



FINANCIAL REVIEW

Third Quarter ended June 30, 2006

FORTUNA SILVER MINES INC.
(Formerly Fortuna Ventures Inc.)

INTERIM CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2006

(Unaudited – Prepared by Management)

(Expressed in Canadian Dollars)

UNAUDITED FINANCIAL STATEMENTS: In accordance with National Instrument 51-102 of the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited financial statements for the nine month period ended June 30, 2006.

FORTUNA SILVER MINES INC.
(Formerly Fortuna Ventures Inc.)
INTERIM CONSOLIDATED BALANCE SHEETS
AS AT JUNE 30, 2006
(Unaudited - Prepared by Management)
(Expressed in Canadian Dollars)

	June 30, 2006	September 30, 2005
ASSETS		
CURRENT		
Cash and equivalents	\$ 8,691,342	\$ 5,850,257
Temporary investments (Note 3)	4,732,277	-
GST and value-added taxes receivable	821,564	39,730
Advances and other receivables	937,980	215
Inventory	393,231	-
Prepaid expenses and deposits	536,133	41,410
Due from related parties (Note 5)	48,093	-
	16,160,620	5,931,612
PROPERTY, PLANT & EQUIPMENT (Note 6, 11)	4,655,892	21,534
ADVANCES FOR EXPLORATION	-	-
MINERAL PROPERTIES (Note 11)	20,108,990	18,187,993
INVESTMENTS (Note 3)	1,000,000	-
	\$ 41,925,502	\$ 24,141,139
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities (Note 5)	\$ 781,514	\$ 870,663
Due to related parties (Note 5)	65,342	8,925
Notes payable (Note 4)	-	5,270,850
	846,856	6,150,438
Asset retirement obligations	1,578,441	1,578,441
Future income tax liability	1,207,149	1,207,149
	3,632,446	8,936,028
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (Note 8)	40,614,932	12,163,851
SHARE SUBSCRIPTIONS	-	2,030,888
OBLIGATION TO ISSUE SHARES AND WARRANTS	-	4,584,954
CONTRIBUTED SURPLUS	4,173,166	296,313
DEFICIT	(6,495,042)	(3,870,895)
	38,293,056	15,205,111
	\$ 41,925,502	\$ 24,141,139

APPROVED BY THE DIRECTORS:

"signed"
 Jorge Ganoza Durant, Director

"signed"
 Simon Ridgway, Director

FORTUNA SILVER MINES INC.
(Formerly Fortuna Ventures Inc.)
INTERIM CONSOLIDATED STATEMENTS OF DEFICIT
FOR THE NINE MONTH PERIOD ENDED JUNE 30, 2006
(Unaudited - Prepared by Management)
(Expressed in Canadian Dollars)

	Three Month Period Ended June 30,		Nine Month Period Ended June 30,	
	2006	2005	2006	2005
DEFICIT - BEGINNING OF PERIOD	\$ (6,857,921)	\$ (3,517,658)	\$ (3,870,895)	\$ (3,265,262)
Net gain/(loss) for the period	362,879	(151,070)	(2,624,147)	(403,466)
DEFICIT - END OF PERIOD	\$ (6,495,042)	\$ (3,668,728)	\$ (6,495,042)	\$ (3,668,728)

FORTUNA SILVER MINES INC.
INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE NINE MONTH PERIOD ENDED JUNE 30, 2006
(Unaudited - Prepared by Management)
(Expressed in Canadian Dollars)

	Three Month Period Ended June 30,		Nine Month Period Ended June 30,	
	2006	2005	2006	2005
EXPENSES				
Amortization	1,685	42	4,910	42
Bank charges and interest	660	1,334	1,702	1,814
Consulting	34,128	16,785	189,006	39,071
Accounting & legal	8,126	40,895	37,339	85,591
Management fees	24,616	-	61,321	2,629
Non cash compensation charge (Note 8)	(19,925)	-	2,193,325	79,646
Office and miscellaneous	4,562	13,203	28,096	23,018
Property investigations	-	-	710	-
Public relations	(108,345)	3,573	262,300	34,980
Regulatory and stock exchange fees	5,804	2,905	39,154	16,261
Rent and utilities	8,361	10,800	18,106	12,714
Salaries and wages	35,120	46,599	107,210	71,884
Telephone and fax	6,908	4,099	14,554	5,912
Travel and accommodation	15,982	17,967	63,567	37,036
LOSS BEFORE OTHER ITEMS	(17,682)	(158,202)	(3,021,300)	(410,598)
OTHER INCOME (EXPENSES)				
Write-off of deferred exploration costs	-	-	(39,511)	-
Interest and miscellaneous income	126,394	-	190,671	-
Foreign exchange gain (Note 4)	254,168	7,132	245,993	7,132
	<u>380,562</u>	<u>7,132</u>	<u>397,153</u>	<u>7,132</u>
NET INCOME/(LOSS) FOR THE PERIOD	\$ 362,879	\$ (151,070)	\$ (2,624,147)	\$ (403,466)
EARNINGS/(LOSS) PER SHARE	\$ 0.01	\$ (0.02)	\$ (0.08)	\$ (0.06)
Weighted average number of shares outstanding	<u>50,112,277</u>	<u>6,411,051</u>	<u>31,274,510</u>	<u>6,377,831</u>

FORTUNA SILVER MINES INC.
(Formerly Fortuna Ventures Inc.)
INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED JUNE 30, 2006
(Unaudited - Prepared by Management)
(Expressed in Canadian Dollars)

	Three Month Period Ended		Nine Month Period Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
OPERATING ACTIVITIES				
Net loss for the period	\$ 362,879	\$ (151,070)	\$ (2,624,147)	\$ (403,466)
Items not involving cash				
Amortization	1,685	42	4,910	42
Write-off of deferred exploration costs	-	-	39,511	-
Stock based compensation charge	(19,925)	-	2,193,325	79,646
	344,640	(151,028)	(386,401)	(323,778)
Changes in non-cash working capital items	(1,577,110)	34,370	(2,696,702)	99,193
	(1,232,470)	(116,658)	(3,083,103)	(224,585)
FINANCING ACTIVITIES				
Proceeds on issuance of common shares	1,683,211	1,186,742	23,450,767	1,186,742
Due from related parties (Note 5)	(35,576)	(8,522)	(48,093)	(8,522)
Due to related parties (Note 5)	47,758	(13,541)	56,417	128,228
Payment of notes payables (Note 4)	(5,270,850)	-	(5,270,850)	-
	(3,575,457)	1,164,679	18,188,241	1,306,448
INVESTING ACTIVITIES				
Mineral property costs	(2,846,041)	(113,515)	(5,031,848)	(374,676)
Business acquisition costs	-	(168,768)	-	(291,158)
Temporary investment	(4,732,277)	-	(4,732,277)	-
Investment	-	-	(1,000,000)	-
Purchase of plant & equipment	(1,268,660)	(10,790)	(1,499,928)	(13,700)
	(8,846,978)	(293,073)	(12,264,053)	(679,534)
INCREASE (DECREASE) IN CASH	(13,654,905)	754,948	2,841,085	402,329
Cash - beginning of period	22,346,247	43,702	5,850,257	396,321
CASH - END OF PERIOD	\$ 8,691,342	\$ 798,650	\$ 8,691,342	\$ 798,650
Supplementary disclosure of cash flow information:				
Cash paid for interest	\$ -	\$ -	\$ -	\$ -
Cash paid for income taxes	\$ -	\$ -	\$ -	\$ -

Non-cash Transactions - Note 10

Fortuna Silver Mines Inc.**(Formerly Fortuna Ventures Inc.)**

Notes to the Interim Consolidated Financial Statements

(Unaudited – Prepared by Management)

Nine Months Ended June 30, 2006

1. Nature and Continuance of Operations

On June 28, 2005 Fortuna Silver Mines Inc. (the “Company”) changed its name from Fortuna Ventures Inc. The consolidated financial statements contained herein include the accounts of the Company and its wholly-owned subsidiaries located in Guatemala and Peru.

The Company is in the business of acquiring, exploring and developing mineral resource properties and is presently in the process of exploring and developing its mineral properties in Peru and Mexico. The Company has determined that the Caylloma properties in Peru contain reserves that it expects to be economically recoverable, and has adequate funding to take the project to completion. The Company has not yet determined whether its other properties contain reserves that are economically recoverable.

The interim period consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles. All financial summaries included are presented on a comparative and consistent basis showing the figures for the corresponding period in the preceding year. The preparation of financial data is based on accounting principles and practices consistent with those used in the preparation of the annual financial statements. Certain information and footnote disclosure normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These interim period statements should be read together with the audited financial statements and the accompanying notes included in the Company’s latest annual report. In the opinion of the Company, its unaudited interim consolidated financial statements contain all adjustment necessary in order to present a fair statement of the results of the interim periods presented.

2. Significant Accounting Policies

The interim consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles. Due to precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements for a period necessarily involves the use of estimates, which have been made using careful judgment. Actual results may differ from these estimates.

a) Cash and equivalents

Cash and cash equivalents include highly liquid investments with original maturities of three months or less.

b) Mineral Properties

The Company defers the cost of acquiring, maintaining its interest, exploring and developing mineral properties until such time as the properties are placed into production, abandoned, sold or considered to be impaired in value. Costs of producing properties will be amortized on a unit of production basis and costs of abandoned properties are written-off. Proceeds received on the sale of interests in mineral properties are credited to the carrying value of the mineral properties, with any excess included in operations. Write-downs due to impairment in value are charged to operations.

Fortuna Silver Mines Inc.

(Formerly Fortuna Ventures Inc.)

Notes to the Interim Consolidated Financial Statements

(Unaudited – Prepared by Management)

Nine Months Ended June 30, 2006

2. Significant Accounting Policies – (cont'd)

b) Mineral Properties (cont'd)

The Company is in the process of exploring and developing its mineral properties. Management reviews the carrying value of mineral properties on a periodic basis and will recognize impairment in value based upon current exploration results, the prospect of further work being carried out by the Company, the assessment of future probability of profitable revenues from the property or from the sale of the property. Amounts shown for properties represent costs incurred net of write-downs and recoveries, and are not intended to represent present or future values.

Environmental expenditures that relate to current operations are expensed or capitalized as appropriate. Expenditures that relate to an existing condition caused by past operations and which do not contribute to current or future revenue generation are expensed. Liabilities are recorded when environmental assessments and/or remedial efforts are probable, and the costs can be reasonably estimated. Generally, the timing of these accruals coincides with the earlier of completion of a feasibility study or the Company's commitment to a plan of action based on the then known facts.

c) Basic and Diluted Loss Per Share

When there is a loss for the period, basic loss per share ("LPS") applies and is calculated by dividing the net loss applicable to common shareholders by the weighted average number of common shares outstanding for the year. Potentially dilutive securities are excluded from the calculation of LPS, as they were anti-dilutive.

When there is a gain for the period, diluted LPS applies and is calculated by including in the weighted average number of shares the potential dilution that could occur if potentially dilutive securities are exercised or converted to common stock.

d) Stock-based Compensation

Effective for fiscal years commencing on or after January 1, 2004, Canadian generally accepted accounting principles require the fair value of all share purchase options granted on or after fiscal years commencing on or after January 1, 2002 to be expensed over their vesting period with a corresponding increase to contributed surplus. Upon exercise of share purchase options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital. The Company had not granted any share purchase options prior to October 1, 2004 and accordingly this change in policy has no effect on prior year's operations

e) Asset Retirement Obligations

The fair value of obligations associated with the retirement of tangible long-lived assets are recorded in the period in which it is incurred and a reasonable estimate of the fair value can be made, with a corresponding increase to the carrying amount of the related asset. The obligations recognized are statutory, contractual or legal obligations. The liability is accreted over time for changes in the fair value of the liability through charges to accretion, which is included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized in a manner consistent with the depletion and depreciation of the related asset.

Fortuna Silver Mines Inc.**(Formerly Fortuna Ventures Inc.)**

Notes to the Interim Consolidated Financial Statements

(Unaudited – Prepared by Management)

Nine Months Ended June 30, 2006

2. Significant Accounting Policies – (cont'd)

f) Foreign Currency Translation

Monetary items denominated in a foreign currency are translated into Canadian dollars at exchange rates prevailing at the balance sheet date and non-monetary items are translated at exchange rates prevailing when the assets were acquired or obligations incurred. Foreign currency denominated revenue and expense items are translated at the exchange rates prevailing at the transaction date. Gains or losses arising from the translations are included in operations.

3. Investments

Temporary Investments

Investments under current assets consist of a portfolio of money market instruments and highly liquid debt securities. The company carries these investments at cost.

Investments

The Company purchased by way of a private placement 5,000,000 shares of Continuum Resources Ltd. at a price of \$0.20 per share for a total purchase price of \$1,000,000. Continuum is required to use the proceeds to perform geological work on other silver projects that Continuum holds in the State of Oaxaca, Mexico and for the acquisition of additional silver targets in that State. Continuum has granted to the Company an exclusive right to review all data prepared by or made available to Continuum in respect of those properties and an exclusive right to acquire an undivided 60% interest in Continuum's interest in any of those properties upon the Company conducting additional exploration activities on a property in an amount not less than the greater of (a) twice the amount expended by Continuum on that property and (b) \$500,000.

The investment is carried at cost less "other than temporary" impairments.

4. Note Payable

The US\$4,500,000, non-interest bearing note payable secured by the shares of Bateas, was paid on June 27, 2006. The CDN value was \$5,270,850 which generated a foreign exchange gain of \$200,700 CDN.

5. Related Party Transactions

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

	Nine Month Period Ending June 30,	
	<u>2006</u>	<u>2005</u>
Mineral property costs – geological fees	\$ 90,180	\$ 13,137
Consulting fees	\$ 60,342	\$ 18,522
Salaries and wages	\$ 9,556	\$ 58,000
Management fees	\$ 61,321	\$ -

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

Fortuna Silver Mines Inc.**(Formerly Fortuna Ventures Inc.)**

Notes to the Interim Consolidated Financial Statements

(Unaudited – Prepared by Management)

Nine Months Ended June 30, 2006

5. Related Party Transactions – (cont'd)

At June 30, 2006, accounts payable and accrued liabilities included \$nil (Sept 2005: \$181,036) to a company with a common director.

At June 30, 2006, due to related parties consists of an amount owing to an officer and to companies with a common director. These amounts were incurred as a result of shared administrative costs. These amounts are unsecured, non-interest bearing and payable in the normal course of business.

At June 30, 2006, due from related parties consists of amounts owed from companies with a common director which were incurred as a result of shared administrative costs. This amount is unsecured, non-interest bearing and will be collected in the normal course of business.

6. Property Plant & Equipment

	As at June 30, 2006		
Canada	Cost	Accumulated Amortization	Net
Office furniture & equipment	\$ 1,271	\$ 198	\$ 1,073
Computer hardware	11,845	2,116	9,729
	<u>\$ 13,116</u>	<u>\$ 2,315</u>	<u>\$ 10,802</u>
Peru			
Office furniture & equipment	\$ 93,380	\$ 693	\$ 92,687
Computer hardware	91,740	2,982	88,758
Machinery & equipment	2,176,105	1,963	2,174,142
Buildings	1,235,297	-	1,235,297
Vehicles	7,080	-	7,080
Construction in progress	1,044,216	-	1,044,216
	<u>\$ 4,647,819</u>	<u>\$ 5,639</u>	<u>\$ 4,642,181</u>
Guatemala			
Office furniture & equipment	\$ 2,910	\$ -	\$ 2,910
	<u>\$ 4,663,846</u>	<u>\$ 7,953</u>	<u>\$ 4,655,892</u>

Fortuna Silver Mines Inc.
(Formerly Fortuna Ventures Inc.)
Notes to the Interim Consolidated Financial Statements
(Unaudited – Prepared by Management)
Nine Months Ended June 30, 2006

7. Mineral Properties

The Company's mineral properties are located in Peru and Mexico. Expenditures incurred on the properties are as follows:

	General Exploration	Guatemala El Tambor	Mexico San Jose	Peru Caylloma	Nine Month Period Ended Jun. 30, 2006	Year Ended Sept. 30, 2005
<u>ACQUISITION COSTS</u>						
BALANCE - BEGINNING OF PERIOD	\$ -	\$ -	\$ -	\$ 12,772,059	\$ 12,772,059	\$ 3,457
Acquired mineral rights						
Shares	-	-	68,000	-	68,000	4,584,954
Cash	-	-	-	75,025	75,025	8,187,105
	-	-	68,000	75,025	143,025	12,772,059
Write-off Acquisition Costs	-	-	-	-	-	(3,457)
BALANCE - END OF PERIOD	-	-	68,000	12,847,084	12,915,084	12,772,059
<u>EXPLORATION PROPERTY COSTS</u>						
BALANCE - BEGINNING OF PERIOD	\$ 8,471	\$ -	\$ -	\$ -	\$ 8,471	\$ -
Resource property overhead	1,306	36,237	113,158	-	150,701	155,607
Camp, equipment and supplies	-	76	19,499	-	19,575	1,281
Drilling & Assays	-	-	892,166	-	892,166	3,441
Geological consulting	1,772	3,199	113,767	-	118,738	27,342
	3,078	39,511	1,826,466	-	1,869,055	187,671
Write-off Exploration Costs	-	(39,511)	-	-	(39,511)	(179,200)
BALANCE - END OF PERIOD	11,549	-	1,826,466	-	1,838,015	8,471
<u>ASSET RECLAMATION OBLIGATION</u>						
BALANCE - BEGINNING OF PERIOD	\$ -	\$ -	\$ -	\$ 1,578,441	\$ 1,578,441	\$ -
Asset reclamation obligation	-	-	-	-	-	1,578,441
	-	-	-	-	-	1,578,441
BALANCE - END OF PERIOD	-	-	-	1,578,441	1,578,441	1,578,441
<u>MINE CONSTRUCTION IN PROGRESS</u>						
BALANCE - BEGINNING OF PERIOD	\$ -	\$ -	\$ -	\$ 689,682	\$ 689,682	\$ 18,019
Mine Development	-	-	-	310,765	310,765	19,313
Mine drilling and assays	-	-	-	796,097	796,097	47,442
Mine camp, consulting, legal	-	-	-	1,344,448	1,344,448	604,908
Salaries and wages	-	-	-	373,201	373,201	-
Administrative overhead	-	-	-	263,257	263,257	-
	-	-	-	3,087,769	3,087,769	671,663
BALANCE - END OF PERIOD	-	-	-	3,777,451	3,777,451	689,682
TOTAL MINERAL PROPERTIES	\$ 11,549	\$ -	\$ 1,894,466	\$ 18,202,975	\$ 20,108,990	\$ 15,048,653

Fortuna Silver Mines Inc.

(Formerly Fortuna Ventures Inc.)

Notes to the Interim Consolidated Financial Statements

(Unaudited – Prepared by Management)

Nine Months Ended June 30, 2006

7. Mineral Properties – (cont'd)

a) Caylloma Mine, Peru

During the year ended September 30, 2005, the Company acquired a 100% interest in the Caylloma Mine in southern Peru. A 2% net smelter returns royalty payable to the vendors will accrue after 21 million ounces of silver have been recovered from the property.

b) San Jose Project, Mexico

In 2005, the Company reached an agreement with Continuum Resources Ltd. (“Continuum”) in which the Company can earn a 70% interest in Continuum’s 80% share of the San Jose silver-gold project located in Oaxaca, Mexico. In addition, Continuum may make certain cash and share payments to earn an 80% interest in the property and has right of first refusal on the remaining 20%.

In order to keep the option in good standing, the Company must spend CAD\$2 million in exploration by December 2007, primarily on diamond drilling, with a minimum of \$1.0 million to be spent on or before August 1, 2006 (spent). At the termination of the drill program, and based on a NI 43-101 compliant resource calculation, the Company will be required to pay Continuum US\$0.50 for each ounce of silver or silver equivalent in the Measured resource category, and US\$0.35 for each ounce of silver or silver equivalent in the Indicated resource category corresponding to the interest of the Company in the ounces.

Fortuna Silver Mines Inc.
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Notes to the Interim Consolidated Financial Statements
(Unaudited – Prepared by Management)
Nine Months Ended June 30, 2006

8. Capital Stock

Authorized			
Unlimited common shares without par value			
Issued	Number of Shares	Price per share \$	Amount
Balance, September 30, 2004	6,452,691		\$ 3,697,482
Cancellation of shares for debt	(4,000)	0.25	(1,000)
Cancellation of escrow shares	(87,470)	0.07	(6,123)
Private placement for cash	1,500,000	0.70	1,050,000
Private placement for cash	9,600,000	0.75	7,200,000
Property acquisition	574,744	0.35	198,287
Exercise of options	47,500	0.37	17,575
Exercise of warrants	2,000,000	0.30	600,000
Transfer of contributed surplus on exercise of options	47,500	0.16	7,530
	<u>13,630,774</u>		<u>9,066,269</u>
Less issue costs			(599,900)
Balance, September 30, 2005	<u>20,083,465</u>		<u>\$ 12,163,851</u>
Exercise of options	277,500	0.37	102,675
Exercise of options	77,500	0.72	55,800
Exercise of options	205,000	0.80	164,000
Exercise of options	45,000	1.35	60,750
Exercise of warrants	1,500,000	0.75	1,125,000
Exercise of warrants	921,215	0.80	736,972
Exercise of warrants	1,643,368	1.00	1,643,368
Private placement for cash	4,000,000	0.75	3,000,000
Private placement for cash	12,700,000	1.50	19,050,000
Private placement commission	760,261	1.50	1,140,392
Property acquisition	1,897,621	1.43	2,713,598
Property acquisition	50,000	1.36	68,000
Transfer of contributed surplus on exercise of options	277,500	0.16	43,979
Transfer of contributed surplus on exercise of options	77,500	0.50	38,750
Transfer of contributed surplus on exercise of options	175,000	0.26	38,150
Transfer of contributed surplus on exercise of options	10,000	0.91	9,100
Transfer of contributed surplus on exercise of options	35,000	1.19	41,650
Transfer of contributed surplus on exercise of options	30,000	0.54	16,200
Less issue costs			(1,597,303)
Balance, June 30, 2006	<u><u>44,160,930</u></u>		<u><u>\$ 40,614,932</u></u>

Stock Options

The Company has established a formal stock option plan in accordance with the policies of the TSX-V 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 equals the market price of the Company's stock as calculated on the date of grant. Upon the Company becoming a Tier 1 issuer on the TSX Venture Exchange on January 13, 2006, the options are for a maximum term of ten years.

Fortuna Silver Mines Inc.
(Formerly Fortuna Ventures Inc.)

Notes to the Interim Consolidated Financial Statements
(Unaudited – Prepared by Management)
Nine Months Ended June 30, 2006

8. Capital Stock (cont'd)

Stock Options (cont'd)

The following stock options were outstanding at June 30, 2006:

<u>Number of shares</u>	<u>Exercise Price \$</u>	<u>Expiry Date</u>
125,000	2.29	March 30, 2007
177,500	0.37	December 2, 2009
72,500	0.72	July 13, 2010
50,000	0.80	July 24, 2010
75,000	1.35	November 17, 2010
675,000	1.35	February 5, 2016
500,000	2.29	March 30, 2016
130,000	1.75	May 8, 2016
200,000	1.75	May 22, 2016
<u>2,005,000</u>		

Warrants

The following share purchase warrants were outstanding at June 30, 2006:

<u>Number of shares</u>	<u>Exercise Price \$</u>	<u>Expiry Date</u>
50,000	1.50	February 20, 2007
952,275	1.85	September 23, 2007
8,970,000	1.25	September 26,2007
272,785	0.80	September 26,2007
3,034,132	1.25	October 6, 2007
189,056	0.80	October 6, 2007
6,730,130	1.85	March 23, 2008
862,117	0.345	June 27, 2010
1,613,238	0.345	Nov 17, 2010
<u>22,673,733</u>		

Escrow Securities

All of the 87,470 shares held in escrow were cancelled by the regulatory authorities on March 9, 2005. The issued share capital reflects the cancellation of these shares.

Fortuna Silver Mines Inc.**(Formerly Fortuna Ventures Inc.)**

Notes to the Interim Consolidated Financial Statements

(Unaudited – Prepared by Management)

Nine Months Ended June 30, 2006

8. Capital Stock (cont'd)**Escrow Securities (cont'd)**

As at June 1, 2005, there were placed in escrow 495,422 common shares and warrants and options to purchase up to 694,800 common shares. On June 27, 2005, 10% of these securities were released from escrow, leaving a balance in escrow of 445,880 common shares, and warrants and options to purchase up to 625,320 common shares. On September 8, 2005, 288,000 of these warrants were exercised, leaving a balance in escrow of 733,880 common shares, and warrants and options to purchase up to 337,320 common shares. Subsequent releases from escrow have been effected as follows:

<u>Date</u>	<u>Percentage Released</u>	<u>Balance in Escrow</u>	
		<u>Shares</u>	<u>Options/Warrants</u>
December 27, 2005	15%	659,567	210,900
January 20, 2006	25%	427,255	167,857
June 27, 2006	25%	213,628	83,928

Subsequent to June 30, 2006 the final release of 25% of the original number securities will be on December 27, 2006.

Stock-Based Compensation

The Company uses the fair value based method of accounting for share options granted to consultants, directors, officers and employees. The non-cash compensation charge of \$2,193,325 recognized for the nine months ended June 30, 2006 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:

Risk-free interest rate	2.93% - 4.21%
Expected stock price volatility	43.0% - 92.0%
Expected term in years	1 - 10
Expected dividend yield	0.0%

Fortuna Silver Mines Inc.
(Formerly Fortuna Ventures Inc.)
Notes to the Consolidated Financial Statements
(Unaudited – Prepared by Management)
Nine Months Ended June 30, 2006

9. Segmented Information

Details of identifiable assets by geographic segments are as follows:

	<u>June 30, 2006</u>	<u>Sept 30, 2005</u>
Canada		
Current assets	\$ 14,023,910	\$ 5,846,705
Investments	1,000,000	-
Plant and equipment	22,171	18,624
	<u>\$ 15,046,081</u>	<u>\$ 5,865,329</u>
Peru		
Current assets	\$ 2,134,014	\$ 82,452
Plant and equipment	4,630,812	-
Mineral properties	18,202,975	18,179,522
	<u>\$ 24,967,801</u>	<u>\$18,261,974</u>
Guatemala		
Current assets	\$ 2,695	\$ 2,455
Plant and equipment	2,910	2,910
	<u>\$ 5,605</u>	<u>\$ 5,365</u>
Mexico		
Mineral properties	<u>\$ 1,894,466</u>	<u>\$ -</u>
Latin America - General		
Mineral properties	<u>\$ 11,549</u>	<u>\$ 8,471</u>
	<u>\$ 41,925,502</u>	<u>\$24,141,139</u>

10. Supplementary Disclosure of Non-cash Transactions

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

During the nine months ended June 30, 2006 the following non-cash transactions occurred:

	<u>Number of shares</u>	<u>Amount</u>
Shares issued for property acquisition, previously booked as an obligation	1,897,621	\$2,713,598
Warrants issued for property acquisition, previously booked as an obligation	1,613,238	\$1,871,356
Shares issued for property finders fee	50,000	\$ 68,000
Shares issued for commission on private placement	760,261	\$1,140,392

11. Comparative Figures

Certain of the comparative figures have been reclassified to conform with the current years presentation.



MANAGEMENT'S DISCUSSION AND ANALYSIS

Third Quarter Report – June 30, 2006

General

This Management's Discussion and Analysis ("MD&A") supplements the unaudited financial statements of Fortuna Silver Mines Inc. (the "Company") for the nine months ended June 30, 2006. The following information, prepared as of August 21, 2006, should be read in conjunction with the June 30, 2006 financial statements, which have been prepared in accordance with Canadian generally accepted accounting principles. All amounts are expressed in Canadian dollars unless otherwise indicated. The June 30, 2006 financial statements have not been reviewed by the Company's auditors.

Business of the Company

The Company is an emerging silver-gold and base metal producer focused on Latin America., with its principal assets being the Caylloma Silver Mine in southern Peru and the San Jose Silver-Gold Project in Oaxaca, Mexico.

Peru – Caylloma Silver Mine

Fortuna continues with the implementation of modifications and upgrades to the processing plant. The flotation cells, thickeners and filters for the silver-lead and zinc circuits have been installed. The overhaul of the grinding circuit composed of four ball mills has been concluded. The primary crusher has been installed and the secondary and tertiary crushers are expected on site for the last week of August. Management expects the plant to be operational at 700 tonnes per day capacity by the end of September, 2006. The plant will be ready to accommodate a throughput increase up to the permitted 1,100 tonnes per day.

Mining of four stopes on the Animas vein is already taking place. Preparation of additional stopes continues at an accelerated pace to meet plant capacity by year end. A 4x4 m cross-cut ramp on intermediate level eight on the Animas vein intersected the structure in August. This new heading will assist in giving more speed to stope preparation on Animas.

A new mine resource estimate for Caylloma has been published on August 21st. A fifty percent increase in measured and indicated resources for the Animas vein has been obtained by remodeling the structure to include Ag-Pb-Zn zones. Management expects to report a significant portion of these resources as reserves before year end. Stope preparation and mining of some of these resource blocks is already taking place.

Table 1. Silver Veins Proven & Probable Reserves

Vein	Tonnes	Ag gpt	Au gpt	Pb %	Zn %	Contained Ag oz
<i>PROVEN</i>						
San Cristóbal	145,851	422	0.3	0.0	0.0	1,980,562
San Pedro	52,102	407	1.0	0.0	0.0	682,646
San Carlos	5,392	622	0.2	0.3	0.7	107,751
La Plata	8,537	478	2.1	0.2	0.1	131,184
Cimoide (La Plata)	30,269	575	3.4	0.0	0.1	560,075
Paralela	11,200	592	0.1	0.0	0.0	213,294
Proven Reserves	253,351	451	0.9	0.0	0.0	3,675,513
<i>PROBABLE</i>						
San Cristóbal	35,989	507	0.4	0.2	0.3	586,410
San Pedro	33,650	340	0.9	0.0	0.1	368,157
San Carlos	7,921	656	0.1	0.3	0.7	167,020
La Plata	1,954	720	4.1	0.1	0.1	45,213
Cimoide (La Plata)	5,691	414	3.0	0.0	0.1	75,814
Paralela	4,491	688	0.0	0.1	0.2	99,339
Probable Reserves	89,695	465	0.8	0.1	0.2	1,341,953
Proven + Probable	343,046	454	0.8	0.1	0.1	5,017,466

Table 2. Animas Vein Measured and Indicated Resources

Vein	Tonnes	Ag gpt	Au gpt	Pb %	Zn %	Contained Ag oz
Measured	484,540	152	0.8	2.3	4.2	2,388,782
Indicated	688,786	137	0.5	2.3	4.2	3,037,544
Measured+Ind.	1,173,326	143	0.7	2.3	4.2	5,426,326

Table 3. Inferred Resources

Vein	Tonnes	Ag gpt	Au gpt	Pb %	Zn %	Contained Ag oz
San Cristóbal	135,513	407	0.2	0.3	0.4	1,771,635
San Pedro	92,896	369	0.2	0.7	1.4	1,100,831
San Carlos	16,626	766	0.2	0.5	1.2	409,654
La Plata	40,540	663	2.5	0.2	0.7	863,893
Cimoide (La Plata)	7,326	231	2.0	0.0	0.1	54,330
Paralela	52,473	563	0.0	0.2	0.3	950,452
Ramal paralela	90,094	362	0.1	0.3	0.7	1,049,011
Animas	980,032	243	0.5	2.7	4.2	7,626,114
Inferred	1,415,499	305	0.4	2.0	3.1	13,825,919

Tables 1 through 3 may not check exactly due to rounding.

The Company continues to explore the northeast extension of the Animas vein as all the measured and indicated resources reported above are located along 1.5 km of the 3.8 km long vein. 3000 meters of drilling are planned, for completion by year end.

The Company is working to update the production and financial models provided in the April, 2005 Caylloma technical report, to reflect changes in production scenarios on the Animas vein and metal prices. The April, 2005 Caylloma technical report is available on SEDAR and on the Company's website at www.fortunasilver.com.

Capital Expenditures: The Company is accelerating the original capital expenditures budget of US\$6.5 million over three years and it is expected that this amount will be invested in great part during the first year, giving more versatility to the mine in an environment of historically high commodity prices. The capital expenditures budget is part of the April, 2005 Caylloma technical report available on SEDAR and on the Company's website at www.fortunasilver.com.

Mexico – San Jose Silver-Gold Project

On June 12, 2006 Fortuna concluded the first phase drill program at San Jose, which begun on February, totalling 11,941 meters in 37 core holes. The first group of assay results was made public in a news release dated May 15th. Initial results for nine holes on the Trinidad zone of the vein returned high grade silver and gold mineralization extending the zone 100 meters down dip and along strike to the south from previous drilling. A schematic long section showing the pierce points within the vein structure is available on our website at www.fortunasilver.com. Results have been slow to arrive. The Company still has pending assays for the main Trinidad zone. Management is evaluating the results on hand and as soon as pending assays arrive a comprehensive news release will be made.

In November 2005, the Company reached an agreement with Continuum Resources Ltd. (TSXV:CNU) in which the Company can earn a 70% interest in Continuum's 80% share of the San Jose silver-gold deposit located in Oaxaca, Mexico. The agreement calls for the Company to spend CAD\$2 million in exploration by December 2007, primarily on diamond drilling, with a minimum of \$1.0 million to be spent by August 1, 2006 (spent). At the termination of the drill program, and based on a NI 43-101 compliant resource calculation, the Company will be required to pay Continuum US\$0.50 for each ounce of silver or silver equivalent in the Measured resource category, and US\$0.35 for each ounce of silver or silver equivalent in the Indicated resource category corresponding to the interest of the Company in the ounces.

Acquisitions

Fortuna is constantly evaluating new opportunities in order to meet our corporate objective of building significant silver inventory and future cash flow, by acquiring advanced projects and near term producers accretive to shareholder value. Through this aggressive growth strategy, the Company has obtained interests in two significant projects in less than a year, with high expectations for additional success in the coming months. We look forward to continued growth through the advancement and development of our existing projects and future acquisitions.

Results of Operations

For the nine months ended June 30, 2006, the Company had a net loss of \$2,624,147 (\$0.08 per share) compared to a net loss of \$403,466 (\$0.06 per share) for the nine months ended June 30, 2005. Every category of corporate expenses in the current nine-month period, except accounting and legal and bank charges, have increased significantly compared to the 2005 period due to the overall increase in the Company's exploration and corporate activity. The most significant increases have occurred in the areas of consulting and management

fees, public relations (printing and distributing marketing materials to at least 250,000 persons), regulatory fees, and travel. In addition, the 2006 net loss includes a \$2,193,325 non-cash compensation charge. During the three months ended June 30, 2006, a significant credit was recorded for public relations as the marketing program was terminated prior to its completion and the Company was not required to make the additional payment instalment to the marketing services provider.

Quarterly Information

The following table provides information for the eight fiscal quarters ended June 30, 2006:

	Third Quarter ended June 30, 2006 (\$) *	Second Quarter ended Mar. 31, 2006 (\$) *	First Quarter ended Dec. 31, 2005 (\$) *	Fourth Quarter ended Sept. 30, 2005 (\$) *	Third Quarter ended June 30, 2005 (\$) *	Second Quarter ended Mar. 31, 2005 (\$) *	First Quarter ended Dec. 31, 2004 (\$) *	Fourth Quarter ended Sept. 30, 2004 (\$) *
Total Income	126,394	45,813	18,464	279	-	-	-	-
Net Earnings (Loss)	362,879	(2,370,712)	(616,314)	(202,166)	(151,070)	(146,887)	(105,510)	(16,473)
Net Earnings (Loss) per share	0.01	(0.09)	(0.03)	(0.02)	(0.02)	(0.02)	(0.02)	(0.01)

*As the quarter ended June 30, 2006 resulted in a net gain, the net earnings per share is calculated on both a basic and diluted basis, and equals \$0.01 per share in each case.

Mineral Property Expenditures

Guatemala - During the nine months ended June 30, 2006, \$39,511 was spent on exploration of the Tambor Property in Guatemala. Of that amount, \$36,237 was spent on property overhead. The total deferred exploration costs of \$39,511 have been written off as the Company is not continuing with its option to earn an interest in this property.

Mexico - During the nine months ended June 30, 2006, \$1,826,466 was spent on exploration of mineral properties in Mexico. Of that amount, the major expenditure categories include \$892,166 for drilling and assays, \$113,767 for geological and other consulting, and \$113,158 for property overhead.

Peru - During the nine months ended June 30, 2006, \$3,087,769 was spent on mine construction at the Caylloma Mine, Peru. Of that amount, the major expenditure categories include \$1,344,448 for mine camp and consulting, and \$796,097 for drilling and assays.

Liquidity and Capital Resources

The Company's cash resources and liquid investments increased during the nine months ended June 30, 2006 by approximately \$7.6 million. During the period, the Company received \$3,888,565 from the exercise of warrants and stock options, and gross proceeds of \$19,050,000 from a private placement financing. The Company invested \$1.0 million by purchasing shares in Continuum Resources Ltd., the Company's joint venture partner in Mexico. Subsequent to June 30, 2006, certain stock options and warrants were exercised, providing the Company with additional cash proceeds of \$20,367. Working capital increased from a deficiency of \$218,826 at September 30, 2005 to positive working capital of \$15,313,764 at June 30, 2006.

Management expects that the Company will have sufficient working capital to meet its corporate and exploration commitments over at least the next 12 months. Actual funding requirements may vary from those planned due to a number of factors, including the progress of exploration and development activity. Management believes it will be able to raise equity capital as required in both the short and long term, but recognizes the uncertainty attached thereto. The Company continues to use various strategies to minimize its dependence on equity capital, including the securing of joint venture partners where appropriate.

Other Data

Additional information related to the Company is available for viewing at www.sedar.com.

Share Position and Outstanding Warrants and Options

The Company's outstanding share position at August 21, 2006 is 44,187,597 common shares. In addition, a total of 22,657,066 share purchase warrants and incentive stock options are currently outstanding as follows:

<u>Type of Security</u>	<u>Number</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
Warrants	50,000	\$1.50	February 20, 2007
	952,275	\$1.85	September 23, 2007
	272,785	\$0.80	September 26, 2007
	8,970,000	\$1.00 / \$1.25	September 26, 2007
	189,056	\$0.80	October 6, 2007
	3,017,465	\$1.00 / \$1.25	October 6, 2007
	6,730,130	\$1.85	March 22, 2008
	862,117	\$0.345	June 27, 2010
	<u>1,613,238</u>	\$0.345	November 17, 2010
	22,657,066		
Options	125,000	\$2.29	March 30, 2007
	167,500	\$0.37	December 2, 2009
	72,500	\$0.72	July 13, 2010
	50,000	\$0.80	July 24, 2010
	75,000	\$1.35	November 17, 2010
	675,000	\$1.35	February 5, 2016
	500,000	\$2.29	March 30, 2016
	130,000	\$1.75	May 8, 2016
	200,000	\$1.75	May 22, 2016
	485,000	\$1.55	July 5, 2016
	<u>995,000</u>	\$1.66	July 10, 2016
3,475,000			

Related Party Transactions

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

	Nine Month Period Ending June 30,	
	<u>2006</u>	<u>2005</u>
Mineral property costs – geological fees	\$ 90,180	\$ 13,137
Consulting fees	\$ 60,342	\$ 18,522
Salaries and wages	\$ 9,556	\$ 58,000
Management fees	\$ 61,321	\$ -

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

At June 30, 2006, accounts payable and accrued liabilities included \$nil (Sept 2005: \$181,036) to a company with a common director.

At June 30, 2006, due to related parties consists of an amount owing to an officer and to companies with a common director. These amounts were incurred as a result of shared administrative costs. These amounts are unsecured, non-interest bearing and payable in the normal course of business.

At June 30, 2006, due from related parties consists of amounts owed from companies with a common director which were incurred as a result of shared administrative costs. This amount is unsecured, non-interest bearing and will be collected in the normal course of business.

Financial Instruments

The carrying value of cash and cash equivalents, receivables, due from/to related parties and accounts payable and accrued liabilities approximate fair value because of the short-term maturity of those instruments. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments.

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, performance or achievements of the company to materially differ from any future results, performance or achievements expressed or implied by such forward-looking statements. 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 below.

Risks and Uncertainties

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. 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. Other risks facing the Company include competition, environmental and insurance risks, fluctuations in metal prices, share price volatility and uncertainty of additional financing.

Internal Disclosure Controls and Procedures

We have evaluated the effectiveness of our disclosure controls and procedures and have concluded that they are sufficiently effective to provide reasonable assurance that material information relating to the Company and its consolidated subsidiaries is made known to management and disclosed in accordance with applicable securities regulations.

