



**F O R T U N A**  
S I L V E R M I N E S I N C .

**FINANCIAL REVIEW**

**Third Quarter Ended September 30, 2009**

**FORTUNA SILVER MINES INC.**

**UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**Third Quarter Ended September 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 nine months ended September 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 nine month periods ended September 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](http://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	September 30, 2009	December 31, 2008
<b>ASSETS</b>			
<b>CURRENT</b>			
Cash and cash equivalents		\$ 33,676	\$ 29,454
Derivatives	4	-	1,418
Accounts receivable and prepaid expenses	5	8,639	1,865
GST and value added tax		1,245	5,127
Inventories	6	1,793	1,727
		<b>45,353</b>	<b>39,591</b>
<b>LONG TERM RECEIVABLES</b>		<b>48</b>	<b>114</b>
<b>LONG TERM INVESTMENT AND RECEIVABLE</b>	7	-	3,093
<b>PROPERTY, PLANT &amp; EQUIPMENT</b>	8	<b>16,161</b>	<b>13,285</b>
<b>MINERAL PROPERTIES</b>	9	<b>69,810</b>	<b>59,285</b>
		<b>\$ 131,372</b>	<b>\$ 115,368</b>
<b>LIABILITIES</b>			
<b>CURRENT</b>			
Accounts payable and accrued liabilities		\$ 6,370	\$ 4,735
Due to related parties, net	10	23	38
Derivatives	4	3,065	-
Current portion of obligation under capital lease	11 a)	1,037	682
Current portion of long term liability	11 b)	-	80
		<b>10,495</b>	<b>5,535</b>
<b>OBLIGATIONS UNDER CAPITAL LEASE</b>	11 a)	<b>894</b>	<b>717</b>
<b>LONG TERM LIABILITY</b>	11 b)	<b>630</b>	<b>665</b>
<b>ASSET RETIREMENT OBLIGATION</b>	12	<b>1,887</b>	<b>1,066</b>
<b>FUTURE INCOME TAX LIABILITY</b>		<b>10,715</b>	<b>9,410</b>
<b>NON-CONTROLLING INTEREST</b>		-	9,007
		<b>24,621</b>	<b>26,400</b>
<b>SHAREHOLDERS' EQUITY</b>			
<b>SHARE CAPITAL</b>		<b>104,516</b>	<b>98,206</b>
<b>CONTRIBUTED SURPLUS</b>		<b>12,111</b>	<b>11,798</b>
<b>DEFICIT</b>		<b>(10,394)</b>	<b>(9,980)</b>
<b>ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME</b>		<b>518</b>	<b>(11,056)</b>
		<b>106,751</b>	<b>88,968</b>
		<b>\$ 131,372</b>	<b>\$ 115,368</b>
<b>Nature and continuance of operations</b>	<b>1</b>		
<b>Commitments and contingencies</b>	<b>15</b>		
<b>Subsequent events</b>	<b>18</b>		

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)

	Notes	Three months ended September 30,		Nine months ended September 30,	
		2009	2008	2009	2008
Sales		\$ 13,230	\$ 7,492	\$ 35,072	\$ 22,072
Cost of sales (including depletion, depreciation and accretion of \$4,492 (2008: \$3,543))		6,156	5,758	17,718	15,186
<b>MINE OPERATING INCOME</b>		<b>7,074</b>	<b>1,734</b>	<b>17,354</b>	<b>6,886</b>
Selling, general and administrative expenses (includes depreciation of \$48 (2008: \$33))	10	2,563	2,088	6,970	5,598
Stock-based compensation	13 d)	123	29	483	652
Write-off of deferred exploration costs		-	-	1,081	-
		<b>2,686</b>	<b>2,117</b>	<b>8,534</b>	<b>6,250</b>
<b>OPERATING INCOME (LOSS)</b>		<b>4,388</b>	<b>(383)</b>	<b>8,820</b>	<b>636</b>
Interest and other income and expenses		187	382	586	1,063
Interest and finance expenses		(46)	(25)	(118)	(70)
Net (loss) on commodity contracts		(3,467)	694	(5,239)	2,322
(Loss) on disposal of property, plant and equipment		(1)	(26)	(7)	(49)
(Loss) on disposal of investment		1	-	(236)	-
Foreign exchange (loss) gain		(312)	(138)	(683)	285
		<b>(3,638)</b>	<b>887</b>	<b>(5,697)</b>	<b>3,551</b>
<b>INCOME BEFORE INCOME TAXES AND NON-CONTROLLING INTEREST</b>		<b>750</b>	<b>504</b>	<b>3,123</b>	<b>4,187</b>
Income tax provision		1,306	847	3,717	2,601
Non-controlling interest		-	(46)	(180)	28
<b>NET (LOSS) INCOME FOR THE PERIOD</b>		<b>\$ (556)</b>	<b>\$ (297)</b>	<b>\$ (414)</b>	<b>\$ 1,558</b>
<b>(Loss) Earnings per Share - Basic and Diluted</b>		<b>\$ (0.01)</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 0.02</b>
<b>Weighted average number of shares outstanding - Basic</b>		<b>92,736,581</b>	<b>85,331,659</b>	<b>90,756,857</b>	<b>84,088,475</b>
<b>Weighted average number of shares outstanding - Fully Diluted</b>		<b>92,736,581</b>	<b>85,331,659</b>	<b>90,756,857</b>	<b>84,741,104</b>

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)

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	2009	2008	2009	2008
<b>Net (loss) income for the period</b>	\$ (556)	\$ (297)	\$ (414)	\$ 1,558
<b>Other comprehensive income (loss), net of taxes</b>				
Unrealized gain (loss) on available for sale long term investments	-	(3)	148	(624)
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	4,256	(2,930)	10,964	(5,948)
<b>Other comprehensive income (loss)</b>	<b>4,256</b>	<b>(2,933)</b>	<b>11,574</b>	<b>(6,572)</b>
<b>Comprehensive income (loss)</b>	<b>\$ 3,700</b>	<b>\$ (3,230)</b>	<b>\$ 11,160</b>	<b>\$ (5,014)</b>

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

	Notes	Three months ended September 30,		Nine months ended September 30,	
		2009	2008	2009	2008
<b>OPERATING ACTIVITIES</b>					
Net (loss) income for the period		\$ (556)	\$ (297)	\$ (414)	\$ 1,558
Items not involving cash					
Depletion and depreciation		1,489	1,401	4,439	3,638
Accretion expense		40	26	101	78
Future income tax		(84)	826	601	2,416
Stock based compensation		123	29	483	652
Unrealized loss (gain) on commodity contracts		1,966	436	4,483	(880)
Non-controlling interest		-	(46)	(180)	28
Write-off of deferred exploration costs		-	-	1,081	-
Loss on disposal of equipment		1	26	7	49
Loss on disposal of investments		(1)	-	236	-
Other		10	(5)	28	(5)
Unrealized foreign exchange loss (gain)		(330)	181	44	125
		<u>2,658</u>	<u>2,577</u>	<u>10,909</u>	<u>7,659</u>
Changes in non-cash working capital items					
Accounts receivable and prepaid expenses		(136)	(1,702)	(4,849)	(3,851)
Inventories		(222)	(185)	150	(328)
Accounts payable		1,217	(514)	1,457	(921)
Payments from (to) related parties		(3)	(14)	(19)	2
<b>Net cash provided by (used in) operating activities</b>		<u>3,514</u>	<u>162</u>	<u>7,648</u>	<u>2,561</u>
<b>FINANCING ACTIVITIES</b>					
Net proceeds on issuance of common shares		774	-	915	8,004
Capital lease obligations		(302)	(40)	(678)	(169)
<b>Net cash (used in) provided by financing activities</b>		<u>472</u>	<u>(40)</u>	<u>237</u>	<u>7,835</u>
<b>INVESTING ACTIVITIES</b>					
Costs relating to the acquisition of Continuum		(3)	-	(162)	-
Mineral property expenditures		(2,721)	(4,119)	(7,655)	(13,113)
Value added taxes on purchase of property, plant & equipment		51	(397)	2,024	(1,003)
Property, plant & equipment		(989)	(771)	(1,962)	(2,066)
Long term receivable		33	(12)	64	(12)
Proceeds on disposal of equipment		24	1	24	11
Acquisition of long term investments		(8)	-	(229)	-
Proceeds on disposal of long term investments		16	-	477	-
<b>Net cash (used in) provided by investing activities</b>		<u>(3,597)</u>	<u>(5,298)</u>	<u>(7,419)</u>	<u>(16,183)</u>
Effect of exchange rate changes on cash and cash equivalents		2,122	(1,238)	3,756	(2,644)
<b>INCREASE (DECREASE) IN CASH</b>		<b>389</b>	<b>(5,176)</b>	<b>466</b>	<b>(5,787)</b>
Cash - beginning of period		31,165	46,139	29,454	48,156
<b>CASH AND CASH EQUIVALENTS - END OF PERIOD</b>		<u>\$ 33,676</u>	<u>\$ 39,725</u>	<u>\$ 33,676</u>	<u>\$ 39,725</u>
<b>Supplementary disclosure of cash flow information:</b>					
Cash received for interest		\$ 93	\$ (403)	\$ 160	\$ (1,206)
Cash paid for income taxes		\$ 110	\$ 101	\$ 253	\$ 377
<b>Non-cash Transactions:</b>					
Issue of shares on purchase of resource property	9	\$ -	\$ -	\$ 5,194	\$ -
Reassessment of asset retirement obligation	9, 12	\$ 405	\$ -	\$ 694	\$ -
Cancellation of Minera Condor liability	11	\$ -	\$ -	\$ 156	\$ -
Equipment purchased through capital lease		\$ 83	\$ -	\$ 1,210	\$ -
Purchase of resource property on a deferred payment plan		\$ -	\$ 578	\$ -	\$ 578
Sale of equipment for a long-term receivable		\$ -	\$ 192	\$ -	\$ 192
Fair value of options exercised		\$ 84	\$ -	\$ 155	\$ 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 NINE MONTHS ENDED SEPTEMBER 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		255,000	187	-	-	-	187
Exercise of warrants		2,475,355	776	-	-	-	776
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		-	155	(155)	-	-	-
Stock based compensation		-	-	468	-	-	468
(Loss) income for the period		-	-	-	(414)	-	(414)
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		-	-	-	-	10,964	10,964
<b>Balance - September 30, 2009</b>		<b>94,848,684</b>	<b>\$ 104,516</b>	<b>\$ 12,111</b>	<b>\$ (10,394)</b>	<b>\$ 518</b>	<b>\$ 106,751</b>

	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		-	-	652	-	-	652
Income (loss) for the period		-	-	-	1,558	-	1,558
Unrealized loss of AFS shares		-	-	-	-	(624)	(624)
Unrealized gain/(loss) on translation of functional currency to reporting currency		-	-	-	-	(5,948)	(5,948)
Balance - September 30, 2008		85,331,659	\$ 98,207	\$ 11,158	\$ (7,512)	\$ 4,815	\$ 106,668

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 NINE MONTH PERIODS ENDED SEPTEMBER 30, 2009 AND 2008**

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

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#### **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 principles (“Canadian GAAP”) applicable to going concerns, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. During the three and nine months ended September 30, 2009 and 2008, the Company had a net loss of \$556 (2008: loss \$297) and \$414 (2008: income \$1,558), respectively, and as at September 30, 2009, had an accumulated deficit of \$10,394. 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 S.A.C. (“Bateas”); Fortuna Silver (Barbados) Inc.; Compania Minera Cuzcatlan SA (“Cuzcatlan”); Continuum Resources Ltd. (“Continuum”); and Fortuna Silver Mines Peru S.A.C.

These unaudited interim consolidated financial statements reflect, in the opinion of management, all adjustments necessary to present fairly the consolidated financial position as at September 30, 2009 and the consolidated statement of income and consolidated cash flows for the three and nine 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 NINE MONTH PERIODS ENDED SEPTEMBER 30, 2009 AND 2008**

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

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**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

i. Goodwill and Intangible Assets (Section 3064)

In February 2008, the CICA issued the following Handbook Sections : Section 3064, “Goodwill and Intangible Assets”, which replaces Section 3062, “Goodwill and Intangible Assets”, Section 3450, “Research and Development Costs”, and 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 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 NINE MONTH PERIODS ENDED SEPTEMBER 30, 2009 AND 2008**

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

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**2. Summary of Significant Accounting Policies (continued)**

c) Adoption of New Accounting Standards (continued)

ii. 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.

iii. 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 has 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, 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 NINE MONTH PERIODS ENDED SEPTEMBER 30, 2009 AND 2008**

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

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**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.

e) Comparative figures

The Company has reclassified certain amounts in the consolidated statements of cash flows, as at period ended September 30, 2009, primarily between future income taxes, the effect of exchange rate changes on cash and cash equivalents, and increase (decrease) of cash which have no impact on the Company's consolidated balance sheets, statement of operations, statements of comprehensive income (loss), or statements of shareholders' equity.

**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:

a) 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.

**FORTUNA SILVER MINES INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2009 AND 2008**

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

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**3. Recently released Canadian Accounting Standards (continued)**

a) Convergence with International Financial Reporting Standards (“IFRS”) (continued)

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. In the third quarter of 2009, the Company completed a high-level impact assessment to identify key areas that will be affected by the conversion. The detailed analysis of the IFRS - Canadian GAAP differences, and the selection of accounting policy choices under IFRS has commenced and is expected to be completed by the end of the fourth quarter 2009. The Company will continue to monitor changes in IFRS leading up to the changeover date, and will update its conversion plan as required.

b) Business Combinations

In January 2009, the CICA issued the following Handbook Sections: 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.

c) Comprehensive revaluation of assets and liabilities and Equity

In August 2009, the CICA amended Section 1625, “Comprehensive revaluation of assets and liabilities” as a result of issuing “Business Combinations, Section 1582, “Consolidated Financial Statements”, Section 1601, and Non-Controlling Interests”, Section 1602, in January 2009.

In August 2009, the CICA amended Section 3251, “Equity” as a result of issuing Section 1602, “Non-controlling Interests”. These amendments only apply to entities that have adopted Section 1602.

These amendments apply prospectively to comprehensive revaluations of assets and liabilities occurring in fiscal years beginning on or after January 1, 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.

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**3. Recently released Canadian Accounting Standards (continued)**

d) Financial Instruments and Impaired Loans

In August 2009, the CICA issued amendments to Section 3855, "Financial Instruments: Recognition and Measurement". These amendments will permit (or require in certain circumstances) entities to reclassify certain investments in debt instruments, will amend the guidance regarding impairment measurement for Held to Maturity debt instruments and will require reversals of impairment losses for Available for Sale debt instruments when conditions have changed. These amendments apply only to investments in debt instruments and do not apply to investments in equity investments or to debt instruments that have been designated at origination as Held for Trading.

In August 2009, the CICA amended Section 3025, "Impaired loans" to conform with the definition of a loan to that in amended Section 3855 and to include held-to-maturity investments within the scope of this Section.

These amendments are effective for annual financial statements relating to fiscal years beginning on or after November 1, 2008 with early adoption permitted for interim financial statements issued on or after August 20, 2009. 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 the year, 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 June 2010. The contracts are spread evenly over the periods shown below with settlement occurring on a monthly basis. No initial premium associated with these trades has been paid. The counterparties are Standard Bank PLC, Banco Bilbao Vizcaya Argentaria, S.A., Macquarie Bank Limited, and Goldman Sachs.

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

*January 2009* - settlements throughout February 2009 to July 2009:

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

*July 2009* - settlements throughout August 2009 to December 2009:

Lead forward contracts:	\$1,645/t, for the total of 2,675 tons
Zinc forward contracts:	\$1,561/t, for the total of 3,000 tons

*August 2009* - settlements throughout January 2010 to June 2010:

Lead forward contracts:	\$1,910/t, for the total of 1,800 tons
Zinc forward contracts:	\$1,787/t, for the total of 1,050 tons

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**4. Derivatives (continued)**

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

The estimated fair value of the outstanding derivative contracts of (\$3,065) (2008: \$1,418) was determined with reference to the published market prices for underlying commodities quoted at the London Metal Exchange.

**5. Accounts receivable and prepaid expenses**

	<b>September 30, 2009</b>		<b>December 31, 2008</b>	
Trade accounts receivable	\$	<b>6,986</b>	\$	-
Advances and other receivables		<b>1,367</b>		1,701
Prepaid expenses and deposits		<b>286</b>		164
	\$	<b>8,639</b>	\$	1,865

Accounts receivable and prepaid expenses include prepaid income tax of \$9 (2008: \$605), \$118 (2008: \$102) short term portion of the long term receivable, and \$198 (2008: \$33) in guaranteed deposits.

**6. Inventories**

Inventories consist of the following:

	<b>September 30, 2009</b>		<b>December 31, 2008</b>	
Stockpile ore	\$	<b>256</b>	\$	322
Concentrate inventory		<b>108</b>		90
Materials and supplies		<b>1,429</b>		1,315
	\$	<b>1,793</b>	\$	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. c).

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**7. Long term investment and receivable (continued)**

	<b>September 30, 2009</b>		<b>December 31, 2008</b>	
Investment in shares in Continuum	\$	-	\$	91
Loan to Continuum		-		3,002
	<b>\$</b>	<b>-</b>	<b>\$</b>	<b>3,093</b>

**8. Property, Plant & Equipment**

Property, plant and equipment are comprised of the following:

	<b>September 30, 2009</b>			<b>December 31, 2008</b>		
	<b>Cost</b>	<b>Accumulated Depreciation</b>	<b>Net Book Value</b>	<b>Cost</b>	<b>Accumulated Depreciation</b>	<b>Net Book Value</b>
Land	\$ 258	\$ -	\$ 258	\$ 231	\$ -	\$ 231
Machinery & equipment	8,888	2,684	6,204	7,867	1,704	6,163
Buildings	3,716	947	2,769	3,410	602	2,808
Furniture & other equipment	1,461	392	1,069	1,193	218	975
Transport units	338	210	128	526	171	355
Equipment under capital lease	3,075	472	2,603	1,615	216	1,399
Work in progress	3,130	-	3,130	1,354	-	1,354
	<b>\$ 20,866</b>	<b>\$ 4,705</b>	<b>\$ 16,161</b>	<b>\$ 16,196</b>	<b>\$ 2,911</b>	<b>\$ 13,285</b>

**9. Mineral Properties**

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

	<b>September 30, 2009</b>				<b>December 31, 2008</b>			
	<b>Cost</b>	<b>Depletion</b>	<b>Write-off</b>	<b>Net Book Value</b>	<b>Cost</b>	<b>Depletion</b>	<b>Write-off</b>	<b>Net Book Value</b>
Caylloma, Peru	\$ 40,174	\$ 10,682	\$ 160	\$ 29,332	\$ 32,915	\$ 7,154	\$ -	\$ 25,761
San Jose, Mexico	41,508	82	1,054	40,372	33,843	34	285	33,524
Predilecta, Mexico	106	-	-	106	-	-	-	-
Tlacolula, Mexico	-	-	-	-	-	-	-	-
	<b>\$ 81,788</b>	<b>\$ 10,764</b>	<b>\$ 1,214</b>	<b>\$ 69,810</b>	<b>\$ 66,758</b>	<b>\$ 7,188</b>	<b>\$ 285</b>	<b>\$ 59,285</b>

**a) Caylloma Project, Peru**

For the nine months ending September 30, 2009, additions to the Caylloma mineral property includes development and exploration costs of \$3,638, an increase of \$694 resulting from a revision to the estimate for the asset retirement obligation, and \$160 write off of exploration costs.

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**9. Mineral Properties (continued)**

b) San Jose Project, Mexico

For the nine months ending September 30, 2009, additions to the San Jose mineral property consist of development and exploration costs capitalized of \$3,726. Included in the additions for the San Jose property is \$52 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. b)). The present value of the \$800 was \$589 and this is being accreted monthly with the accretion amount being capitalized to the mineral property.

Also included in additions to the San Jose mineral property is depreciation of equipment involved in construction work of \$146 (2008: \$181), and general and administrative costs to develop the mine of \$1,072 (2008: \$1,087), and \$121 received as interest on VAT recovered. There was also a decrease of \$324 resulting from the purchase price discrepancy upon the acquisition of Continuum. The San Jose Project is owned and operated by Cuzcatlan, a wholly owned subsidiary of 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 \$1,054. This decision was based on existing geological information and is part of an effort to prioritize capital expenditures.

c) Acquisition of Continuum

On March 6, 2009, the Company closed the acquisition of all the issued and outstanding shares of Continuum which had 124,037,920 shares outstanding as of March 6, 2009. The Company agreed to issue 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.

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**9. Mineral Properties (continued)**

## c) Acquisition of Continuum (continued)

The preliminary purchase price allocation is as follows:

<b>Purchase price</b>		
6,786,706 common shares of Fortuna	\$	5,194
Acquisition costs		113
Loan to Continuum		3,184
Cost of shares previously acquired		130
<b>Total purchase price</b>	<b>\$</b>	<b>8,621</b>

**Purchase price allocation**

Net assets acquired:

Cash received	\$	5
Property, plant & equipment		6
Mineral property interests		8,749
Accounts payable and accrued liabilities		(139)
<b>Net identifiable assets of Continuum</b>	<b>\$</b>	<b>8,621</b>

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

## d) Tlacolula Project, Mexico

In September 2009, the Company was granted an option to acquire a 60% interest in the Tlacolula silver project located in the State of Oaxaca, Mexico from Radius Gold Inc. ("Radius") (a related party by way of directors in common with the Company). The Company can earn the interest by spending \$2,000, which includes a commitment to drill 1,500 meters within three years, and making staged annual payments of \$250 cash and \$250 in common stock to Radius according to the following schedule:

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

As at September 30, 2009, the transaction is pending stock exchange approval and no payments have been made.

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**10. Related Party Transactions**

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

<b>Transactions with related parties</b>	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Consulting fees <sup>1</sup>	\$ 38	\$ 27	\$ 103	\$ 42
Salaries and wages <sup>2</sup>	28	45	88	58
Other general and administrative expenses <sup>3</sup>	36	39	102	39
	\$ 102	\$ 111	\$ 293	\$ 139

<sup>1</sup> Consulting fees includes fees paid to two directors, Simon Ridgway and Mario Szotlender.

<sup>2,3</sup> Radius Gold Inc. ("Radius") 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.

<sup>2</sup> 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.

In September 2009, the Company was granted an option to acquire a 60% interest in the Tlacolula silver project located in the State of Oaxaca, Mexico from Radius. Refer to Notes to the Consolidated Financial Statements Note 9. d).

<b>Amounts due to/(from) related parties</b>	<b>September 30, 2009</b>	<b>December 31, 2008</b>
Owing to a company with common directors <sup>3</sup>	\$ 23	\$ 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****a) 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.

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

## a) Obligations under capital lease (continued)

	Interest Rate	Maturity Date	September 30, 2009	December 31, 2008
Scotia Bank	9.29%	2009	\$ -	\$ 14
Interamericano de Finanzas	8.50%	2009	4	38
Scotia Bank	8.20%	2009	35	134
Scotia Bank	8.66%	2010	133	226
Scotia Bank	8.20%	2010	325	26
Scotia Bank	8.49%	2010	71	534
Scotia Bank	8.34%	2010	17	110
Scotia Bank	8.49%	2011	117	248
Scotia Bank	6.75%	2011	18	-
Scotia Bank	6.75%	2011	23	-
Interbank	9.12%	2011	190	69
Interbank	9.75%	2012	99	-
Interbank	9.75%	2012	899	-
Lease payments			\$ 1,931	\$ 1,399
Less current amount			(1,037)	(682)
			\$ 894	\$ 717

## b) 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. b)) 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 September 30, 2009.

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

## b) Long term liability (continued)

	<b>September 30,</b>	<b>December 31,</b>
	<b>2009</b>	<b>2008</b>
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	41	46
Less: payments	-	(30)
Liability at period end	630	745
Less: current portion of long term liability	-	(80)
	\$ 630	\$ 665
Principal minimum repayment terms will be :		
2009	\$ -	
2010	-	
2011	-	
2012	800	
	\$ 800	

## c) 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 expired on July 27, 2009. This letter has been 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 \$1,887 as of September 30, 2009 consisting of accretion of the previously recorded asset retirement obligation of \$1,066 as of December 31, 2008 by \$101, an increase in the estimated amount of the asset retirement obligation of \$694, 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 \$694.

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**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	<b>250,000</b>	<b>0.83</b>
Exercised	<b>(255,000)</b>	<b>0.85</b>
Expired	<b>(920,000)</b>	<b>2.38</b>
Forfeited	-	-
<b>Balance, September 30, 2009</b>	<b>6,809,000</b>	<b>\$ 1.71</b>

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**13. Share Capital (continued)**

## b) Stock Options (continued)

During the period, 920,000 share purchase options with exercise prices ranging from CAD\$0.85 to CAD\$3.22 per share expired unexercised, 255,000 share purchase options were exercised at an exercise price of CAD\$0.85 per share. During the period, the Company granted to an officer and an employee an aggregate of 250,000 share purchase options with an exercise price of CAD\$0.83 per share, exercisable for ten years, with 200,000 share purchase options vested immediately and 50,000 share purchase options vesting on October 1, 2009.

The following share purchase options were outstanding at September 30, 2009:

Number of shares	Exercise Price CAD\$	Expiry Date	Weighted Average Remaining Contractual Life - Years
29,000	\$ 0.37	December 2, 2009	0.2
30,000	\$ 0.80	July 24, 2010	0.8
270,000	\$ 1.35	February 5, 2016	6.4
250,000	\$ 2.29	March 30, 2016	6.5
60,000	\$ 1.75	May 8, 2016	6.6
200,000	\$ 1.75	May 22, 2016	6.6
20,000	\$ 0.85	July 5, 2016	6.8
245,000	\$ 1.55	July 5, 2016	6.8
860,000	\$ 1.66	July 10, 2016	6.8
225,000	\$ 1.61	September 13, 2016	7.0
110,000	\$ 0.85	January 11, 2017	7.3
730,000	\$ 2.22	January 11, 2017	7.3
50,000	\$ 2.75	February 6, 2017	7.4
15,000	\$ 0.85	April 22, 2017	7.6
10,000	\$ 0.85	May 31, 2017	7.7
50,000	\$ 0.85	June 27, 2017	7.7
50,000	\$ 0.85	July 2, 2017	7.8
1,075,000	\$ 3.22	July 2, 2017	7.8
25,000	\$ 0.85	October 24, 2017	8.1
250,000	\$ 2.52	February 5, 2018	8.4
150,000	\$ 1.25	August 25, 2018	8.9
1,205,000	\$ 0.85	October 5, 2018	9.0
650,000	\$ 0.85	November 5, 2018	9.1
250,000	\$ 0.83	July 6, 2019	9.8
<b>6,809,000</b>			<b>7.77</b>

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**13. Share Capital (continued)**

## b) Stock Options (continued)

As at September 30, 2009, 6,759,000 share purchase options have vested and 50,000 share purchase options remain unvested. Subsequent to September 30, 2009, 6,809,000 share purchase options have vested, 50,000 share purchase options with exercise prices ranging from CAD\$1.55 to CAD\$2.22 expired, and 15,000 share purchase options were exercised at CAD\$0.85 per share. In addition, the Company granted incentive stock options, subject to shareholder approval, to its directors and officers to purchase up to 2,150,000 shares exercisable for ten years at a price of CAD\$1.60 per share.

## 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	(2,475,355)	0.35
Expired	(8,588,000)	2.30
<b>Balance, September 30, 2009</b>	<b>-</b>	<b>\$ -</b>

As at September 30, 2009, no share purchase warrants were outstanding.

## 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 \$483 recognized for the nine months ended September 30, 2009 (2008: \$652) 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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**13. Share Capital (continued)**

## d) Stock-Based Compensation (continued)

	<b>Nine months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Risk-free interest rate	<b>2.42% - 3.45%</b>	2.97% - 3.78%
Expected stock price volatility	<b>70% - 78%</b>	63% - 75%
Expected term in years	<b>5 &amp; 10</b>	3, 5 & 10
Expected dividend yield	<b>0%</b>	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**

## a) Industry Information

The Company operates in one reportable operating segment, being the acquisition, exploration, development, and operation of mineral properties.

## b) Geographic Information

The following is the summary of operations and summary of certain assets on a geographical basis.

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**14. Segmented Information (continued)**

## b) Geographic Information (continued)

	Canada	Peru	Mexico	Other	Total
<b>Three months ended September 30,</b>					
Revenues	\$ -	\$ 13,230	\$ -	\$ -	\$ 13,230
Operating (loss) income	\$ (977)	\$ 5,373	\$ -	\$ (8)	\$ 4,388
Three months ended September 30, 2008					
Revenues	\$ -	\$ 7,492	\$ -	\$ -	\$ 7,492
Operating (loss) income	\$ 291	\$ (663)	\$ -	\$ (11)	\$ (383)
<b>Nine months ended September 30,</b>					
Revenues	\$ -	\$ 35,072	\$ -	\$ -	\$ 35,072
Operating income (loss)	\$ (2,643)	\$ 12,445	\$ (921)	\$ (61)	\$ 8,820
Nine months ended September 30, 2008					
Revenues	\$ -	\$ 22,072	\$ -	\$ -	\$ 22,072
Operating (loss) income	\$ (2,791)	\$ 3,441	\$ -	\$ (14)	\$ 636
<b>As at September 30, 2009</b>					
Property, plant & equipment	\$ 12	\$ 11,356	\$ 4,790	\$ 3	\$ 16,161
Total assets	\$ 25,965	\$ 60,890	\$ 44,505	\$ 12	\$ 131,372
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

## c) Major Customers

For the three month periods ended September 30, 2009 and 2008, there was one customer accounting for greater than 10% of revenues and represented 96% and 100% of total sales of the Company, respectively.

For the nine month periods ended September 30, 2009 and 2008, there was one customer accounting for greater than 10% of revenues and represented 96% and 100% of total sales of the Company, respectively.

**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.

**FORTUNA SILVER MINES INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2009 AND 2008**

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

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**15. Commitments and Contingencies (continued)**

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 September 30, 2009, these obligations amounted to \$1,237 and mature in 2010.

a) 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 September 30, 2009 and December 31, 2008, \$1,887 and \$1,066, respectively, were accrued for reclamation costs relating to mineral properties in accordance with Section 3110, "Asset Retirement Obligations". See Note 12.

b) 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.

c) 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.

**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.

**FORTUNA SILVER MINES INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2009 AND 2008**

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

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**16. Management of capital risk (continued)**

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. The Company's Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework and reviews the Company's policies on an ongoing basis.

a) Fair value of financial instruments

The carrying value of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, due to related parties, net, approximate their fair value due to the relatively short periods to maturity and the terms of these financial instruments.

Fair value estimates are made a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and, therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

b) Currency risk

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Canada, Peru, 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 September 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):

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

FOR THE THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2009 AND 2008

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

**17. Management of financial risk (continued)**

## b) Currency risk (continued)

	September 30, 2009			December 31, 2008		
	Canadian Dollars	Nuevo Soles	Mexican Pesos	Canadian Dollars	Nuevo Soles	Mexican Pesos
Cash and cash equivalents	\$ 23,821	S/. 2,526	\$ 4,610	\$29,748	S/. 629	\$ 3,864
Accounts receivable	7	334	18,490	13	10,400	46,460
Accounts payable and accrued liabilities	(87)	(11,291)	(641)	(172)	(5,281)	(10,259)

Based on the above net exposure as at September 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)     \$   2,429

Impact to net income (loss)     \$   (325)   \$   200

## c) Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The Company's cash 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 September 30, 2009, the Company has a Mexican value added tax of \$1,294 and Peruvian value added tax of \$149. The Company expects to recover the full amounts from the Mexican and Peruvian Governments.

## d) Liquidity risk

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

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

FOR THE THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2009 AND 2008

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

**17. Management of financial risk (continued)**

## d) Liquidity risk (continued)

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

	<b>Expected payments due by period as at September 30, 2009</b>					Total
	Less than			After		
	1 year	1 - 3 years	4 - 5 years	5 years		
Accounts payable and accrued liabilities	\$ 6,370	\$ -	\$ -	\$ -	\$ 6,370	
Due to related parties, net	23	-	-	-	23	
Derivatives	3,065	-	-	-	3,065	
Capital lease obligations	1,037	894	-	-	1,931	
Long term liability	-	630	-	-	630	
<b>Total <sup>1</sup></b>	<b>\$ 10,495</b>	<b>\$ 1,524</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 12,019</b>	

<sup>1</sup> Amounts above do not include payments related to the following: (i) the Company's anticipated asset retirement obligation of \$1,887 associated with mine closure, land reclamation, and other environmental matters.

## e) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The risk that the Company will realize a loss as a result of a decline in the fair value 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.

## f) 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 FOR THE**

**THIRD QUARTER ENDED SEPTEMBER 30, 2009**

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

**FORTUNA SILVER MINES INC.**  
**Management's Discussion and Analysis**  
**For the third quarter ended September 30, 2009**  
**(Dollar amounts expressed in US dollars, unless otherwise indicated)**

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*Management's Discussion and Analysis ("MD&A") is intended to help the reader understand the significant factors that have affected Fortuna Silver Mines Inc. and its subsidiaries' ("Fortuna" or the "Company") performance and such factors that may affect its future performance. For a comprehensive understanding of Fortuna's financial condition and results of operations, this MD&A should be read in conjunction with the Company's unaudited consolidated financial statements for the nine months ended September 30, 2009 and the related notes contained therein. The Company reports its financial position, results of operations and cash flows in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). In addition, the following should be read in conjunction with the Consolidated Financial Statements of the Company for the year ended December 31, 2008, the related MD&A, and Fortuna's Annual Information Form (available on SEDAR at [www.sedar.com](http://www.sedar.com)). This MD&A refers to various non-GAAP measures, such as cash cost per tonne of processed ore, cash cost per ounce of payable silver, and adjusted net income (loss) used by the Company to manage and evaluate operating performance and ability to generate cash and are widely reported in the silver mining industry as benchmarks for performance. Non-GAAP measures do not have standardized meaning. Accordingly, non-GAAP measures should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP. To facilitate a better understanding of these measures as calculated by the Company, we have provided detailed descriptions and reconciliations where applicable.*

***This MD&A is prepared as of November 5, 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.

This MD&A also contains references to estimates of mineral reserves and mineral resources. The estimation of reserves and resources is inherently uncertain and involves subjective judgments about many relevant factors. The accuracy of any such estimates is a function of the quantity and quality of available data, and of the assumptions made and judgments used in engineering and geological interpretation, which may prove to be unreliable. There can be no assurance that these estimates will be accurate or that such mineral reserves and mineral resources can be mined or processed profitably. Mineral resources that are not mineral reserves do not have demonstrated economic viability. Except as required by law, the Company does not assume the obligation to revise or update these forward looking statements after the date of this document or to revise them to reflect the occurrence of future unanticipated events.

In particular, forward-looking information and statements include:

- The copper circuit is now scheduled to be commissioned in December 2009 (page 6);
- "Management plans to have all the engineering and permits required to initiate construction at San Jose concluded by year end." (page 7);

## **FORTUNA SILVER MINES INC.**

### **Management's Discussion and Analysis**

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

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- “The Company’s engineering staff is currently conducting an internal review of the various engineering projects and continues to work towards the delivery of the final study for December 2009.” (page 9);
- “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 11).

### **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**

During the third quarter of 2009, the Company generated record quarterly sales of \$13.23 million compared to \$7.49 million in the same period of 2008. This represents an increase of 77%.

The loss in the current quarter of \$0.57 million was due primarily to negative mark-to-market movements on our commodity hedge book. The Company’s base metal price protection program generated a loss on commodity contracts of \$3.47 million during the third quarter of 2009 compared to a gain of \$0.69 million for the same period of the prior year.

Adjusting for the mark-to-market effect on derivatives, the third quarter of 2009 resulted in adjusted net income of \$1.22 million compared to \$0.23 million for the same period of 2008. The increase of \$0.99 million is primarily a result of record mine operating income of \$7.07 million compared to \$1.73 million in the same period of 2008.

	Expressed in '000's			
	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
<b>NET (LOSS) INCOME FOR THE PERIOD</b>	\$ (556)	\$ (297)	\$ (414)	\$ 1,558
Items of note:				
<b>Mark-to-Market effect on derivatives</b>	<b>1,780</b>	528	<b>2,263</b>	(1,860)
<b>ADJUSTED NET INCOME (LOSS) FOR THE PERIOD <sup>(1)</sup></b>	<b>\$ 1,224</b>	\$ 231	<b>\$ 1,849</b>	\$ (302)

Cash generated by operating activities before changes in working capital for the period was \$2.66 million compared to \$2.58 million in the same period of 2008.

In the third quarter of 2009, silver production amounted to 438,186 ounces with a negative cash cost per ounce of payable silver of \$5.34. The Company’s Caylloma mine growth trend in metal production that had been showing for the prior 12 consecutive quarters has marginally declined this quarter. In the third quarter, 105,241 tonnes of ore were treated compared to 89,827 tonnes in the same period of 2008 and the cash cost per tonne of treated ore was \$45.09 (Cash cost is a non-GAAP measure. See page 10 for reconciliation of cash cost to the cost of sales in the consolidated statement of operations).

**FORTUNA SILVER MINES INC.**  
**Management's Discussion and Analysis**  
**For the third quarter ended September 30, 2009**  
**(Dollar amounts expressed in US dollars, unless otherwise indicated)**

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**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 released on August 27, 2009, 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.

**New Resource Estimate at San Jose**

On October 26, 2009, the Company released an updated NI 43-101 resource estimation for San Jose, with the full NI 43-101 to be released within 45 days of the release. Highlights are as follows:

Indicated Resources have increased 83% to 2.69 million tonnes with contained silver equivalent ounces increasing 112% to 37.6 million Ag Equivalent<sup>1</sup> ounces. Silver and gold grades in the Indicated Resource category have increased by 12% to 295 g/t and 4% to 2.27 g/t, respectively. The new resource estimate will serve as the basis for pre-feasibility level engineering studies projected for completion by year end.

At a cut-off grade of 150 g/t Ag Equivalent, the Indicated and Inferred Mineral Resources for the Trinidad Zone at San Jose are estimated at:

Indicated Mineral Resource:	2.69 million tonnes grading 295 g/t Ag and 2.27 g/t Au containing 37.6 million Ag Equivalent <sup>1</sup> ounces
Inferred Mineral Resource:	2.41 million tonnes grading 262 g/t Ag and 2.11 g/t Au containing 30.4 million Ag Equivalent <sup>1</sup> ounces.

<sup>1</sup>Silver equivalency estimates were derived using metal prices of US\$13.75/oz for silver and US\$856.16/oz for gold (36-month average + 24 month future metal prices as of July 31, 2009). Metallurgical recoveries were estimated at 92.5% for silver and 91.5% for gold based on metallurgical testing completed by Metcon Research of Tucson, Arizona.

**Approval of Environmental Impact Study for San Jose**

On October 23<sup>rd</sup>, 2009, the "Secretaria de Medio Ambiente y Recursos Naturales" (Mexican Environmental Agency) delivered the authorization of the Environmental Impact Study for full mine and mill construction and operation at the San Jose silver-gold project, located in the southern State of Oaxaca, Mexico.

The Environmental Impact Study authorizes the construction and future operation of the San Jose Mine, including the underground workings, processing plant, tailings facility and other surface infrastructure for a 1,500 tonne per day operation within an area of ninety-two hectares.

**FORTUNA SILVER MINES INC.****Management's Discussion and Analysis****For the third quarter ended September 30, 2009****(Dollar amounts expressed in US dollars, unless otherwise indicated)**

The permit contemplates a processing plant that will use conventional flotation for production of high grade silver- and gold- bearing concentrates. Test work indicates this metallurgical process allows for recoveries of 88% for both metals (see Fortuna release dated January 15, 2009) without the use of cyanide. The primary source of industrial water for the project will be from a gray-water treatment facility located thirteen kilometers from the mine site.

**Quarterly Information**

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

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

	Quarters Ended							
	30-Sep-09	30-Jun-09	31-Mar-09	31-Dec-08	30-Sep-08	30-Jun-08	31-Mar-08	31-Dec-07
Revenues	13,230	12,862	8,980	2,795	7,492	7,772	6,808	8,097
Mine operating income (loss) *	7,074	6,792	3,487	(2,986)	1,734	2,848	2,303	3,469
Net (loss) income	(556)	1,196	(1,054)	(2,468)	(297)	2,493	(638)	1,440
Net (loss) Income per share - basic	(0.01)	0.01	(0.02)	(0.03)	0.00	0.03	(0.01)	0.02
- diluted	(0.01)	0.01	(0.02)	(0.03)	0.00	0.03	(0.01)	0.02

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

**Financial Results**

During the third quarter of 2009, the Company generated record quarterly sales of \$13.23 million compared to \$7.49 million in the same period of 2008. This represents an increase of 77%. When broken down by type of concentrate: silver-lead concentrate sales increased in tonnage by 36%, and the unit value of concentrate increased by 15%. The latter increase is the combined result of an increase in lead price of 1% offset by a decrease in silver price of 2%, and lower smelter treatment charges of \$165 per ton of concentrate. Zinc concentrate sales increased in tonnage by 15% and the unit value of concentrate increased by 21%. The latter increase is a result of a decrease in the metal price of 1% and lower smelter treatment charges of \$124 per ton of concentrate. The quarterly sales also includes copper concentrates of 85 tonnes compared to nil in the same period of 2008.

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 third quarter of 2009 mine operating income was \$7.07 million, 308% above the \$1.73 million achieved in the same period of 2008. This improvement is a reflection of improved head grades, higher throughput, and better commercial terms. Contributing to the loss for the third quarter of \$0.56 million is primarily the non-operating loss in commodity contracts of \$3.47 million.

Mark-to-Market effect: Included in the \$3.47 million loss recorded on commodity contracts, is a mark-to market effect of \$2.26 million related to open contracts as at the end of September 2009 expiring between the months of October 2009 and June 2010.

**FORTUNA SILVER MINES INC.**

**Management's Discussion and Analysis**

**For the third quarter ended September 30, 2009**

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

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Total **cost of sales** for the third quarter of 2009 was \$6.16 million compared to \$5.76 million for the same period of 2008. While tonnage of concentrate sold in the third quarter of 2009 increased 24% with respect to the corresponding quarter in 2008, cost of sales increased only by 7% due to an increase in lead head grade offset by an increase of 1% in unit cash costs per ton. 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 third quarter of 2009 totalled \$2.56 million compared to \$2.09 million for the same period of 2008. The increase is due mainly to higher selling expenses associated with higher tonnage of concentrate sold. Corporate general and administrative expenses increased by \$0.35 million to \$1.78 million; selling and administrative expenses increased by \$0.07 million to \$0.66 million; and government royalty paid by Minera Bateas increased by \$0.06 million to \$0.12 million.

**Stock based compensation** charge totalled \$0.12 million for the third quarter of 2009, compared to \$0.03 million for the same period of 2008.

**Interest and other income and expenses** in the third quarter of 2009 amounted to net income of \$0.19 million compared to net income of \$0.38 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 third quarter 2009 were \$0.05 million compared to \$0.03 million for the same period of 2008. Interest expenses relate primarily to capital lease operations at our operating subsidiary.

**Net loss on commodity contract** for the third quarter of 2009 was \$3.47 million compared to a net gain of \$0.69 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. Included in the \$3.47 million loss recorded on commodity contracts, is a mark-to-market effect of \$2.26 million related to open contracts as at the end of September 2009 expiring between the months of October 2009 and June 2010. 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.

The \$1.31 million **Income tax provision** recorded in the third quarter of 2009 (2008: \$0.85 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 \$1.39 million (2008: \$0.02 million). Future income tax recoverable, amounting to \$0.08 million (2008: expense \$0.83 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.

**FORTUNA SILVER MINES INC.**  
**Management's Discussion and Analysis**  
**For the third quarter ended September 30, 2009**  
**(Dollar amounts expressed in US dollars, unless otherwise indicated)**

**Results of Operations**

Peru - Caylloma Ag-Pb-Zn Mine

Caylloma Mine	Quarters ended							
	30-Sep-09	30-Jun-09	31-Mar-09	31-Dec-08	30-Sep-08	30-Jun-08	31-Mar-08	31-Dec-07
<b>Tonnes milled</b>	105,241	100,881	91,449	91,025	89,827	80,121	70,408	68,615
<b>Average tons milled per day</b>	1,182	1,146	1,051	1,023	1,009	910	800	754
<b>Head Grade</b>								
Silver (g/t)	146.54	160.42	147.81	114.83	97.73	85.49	74.73	75.58
Lead (%)	2.95	3.20	3.11	2.97	2.58	2.29	1.94	1.87
Zinc (%)	3.58	3.82	3.83	3.75	3.64	3.75	3.42	3.09
Copper (%)	0.26	0.26	-	-	-	-	-	-
<b>Recoveries</b>								
Silver (%)*	84.20	86.48	84.58	82.43	80.07	78.12	76.42	77.74
Lead (%)	93.23	92.56	92.97	93.41	92.19	88.94	87.26	87.51
Zinc (%)	88.58	88.60	90.02	87.25	88.11	87.58	86.45	85.09
Copper (%)	7.29	8.60	-	-	-	-	-	-
<b>Production (metal contained)</b>								
Silver (oz)**	438,186	468,822	384,339	291,381	243,280	186,276	140,239	139,433
Lead (lbs)	6,391,201	6,587,412	5,831,227	5,564,467	4,715,688	3,600,149	2,621,296	2,478,107
Zinc (lbs)	7,365,644	7,526,582	6,948,970	6,560,957	6,342,699	5,795,953	4,583,410	3,979,686
Copper (lbs)	44,092	50,706	-	-	-	-	-	-
<b>Unit cash cost and Net smelter return</b>								
Unit cash cost (US\$/oz ag)	(5.34)	(2.98)	0.10	-	-	-	-	-
Unit cash cost (US\$/tonne)	45.09	43.39	44.37	44.60	44.43	46.92	49.97	52.41
Unit Net Smelter Return (US\$/tonne)	121.00	114.00	91.00	60.00	80.40	97.79	97.70	118.41

\* Silver recovery in lead and copper concentrates

\*\* Total silver production

In the third quarter of 2009, metal output at the Caylloma mine increased significantly with respect to the corresponding quarter of 2008 but decreased marginally with respect to the previous quarter. This slight decrease in metal production was contemplated in the annual mine plan. The mine continues to be on target to achieve its silver production forecast of 1.6 million ounces for 2009. Silver production reached 438,186 ounces; 7% decrease over the second quarter of 2009 and 80% increase over the third quarter of 2008. Lead production reached 2,899 tonnes; 3% decrease over the second quarter of 2009 and 36% increase over the third quarter of 2008. Zinc production reached 3,341 tonnes; 2% decrease over the second quarter of 2009 and 16% increase over the third quarter of 2008.

Increments against the third quarter of 2008 were achieved through a combination of higher grades, improved metallurgical recoveries, and a higher throughput which reached an average of 1,182 tpd for the third quarter of 2009, 17% above the average throughput rate for the corresponding quarter of 2008.

The copper circuit is now scheduled to be commissioned in December 2009.

Cash cost per ounce of payable silver net of by-product credits at Caylloma was negative \$5.34 for the third quarter of 2009 compared to negative \$2.98 for second quarter of 2009. This reduction in cash cost is due to higher credits from by-products. Cash cost per tonne of treated ore for the third quarter of 2009 was \$45.09

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compared to \$44.43 for the corresponding quarter of 2008. (See page 10 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 was filed on August 27, 2009. 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*

In January 2009, the Company entered into commodity forward contracts to secure a minimum price level on a portion 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. Subsequently the Company has been gradually extending its hedging programme for the remainder of 2009 and into the first half of 2010 with the objective of securing short term capital requirements for project development.

The contracts are spread evenly over the periods shown below with settlement occurring on a monthly basis:

settlements throughout February 2009 to July 2009:

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

settlements throughout August 2009 to December 2009:

Lead forward contracts:	\$1,645/t, for the total of 2,675 tons
Zinc forward contracts:	\$1,561/t, for the total of 3,000 tons

settlements throughout January 2010 to June 2010:

Lead forward contracts:	\$1,910/t, for the total of 1,800 tons
Zinc forward contracts:	\$1,787/t, for the total of 1,050 tons

Mexico – San Jose Silver-Gold Project

Management plans to have all the engineering and permits required to initiate construction at San Jose concluded by year end. Project staffing for the construction phase is being conducted and the Company has initiated selective searches for long lead equipment.

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*Trinidad Resource Estimation*

On October 26, 2009, the Company released an updated NI 43-101 resource estimation for San Jose, with the full NI 43-101 to be released within 45 days of the release. Highlights are as follows:

Indicated Resources have increased 83% to 2.69 million tonnes with contained silver equivalent ounces increasing 112% to 37.6 million Ag Equivalent<sup>1</sup> ounces. Silver and gold grades in the Indicated Resource category have increased by 12% to 295 g/t and 4% to 2.27 g/t, respectively. The new resource estimate will serve as the basis for pre-feasibility level engineering studies projected for completion by year end.

At a cut-off grade of 150 g/t Ag Equivalent, the Indicated and Inferred Mineral Resources for the Trinidad Zone at San Jose are estimated at:

Indicated Mineral Resource: 2.69 million tonnes grading 295 g/t Ag and 2.27 g/t Au containing 37.6 million Ag Equivalent<sup>1</sup> ounces  
Inferred Mineral Resource: 2.41 million tonnes grading 262 g/t Ag and 2.11 g/t Au containing 30.4 million Ag Equivalent<sup>1</sup> ounces.

<sup>1</sup>Silver equivalency estimates were derived using metal prices of US\$13.75/oz for silver and US\$856.16/oz for gold (36-month average + 24 month future metal prices as of July 31, 2009). Metallurgical recoveries were estimated at 92.5% for silver and 91.5% for gold based on metallurgical testing completed by Metcon Research of Tucson, Arizona.

The resource estimate incorporates data from 196 core drill holes totaling 64,204 meters and 908 underground channel samples. Previously reported NI 43-101 compliant resources for San Jose were estimated at 1.47 million tonnes grading 263 g/t Ag and 2.19 g/t Au in the Indicated category and 3.9 million tonnes grading 261 g/t Ag and 2.57 g/t Au in the Inferred category (see March 31, 2007 Technical Report available on the company website ([www.fortunasilver.com](http://www.fortunasilver.com)) and on SEDAR).

*Approval of Environmental Impact Study*

On October 23<sup>rd</sup>, 2009, the "Secretaria de Medio Ambiente y Recursos Naturales" (Mexican Environmental Agency) delivered the authorization of the Environmental Impact Study for full mine and mill construction and operation at the San Jose silver-gold project, located in the southern State of Oaxaca, Mexico.

The Environmental Impact Study authorizes the construction and future operation of the San Jose Mine, including the underground workings, processing plant, tailings facility and other surface infrastructure for a 1,500 tonne per day operation within an area of ninety-two hectares.

The permit contemplates a processing plant that will use conventional flotation for production of high grade silver- and gold- bearing concentrates. Test work indicates this metallurgical process allows for recoveries of 88% for both metals (see Fortuna release dated January 15, 2009) without the use of cyanide. The primary source of industrial water for the project will be from a gray-water treatment facility located thirteen kilometers from the mine site.

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*Other permits*

Management now looks forward to the approval of the "Estudio Técnico Justificativo" (change of land use) in the coming days; this permit will allow the commencement of construction activities.

On April 28, 2009, the "Comision Federal de Electricidad" (Mexican Federal Energy Commission) issued the permit to connect to the national power grid for up to five megawatts; sufficient power to cover the requirements of a 1,500 tonnes per day mine operation. The future transformer sub-station site will be located within five hundred meters of the main high voltage power line which runs through the Company's property.

*Project Engineering*

The Company has received from its consultants all the engineering components that make up the San Jose Pre-Feasibility Study which include the processing plant, tailings facility, power project, water project, surface infrastructure, mine design, and other matters. The Company's engineering staff is currently conducting an internal review of the various engineering projects and continues to work towards the delivery of the final study for December 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.

Mexico - Tlacolula Silver Project

In September 2009, the Company was granted an option to acquire a 60% interest in the Tlacolula silver project located in the State of Oaxaca, Mexico from Radius Gold Inc. ("Radius") (a related party by way of directors in common with the Company). The Company can earn the interest by spending \$2 million, which includes a commitment to drill 1,500 meters within three years, and making staged annual payments of \$0.25 million cash and \$0.25 million in common stock to Radius according to the following schedule:

- \$0.02 million cash and \$0.02 million cash equivalent in shares upon stock exchange approval;
- \$0.03 million cash and \$0.03 million cash equivalent in shares by the first year anniversary;
- \$0.05 million cash and \$0.05 million cash equivalent in shares by the second year anniversary;
- \$0.05 million cash and \$0.05 million cash equivalent in shares by the third year anniversary; and,
- \$0.10 million cash and \$0.10 million cash equivalent in shares by the fourth year anniversary.

As at September 30, 2009, the transaction is pending stock exchange approval and no payments have been made.

The 12,000 ha Tlacolula property is located 14km E-SE of the city of Oaxaca, 20km north of the Taviche District, where high-grade silver has been mined since Spanish colonial times, and is 30km northeast of the Company's 100% owned San Jose silver-gold development project.

**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

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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:

	<b>\$'000's</b>
<b>Cost of sales</b>	<b>6,156</b>
<b>Add / (Subtract)</b>	
Change in inventory (ore and concentrate stock piles)	102
Depletion, depreciation, and accretion	(1,513)
<b>Cash cost</b>	<b>4,745</b>
<b>Total processed ore (tonnes)</b>	<b>105,241</b>
<b>Cash cost per tonne of processed ore (\$/t)</b>	<b>45.09</b>
<b>Cash cost</b>	<b>4,745</b>
<b>Add / (Subtract)</b>	
By-product credits <sup>1</sup>	(7,179)
Refining charges	354
<b>Cash cost applicable per payable ounce</b>	<b>(2,080)</b>
<b>Payable silver ounces</b>	<b>389,836</b>
<b>Cash cost per ounce of payable silver (\$/oz)</b>	<b>(5.34)</b>

<sup>1</sup> By-product credits are included in the provisional liquidation

**Liquidity and Capital Resources**

The Company's cash resources and liquid investments as at September 30, 2009 were \$33.68 million compared to \$29.45 million as at December 31, 2008.

During the third quarter of 2009, cash generated by operating activities before changes in working capital was \$2.66 million. Further liquidity provided by changes in working capital amounted to \$0.86 million, for total cash generated by operating activities of \$3.51 million.

During the third quarter of 2009, the Company invested a total amount of \$2.72 million in mineral properties and \$0.99 million in plant and equipment. Additionally, the Company collected a net amount of value added tax refundable credit from the Mexican Government of \$0.05 million. This is net of value added tax disbursements on local expenses during the period.

As at September 30, 2009, the Company had working capital of \$34.86 million compared to working capital of \$34.06 million at December 31, 2008.

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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.

#### **Guarantees and Indemnifications**

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

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

The Company acts as a 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.

#### **Off-Balance Sheet Arrangements**

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

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

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

<b>Transactions with related parties</b>	<b>Expressed in \$'000's</b>							
	<b>Three months ended September 30, 2009</b>		<b>Nine months ended September 30, 2009</b>					
Consulting fees <sup>1</sup>	\$	38	\$	27	\$	103	\$	42
Salaries and wages <sup>2</sup>		28		45		88		58
Other general and administrative expenses <sup>3</sup>		36		39		102		39
	\$	102	\$	111	\$	293	\$	139

<sup>1</sup> Consulting fees includes fees paid to two directors, Simon Ridgway and Mario Szotlender.

<sup>2,3</sup> Radius Gold Inc. ("Radius") 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.

<sup>2</sup> 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.

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In September 2009, the Company was granted an option to acquire a 60% interest in the Tlacolula silver project located in the State of Oaxaca, Mexico from Radius. Refer to Notes to the Consolidated Financial Statements Note 9. d).

<b>Amounts due to/(from) related parties</b>	<b>Expressed in \$'000's</b>	
	<b>September 30, 2009</b>	<b>December 31, 2008</b>
Owing to a director	\$ -	\$ -
Owing to a company with common directors <sup>3</sup>	\$ 23	\$ 38
	<b>\$ 23</b>	<b>\$ 38</b>

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.

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*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 cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, due to related parties, net approximate their fair value due to the relatively short periods to maturity and the terms of these financial instruments.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and, therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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 September 30, 2009 the Company estimated the fair value of the outstanding contracts to constitute a liability of \$3.07 million, and

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recorded a loss in the consolidated statements of operations for the third quarter of 2009 of \$3.47 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 the 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 September 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):

	<b>Expressed in '000's</b>					
	<b>September 30, 2009</b>			<b>December 31, 2008</b>		
	<b>Canadian Dollars</b>	<b>Nuevo Soles</b>	<b>Mexican Pesos</b>	<b>Canadian Dollars</b>	<b>Nuevo Soles</b>	<b>Mexican Pesos</b>
Cash and cash equivalents	\$ 23,821	S/. 2,526	\$ 4,610	\$29,748	S/. 629	\$ 3,864
Accounts receivable	7	334	18,490	13	10,400	46,460
Accounts payable and accrued liabilities	(87)	(11,291)	(641)	(172)	(5,281)	(10,259)

Based on the above net exposure as at September 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)	\$ 2,429		
Impact to net income (loss)		\$ (325)	\$ 200

*(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

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Company's trade accounts receivables are held with large international metals trading companies. As at September 30, 2009, the Company has a Mexican value added tax of \$1.29 million and Peruvian value added tax of \$0.15 million. 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.

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

	<b>Expressed in '000's</b>					<b>Total</b>
	<b>Expected payments due by period as at September 30, 2009</b>					
	Less than		After			
	1 year	1 - 3 years	4 - 5 years	5 years		
Accounts payable and accrued liabilities	\$ 6,370	\$ -	\$ -	\$ -	\$ -	\$ 6,370
Due to related parties, net	23	-	-	-	-	23
Derivatives	3,065	-	-	-	-	3,065
Capital lease obligations	1,037	894	-	-	-	1,931
Long term liability	-	630	-	-	-	630
<b>Total</b> <sup>1</sup>	<b>\$ 10,495</b>	<b>\$ 1,524</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 12,019</b>

<sup>1</sup> Amounts above do not include payments related to the following: (i) the Company's anticipated asset retirement obligation of \$1,887 associated with mine closure, land reclamation, and other environmental matters.

*(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.

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**Other Data**

Additional information related to the Company is available for viewing at [www.sedar.com](http://www.sedar.com) and the Company's website at [www.fortunasilver.com](http://www.fortunasilver.com).

**Share Position and Outstanding Warrants and Options**

The Company's outstanding share position at November 5, 2009 is 94,863,684 common shares. In addition, a total of 8,894,000 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>
Director/Employee Stock Options:	29,000	\$0.37	December 2, 2009
	30,000	\$0.80	July 24, 2010
	270,000	\$1.35	February 5, 2016
	250,000	\$2.29	March 30, 2016
	60,000	\$1.75	May 8, 2016
	200,000	\$1.75	May 22, 2016
	20,000	\$0.85	July 5, 2016
	225,000	\$1.55	July 5, 2016
	860,000	\$1.66	July 10, 2016
	225,000	\$1.61	September 13, 2016
	110,000	\$0.85	January 11, 2017
	700,000	\$2.22	January 11, 2017
	50,000	\$2.75	February 6, 2017
	15,000	\$0.85	April 22, 2017
	10,000	\$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	October 24, 2017
	250,000	\$2.52	February 5, 2018
	150,000	\$1.25	August 25, 2018
	1,190,000	\$0.85	October 5, 2018
	650,000	\$0.85	November 5, 2018
	250,000	\$0.83	July 6, 2019
	2,150,000	\$1.60	October 27, 2019
<b>TOTAL OUTSTANDING OPTIONS:</b>	<b><u>8,894,000</u></b>		

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**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 the following Handbook Sections: Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Intangible Assets", Section 3450, "Research and Development Costs", and 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 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.

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*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 has 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.

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**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 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. In the third quarter of 2009, the Company completed a high-level impact assessment to identify key areas that will be affected by the conversion. The detailed analysis of the IFRS - Canadian GAAP differences, and the selection of accounting policy choices under IFRS has commenced and is expected to be completed by the end of the fourth quarter 2009. The Company will continue to monitor changes in IFRS leading up to the changeover date, and will update its conversion plan as required.

*Business Combinations*

In January 2009, the CICA issued the following Handbook Sections: 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.

*Comprehensive revaluation of assets and liabilities and Equity*

In August 2009, the CICA amended Section 1625, "Comprehensive revaluation of assets and liabilities" as a result of issuing "Business Combinations, Section 1582, "Consolidated Financial Statements", Section 1601, and Non-Controlling Interests", Section 1602, in January 2009.

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In August 2009, the CICA amended Section 3251, "Equity" as a result of issuing Section 1602, "Non-controlling Interests". These amendments only apply to entities that have adopted Section 1602.

These amendments apply prospectively to comprehensive revaluations of assets and liabilities occurring in fiscal years beginning on or after January 1, 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.

*Financial Instruments and Impaired Loans*

In August 2009, the CICA issued amendments to Section 3855, "Financial Instruments: Recognition and Measurement". These amendments will permit (or require in certain circumstances) entities to reclassify certain investments in debt instruments, will amend the guidance regarding impairment measurement for Held to Maturity debt instruments and will require reversals of impairment losses for Available for Sale debt instruments when conditions have changed. These amendments apply only to investments in debt instruments and do not apply to investments in equity investments or to debt instruments that have been designated at origination as Held for Trading.

In August 2009, the CICA amended Section 3025, "Impaired loans" to conform with the definition of a loan to that in amended Section 3855 and to include held-to-maturity investments within the scope of this Section.

These amendments are effective for annual financial statements relating to fiscal years beginning on or after November 1, 2008 with early adoption permitted for interim financial statements issued on or after August 20, 2009. 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 58% of zinc and lead production between the months of August and June 2010.

*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.

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The Company currently holds derivatives contracts with Standard Bank PLC, Banco Bilbao Vizcaya Argentaria, S.A., Macquarie Bank Limited, and Goldman Sachs.

*Environmental risk*

The Company has recorded an asset retirement obligation of \$1.89 million as of September 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 Resources 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.

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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**

The Company evaluated the effectiveness of the design and operation of the disclosure controls and procedures as of September 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 September 30, 2009 and has concluded there are no material weaknesses. Management continues to review and refine its internal controls and procedures.