS during implementation process and intends to update the critical accounting policies and procedures to incorporate the changes required by converting to IFRS and the impact of these changes on its financial reporting.

Business Combinations

In January 2009, the CICA issued Section 1582, “Business Combinations”, Section 1601, “Consolidated Financial Statements”, and Section 1602, “Non-controlling Interests”. These new standards are harmonized with International Financial Reporting Standards (IFRS). Section 1582 specifies a number of changes, including: an expanded definition of a business, a requirement to measure all business acquisitions at fair value, a requirement to measure non-controlling interests at fair value, and a requirement to recognize acquisition-related costs as expenses. Section 1601 establishes the standards for preparing consolidated financial statements. Section 1602 specifies that non-controlling interests be treated as a separate component of equity, not as a liability or other item outside of equity. The new standards will become effective in 2011 but early adoption is permitted. The Company is evaluating the attributes of early adoption of this standard and its potential effects if events or transactions occurred that this standard applies to.

Risks and Uncertainties

Metal prices

One of the most significant risks affecting the profitability and viability of the Company’s mining operations is the fluctuation of metal prices. Volatility of metal prices is high by historic measures and strong downturns on these prices can have significant adverse effects on the continuity of the Company’s operations. In order to mitigate this risk in the medium term, the Company put in place price protection strategies for approximately 60% of its zinc and lead metal production during the six month period between February 2009 and July 2009. Subsequently the Company extended the price protection for 65% of zinc and lead production between the months of August and December of 2009.

Credit risk

The Company is subject to credit risk through its trade receivables. The Company enters into one year contracts to sell its concentrate products at Caylloma and transacts only with credit worthy costumers to minimize credit risk. The Company has awarded its full production of 2009 to large international metals trading companies, including Glencore International.

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 credit worthy costumers to minimize credit risk. The Company currently holds derivatives contracts with Standard Bank PLC and BBVA SA.

Environmental risk

The Company has recorded an asset retirement obligation of \$1.44 million as of June 30, 2009 in relation to the cost of reclamation associated with the Caylloma property. This amount has been estimated by a third party in compliance of local regulations and is still in the process of being reviewed by the relevant authorities before definitive approval.

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.

Exchange rate risk

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada, Peru, Mexico, and Barbados 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 results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

Exploration and development

The business of mineral exploration and extraction involves a high degree of risk. Few properties that are in the exploration stage ultimately become producing mines. Major expenses may be required to establish reserves by drilling and to construct mining and processing facilities at a site. It is impossible to ensure that exploration and development programs carried out by the Company will result in profitable commercial mining operations.

Resources and reserves

There is a degree of uncertainty attributable to the estimation of resources and reserves and to expected mineral grades. Mineral Resource and Mineral Reserves may require revision based on actual production experience. Market fluctuations in the price of metals, as well as increased production costs and reduced recovery rates, may render certain mineral reserves uneconomic and may ultimately result in a restatement of resources and/or reserves. Short-term operating factors relating to the mineral resources and reserves, such as the need for sequential development of ore bodies may adversely affect the Company's profitability in any accounting period.

Political and country risk

The Company's mineral properties are located in emerging nations and consequently may be subject to a higher level of risk compared to developed countries. Operations, the status of mineral property rights, title to the properties and the recoverability of amounts shown for mineral properties in emerging nations can be affected by changing economic, regulatory, and political situations.

The State of Oaxaca has a history of social conflicts and political agitation which can lead to public demonstrations and blockades that can from time to time affect the Company's operations.

Internal Controls

During 2008, the Company engaged an external consulting firm to assist Fortuna's management in documenting and assessing the design effectiveness of Internal Control over Financial Reporting on its main business and accounting processes. This is an ongoing effort.

The Company evaluated the effectiveness of the design and operation of the disclosure controls and procedures as of June 30, 2009 under the supervision of the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based on the results of this evaluation the CEO and the CFO have concluded that such disclosure controls are sufficiently effective to provide reasonable assurance that material information relating to the Company is made known to management and disclosed in accordance with the applicable securities laws.

Management is 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 Canadian generally accepted accounting principles. Management of the Company has evaluated the effectiveness of internal control over financial reporting as of June 30, 2009 and has concluded there are no material weaknesses. Management continues to review and refine its internal controls and procedures.