



## **FINANCIAL REVIEW**

**12-Month Quarterly Report Ended September 30, 2006**

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

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 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 twelve month period ended September 30, 2006.

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

	September 30, 2006	September 30, 2005
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash and equivalents	\$ 2,918,891	\$ 5,850,257
Temporary investments (Note 3)	4,830,834	-
GST and value-added taxes receivable	1,763,161	39,730
Advances and other receivables (Note 12)	1,787,309	215
Inventory	967,940	-
Prepaid expenses and deposits	337,916	41,410
Due from related parties (Note 5)	7,647	-
	12,613,698	5,931,612
<b>PROPERTY, PLANT &amp; EQUIPMENT (Note 6, 11)</b>	6,856,863	21,534
<b>MINERAL PROPERTIES (Note 7)</b>	23,235,875	18,187,993
<b>INVESTMENTS (Note 3)</b>	1,000,000	-
	<b>\$ 43,706,436</b>	<b>\$ 24,141,139</b>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable and accrued liabilities (Note 5)	\$ 1,725,180	\$ 870,663
Due to related parties (Note 5)	81,402	8,925
Notes payable (Note 4)	-	5,270,850
	1,806,582	6,150,438
Asset retirement obligations	1,578,441	1,578,441
Future income tax liability	1,207,149	1,207,149
	4,592,172	8,936,028
<b>SHAREHOLDERS' EQUITY</b>		
<b>CAPITAL STOCK (Note 8)</b>	41,372,443	12,163,851
<b>SHARE SUBSCRIPTIONS</b>	8,750	2,030,888
<b>OBLIGATION TO ISSUE SHARES AND WARRANTS</b>	-	4,584,954
<b>CONTRIBUTED SURPLUS</b>	5,972,932	296,313
<b>DEFICIT</b>	(8,239,861)	(3,870,895)
	39,114,264	15,205,111
	<b>\$ 43,706,436</b>	<b>\$ 24,141,139</b>

APPROVED BY THE DIRECTORS:

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

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*"signed"*  
 Simon Ridgway, Director

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

	Three Month Period Ended September 30,		Twelve Month Period Ended September 30,	
	2006	2005	2006	2005
<b>DEFICIT - BEGINNING OF PERIOD</b>	\$ (6,495,042)	\$ (3,668,728)	\$ (3,870,895)	\$ (3,265,262)
Net loss for the period	<u>(1,744,819)</u>	<u>(202,167)</u>	<u>(4,368,966)</u>	<u>(605,633)</u>
<b>DEFICIT - END OF PERIOD</b>	<u><u>\$ (8,239,861)</u></u>	<u><u>\$ (3,870,895)</u></u>	<u><u>\$ (8,239,861)</u></u>	<u><u>\$ (3,870,895)</u></u>

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

	Three Month Period Ended September 30,		Twelve Month Period Ended September 30,	
	2006	2005	2006	2005
<b>EXPENSES</b>				
Amortization	\$ 1,564	\$ 3,001	\$ 6,474	\$ 3,043
Bank charges and interest	3,932	82,677	5,634	84,491
Consulting	21,231	64,181	210,237	103,252
Accounting & legal	10,631	(35,503)	47,970	50,088
Management fees	36,994	-	98,315	2,629
Non cash compensation charge (Note 8)	1,806,750	149,075	4,000,075	228,721
Office and miscellaneous	27,895	(2,638)	55,991	20,380
Property investigations	(3)	-	707	-
Public relations	45,345	97,733	307,645	132,713
Regulatory and stock exchange fees	3,414	6,233	42,568	22,494
Rent and utilities	7,980	(845)	26,086	11,869
Salaries and wages	34,362	57,231	141,572	129,115
Telephone and fax	4,772	4,946	19,326	10,858
Travel and accommodation	23,169	40,842	86,736	77,878
<b>LOSS BEFORE OTHER ITEMS</b>	<u>(2,028,036)</u>	<u>(466,933)</u>	<u>(5,049,336)</u>	<u>(877,531)</u>
<b>OTHER INCOME (EXPENSES)</b>				
Write-off of deferred exploration costs	-	(182,657)	(39,511)	(182,657)
Interest and miscellaneous income	93,956	279	284,627	279
Foreign exchange gain (Note 4)	189,260	447,144	435,253	454,276
	<u>283,216</u>	<u>264,766</u>	<u>680,370</u>	<u>271,898</u>
<b>NET LOSS FOR THE PERIOD</b>	<u>\$ (1,744,819)</u>	<u>\$ (202,167)</u>	<u>\$ (4,368,966)</u>	<u>\$ (605,633)</u>
<b>LOSS PER SHARE</b>	<u>\$ (0.04)</u>	<u>\$ (0.02)</u>	<u>\$ (0.13)</u>	<u>\$ (0.08)</u>
<b>Weighted average number of shares outstanding</b>	<u>44,077,271</u>	<u>9,430,418</u>	<u>34,501,507</u>	<u>7,186,858</u>

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

	Three Month Period Ended September 30,		Twelve Month Period Ended September 30,	
	2006	2005	2006	2005
<b>OPERATING ACTIVITIES</b>				
Net loss for the period	\$ (1,744,819)	\$ (202,167)	\$ (4,368,966)	\$ (605,633)
Items not involving cash				
Amortization	1,564	3,001	6,474	3,043
Write-off of deferred exploration costs	-	182,657	39,511	182,657
Stock based compensation charge	1,806,750	149,075	4,000,075	228,721
Foreign Exchange gain on long-term debt	-	(287,100)	-	(287,100)
	63,495	(154,534)	(322,906)	(478,312)
Changes in non-cash working capital items	(1,223,753)	637,329	(3,920,455)	736,522
	(1,160,258)	482,795	(4,243,361)	258,210
<b>FINANCING ACTIVITIES</b>				
Proceeds on issuance of common shares	759,277	7,080,932	24,210,044	8,267,674
Share subscriptions	-	2,030,888	-	2,030,888
Due from related parties (Note 5)	40,446	-	(7,647)	-
Due to related parties (Note 5)	16,060	(110,781)	72,477	8,925
Payment of notes payables (Note 4)	-	(3,643,545)	(5,270,850)	(3,643,545)
	815,783	5,357,494	19,004,024	6,663,942
<b>INVESTING ACTIVITIES</b>				
Mineral property costs	(3,126,885)	(418,448)	(8,158,733)	(793,124)
Business acquisition costs	-	(349,860)	-	(641,018)
Temporary investment	(98,557)	-	(4,830,834)	-
Investment	-	-	(1,000,000)	-
Purchase of plant & equipment	(2,202,534)	(20,374)	(3,702,462)	(34,074)
	(5,427,976)	(788,682)	(17,692,029)	(1,468,216)
<b>INCREASE (DECREASE) IN CASH</b>	(5,772,451)	5,051,607	(2,931,366)	5,453,936
Cash - beginning of period	8,691,342	798,650	5,850,257	396,321
<b>CASH - END OF PERIOD</b>	<u>\$ 2,918,891</u>	<u>\$ 5,850,257</u>	<u>\$ 2,918,891</u>	<u>\$ 5,850,257</u>
Supplementary disclosure of cash flow information:				
Cash paid for interest	<u>\$ -</u>	<u>\$ 83,025</u>	<u>\$ -</u>	<u>\$ 83,025</u>
Cash paid for income taxes	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Non-cash Transactions - Note 10

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

Notes to the Interim Consolidated Financial Statements

(Unaudited – Prepared by Management)

Twelve Months Ended September 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)

Twelve Months Ended September 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)

Twelve Months Ended September 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:

	Twelve Month Period Ending Sept 30,	
	<u>2006</u>	<u>2005</u>
Mineral property costs – geological fees	\$118,671	\$115,468
Consulting fees	\$ 67,842	\$ 7,371
Salaries and wages	\$ 12,838	\$ 79,185
Management fees	\$ 98,316	\$ 2,629

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)

Twelve Months Ended September 30, 2006

**5. Related Party Transactions – (cont'd)**

At September 30, 2006, accounts payable and accrued liabilities included \$6,202 (Sept 2005: \$181,036) to an officer of the Company.

At September 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 September 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 September 30, 2006

Canada	Cost	Accumulated Amortization	Net
Office furniture & equipment	\$ 1,271	\$ 234	\$ 1,037
Computer hardware	11,845	2,846	8,999
	<u>\$ 13,116</u>	<u>\$ 3,080</u>	<u>\$ 10,036</u>
Peru			
Office furniture & equipment	\$ 111,639	\$ 802	\$ 110,836
Computer hardware	113,379	3,369	110,010
Machinery & equipment	2,427,269	2,266	2,425,003
Buildings	1,235,297	-	1,235,297
Vehicles and other	56,008	-	56,008
Construction in progress	2,906,762	-	2,906,762
	<u>\$ 6,850,354</u>	<u>\$ 6,437</u>	<u>\$ 6,843,917</u>
Guatemala			
Office furniture & equipment	\$ 2,910	\$ -	\$ 2,910
	<u>\$ 6,866,380</u>	<u>\$ 9,517</u>	<u>\$ 6,856,863</u>

**Fortuna Silver Mines Inc.**  
**(Formerly Fortuna Ventures Inc.)**  
Notes to the Interim Consolidated Financial Statements  
(Unaudited – Prepared by Management)  
Twelve Months Ended September 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	Twelve Month Period Ended Sept. 30, 2006	Year Ended Sept. 30, 2005
<b><u>ACQUISITION COSTS</u></b>						
BALANCE - BEGINNING OF PERIOD	\$ -	\$ -	\$ -	\$ 12,772,059	\$ 12,772,059	\$ 3,457
Shares	-	-	-	-	-	-
Cash	-	-	-	-	-	-
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
<b><u>EXPLORATION PROPERTY COSTS</u></b>						
BALANCE - BEGINNING OF PERIOD	\$ 8,471	\$ -	\$ -	\$ -	\$ 8,471	\$ -
Resource property overhead	1,306	36,237	141,733	-	179,277	155,607
Camp, equipment and supplies	-	76	23,368	-	23,444	1,281
Drilling & Assays	-	-	1,623,256	-	1,623,256	3,441
Geological consulting	1,772	3,199	147,614	-	152,584	27,342
	3,078	39,511	1,935,971	-	1,978,560	187,671
Write-off Exploration Costs	-	(39,511)	-	-	(39,511)	(179,200)
BALANCE - END OF PERIOD	11,549	-	1,935,971	-	1,947,520	8,471
<b><u>ASSET RECLAMATION OBLIGATION</u></b>						
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
<b><u>MINE CONSTRUCTION IN PROGRESS</u></b>						
BALANCE - BEGINNING OF PERIOD	\$ -	\$ -	\$ -	\$ 689,682	\$ 689,682	\$ 18,019
Mine Development	-	-	-	1,777,355	1,777,355	19,313
Mine drilling and assays	-	-	-	1,091,078	1,091,078	47,442
Mine camp, consulting, legal	-	-	-	2,015,828	2,015,828	604,908
Salaries and wages	-	-	-	815,329	815,329	-
Administrative overhead	-	-	-	405,558	405,558	-
	-	-	-	6,105,148	6,105,148	671,663
BALANCE - END OF PERIOD	-	-	-	6,794,830	6,794,830	689,682
TOTAL MINERAL PROPERTIES	\$ 11,549	\$ -	\$ 2,003,971	\$ 21,220,355	\$ 23,235,875	\$ 15,048,653

**Fortuna Silver Mines Inc.**

**(Formerly Fortuna Ventures Inc.)**

Notes to the Interim Consolidated Financial Statements

(Unaudited – Prepared by Management)

Twelve Months Ended September 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 could earn a 70% interest in Continuum’s 80% share of the San Jose silver-gold project located in Oaxaca, Mexico. In order to keep the option in good standing, the Company was required to 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).

On September 29, 2006 the Company and Continuum agreed to purchase 100% interest in the San Jose Project in Mexico from the underlying property owner. See Note 13, Subsequent Events.

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

**8. Capital Stock**

	<u>Number of shares</u>	<u>Price per share \$</u>	<u>Amount</u>
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	287,500	0.37	106,375
Exercise of options	77,500	0.72	55,800
Exercise of options	215,000	0.80	172,000
Exercise of options	45,000	1.35	60,750
Exercise of warrants	1,500,000	0.75	1,125,000
Exercise of warrants	998,915	0.80	799,132
Exercise of warrants	2,320,035	1.00	2,320,035
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	287,500	0.16	45,563
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	40,000	0.54	21,600
Less issue costs			(1,597,303)
Balance, September 30, 2006	<u><u>44,935,297</u></u>		<u><u>\$ 41,372,443</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)

Twelve Months Ended September 30, 2006

**8. Capital Stock (cont'd)****Stock Options (cont'd)**

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

<u>Number of shares</u>	<u>Exercise Price \$</u>	<u>Expiry Date</u>
125,000	2.29	March 30, 2007
167,500	0.37	December 2, 2009
72,500	0.72	July 13, 2010
40,000	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
995,000	1.66	July 10, 2016
225,000	1.61	Sept. 13, 2016
<u>3,690,000</u>		

**Warrants**

The following share purchase warrants were outstanding at September 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
8,670,000	1.25	September 26, 2007
270,085	0.80	September 26, 2007
2,657,465	1.00	October 6, 2007 *
114,056	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>21,919,366</u>		

\*The exercise of these warrants increased from \$1.00 per share to \$1.25 per share effective October 7, 2006.

**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)

Twelve Months Ended September 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

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 \$4,000,075 recognized for the twelve months ended September 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% - 4.59%
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)  
Twelve Months Ended September 30, 2006

**9. Segmented Information**

Details of identifiable assets by geographic segments are as follows:

	<u>Sept 30, 2006</u>	<u>Sept 30, 2005</u>
Canada		
Current assets	\$ 9,061,057	\$ 5,846,705
Investments	1,000,000	-
Plant and equipment	10,036	18,624
	<u>\$ 10,071,093</u>	<u>\$ 5,865,329</u>
Peru		
Current assets	\$ 3,549,956	\$ 82,452
Plant and equipment	6,843,917	-
Mineral properties	21,220,355	18,179,522
	<u>\$ 31,614,228</u>	<u>\$18,261,974</u>
Guatemala		
Current assets	\$ 2,685	\$ 2,455
Plant and equipment	2,910	2,910
	<u>\$ 5,595</u>	<u>\$ 5,365</u>
Mexico		
Mineral properties	\$ 2,003,971	\$ -
Latin America - General		
Mineral properties	\$ 11,549	\$ 8,471
	<u>\$ 43,706,436</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 twelve months ended September 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

**Fortuna Silver Mines Inc.**  
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Notes to the Consolidated Financial Statements  
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Twelve Months Ended September 30, 2006

**11. Comparative Figures**

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

**12. Advances and other receivables**

On September 20, 2006 the Company pursuant to the joint venture agreement with Continuum Resources Ltd. advanced \$790,090 which was reimbursed on October 11, 2006. On September 25, 2006 the Company advanced to Continuum \$785,750 to keep in good standing an option payment due to the underlying property owner of San Jose. Subsequent to September 30, 2006 these funds have been put towards the Company's 100% interest in acquiring San Jose from the underlying property owner.

**13. Subsequent Events**

On September 29, 2006 an agreement between the Company and Continuum Resources Ltd. ("Continuum") was reached to purchase 100% interest in the San Jose Project in Mexico from the underlying property owner. In November, 2006, the Company paid the purchase price consisting of US\$10,350,000 cash, \$250,000 US in shares of the Company (168,417 shares) and \$250,000 US in shares of Continuum (1,293,750 shares) currently owned by the Company. The previous option agreement between Fortuna and Continuum dated November 10, 2005 was superseded by this agreement, and a joint venture has been formed to further develop the Project, the Company having a 76% interest and Continuum a 24% interest.



**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**12-Month Quarterly Report – September 30, 2006**

**Change in Fiscal Year End**

In August, 2006, the Company changed its fiscal year end from September 30<sup>th</sup> to December 31<sup>st</sup>. The Company's year end now matches that of its Peruvian subsidiary which owns the Caylloma Mine, resulting in an increase in the efficiency of the Company's accounting operations. A Notice of Change in Fiscal Year End has been filed on sedar.com.

For the current period, the old fiscal year ending September 30, 2006 has been changed to a transitional 15-month fiscal year ending December 31, 2006. Therefore, the accompanying financial statements are for an interim twelve-month period ended September 30, 2006, with comparables to the twelve-month period ended September 30, 2005.

**General**

This Management's Discussion and Analysis ("MD&A") supplements the unaudited financial statements of Fortuna Silver Mines Inc. (the "Company") for the twelve months ended September 30, 2006. The following information, prepared as of November 24, 2006, should be read in conjunction with the September 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 September 30, 2006 financial statements have not been reviewed by the Company's auditors.

**Business of the Company**

Fortuna Silver Mines Inc, is a mining company, focused on Latin America, producing silver, gold, zinc and lead. The Company's principal assets being the Caylloma Silver Mine in southern Peru and the San Jose Silver-Gold Project in southern Mexico.

**Peru – Caylloma Silver Mine**

Fortuna began commercial production of silver-lead and zinc concentrates in October 2006. First revenue from sales has been received the second week of November. Current daily throughput is 500 tonnes per day with an expected increase to 700 tonnes per day for May 2007. The processing plant is permitted and practically ready to accommodate production increments up to 1,100 tonnes per day. Management is accelerating the preparation of stopes on the Ag-Zn-Pb rich Animas vein as well as in the silver rich traditional vein system with the objective of achieving full throughput capacity by early 2008.

Fortuna is currently selling its silver-lead and zinc concentrate production from Caylloma to Swiss company Glencore in Peru. Glencore is a leading global commodity trading firm with mines, smelters and offices in various parts of the world.

Fortuna's silver, gold, zinc, and lead metal production from Caylloma are unhedged. This is allowing the Company and its shareholders to capitalize on historic high metal prices for these metals. Of particular interest today is the zinc and lead component of production at Caylloma, which at current price levels represent over 50 per cent of revenue for the mine. Zinc specially shows very strong fundamentals for sustained high prices over the next years.

Management is satisfied with the smooth start up of mining and processing at Caylloma. It is expected it will take three to four months to work out small improvements to the plant process, especially in regard to the crushing circuit where changes will be made to accommodate larger storage capacity at the coarse ore bin.

The geology office at Caylloma is working on finalizing the 2007 exploration program. The objective of this is to double the size of pure silver ounces in the reserves, measured-indicated and inferred resources from the current 5 million, 5.4 million, and 13.8 million ounces respectively by executing a concerted exploration effort on multiple veins within the Caylloma camp that have seen little work in the past and expanding the resources to depth and along strike on known veins.

#### Mexico – San Jose Silver-Gold Project

The Company concluded successfully the acquisition of a 76 per cent direct ownership of the San Jose project on November 24, 2006. The Company paid US\$9.0-million plus 15-per-cent Mexico goods and services tax on the purchase price, which equals US\$1.35-million. This tax will be refunded to Fortuna by the Mexican government in due course. The Company also paid to the owner of the property 168,417 shares of Fortuna and 1,293,750 shares of Continuum which were owned by Fortuna.

The direct acquisition of the high-grade San Jose silver-gold deposit is a reflection of Management's strong believes in the project merits and its potential to become a profitable silver mine in the short term. A new resource estimate incorporating the results from the latest drill program is expected for December 2006.

Fortuna is evaluating the purchase of a processing plant facility located 10 kilometers from the San Jose project. This plant facility has been processing high grade ore being mined at a rate of 100 tonnes per day from San Jose up until this month of November. The plant has enough capacity to treat up to 350 tonnes per day with some changes and improvements.

San Jose will become a key project for the Company in 2007. With the purchase of the existing plant facility San Jose could be fast-tracked into production at an initial rate of 1.5 million ounces of silver equivalents per year.

The 2007 work program for San Jose is currently being designed but it includes definition and exploration drilling as well as underground development with the objective of bringing inferred resources to the measured and indicated category.

#### Acquisitions

Fortuna is constantly evaluating new mining opportunities in order to meet our corporate objective of building significant silver inventory and cash flow, by acquiring advanced projects or operating mines from private parties in Latin America..

## **Results of Operations**

For the twelve months ended September 30, 2006, the Company had a net loss of \$4,368,966 (\$0.13 per share) compared to a net loss of \$605,633 (\$0.08 per share) for the twelve months ended September 30, 2005. Every category of corporate expenses in the current twelve-month period, except accounting and legal and bank charges and interest, 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 \$4,000,075 non-cash compensation charge.

During the quarter ended September 30, 2006, corporate expenses were also overall greater than in the quarter ended September 30, 2005. The areas of significant increase were in the areas of bank charges and interest, consulting, public relations, regulatory fees, salaries and travel.

## **Quarterly Information**

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

	Fourth Quarter ended Sept. 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 (\$)
<b>Total Income</b>	93,956	126,394	45,813	18,464	279	-	-	-
<b>Net Earnings (Loss)</b>	(1,744,819)	362,879	(2,370,712)	(616,314)	(202,166)	(151,070)	(146,887)	(105,510)
<b>Net Earnings (Loss) per share</b>	(0.04)	0.01	(0.09)	(0.03)	(0.02)	(0.02)	(0.02)	(0.02)

\*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 - The total deferred exploration costs of \$39,511 incurred during the financial year was written off as at December 31, 2005 as the Company is not continuing with its option to earn an interest in this property.

Mexico - During the twelve months ended September 30, 2006, \$1,935,971 was spent on exploration of the San Jose Project in Mexico. Of that amount, the major expenditure categories include \$1,623,256 for drilling and assays, \$147,614 for geological consulting, and \$141,733 for property overhead.

Peru - During the twelve months ended September 30, 2006, \$2.7 million was spent on plant and equipment, \$1.8 million on mine development, and \$1.1 million on drilling and assays. The category Mine Camp under the Schedule of Mineral Properties for which \$2.0 million was spent includes general maintenance for the camp, which at peak of construction activity has housed over 600 people. It also includes transport of supplies and equipment to the mine site, energy, and technical consulting fees among others.

## **Liquidity and Capital Resources**

The Company's cash resources and liquid investments increased during the twelve months ended September 30, 2006 by approximately \$1.9 million. During the period, the Company received \$4,639,092 from the exercise of warrants and stock options, and net proceeds of \$19,570,952 from private placement financings. The Company invested \$1.0 million by purchasing shares in Continuum Resources Ltd., the Company's joint venture partner in Mexico. Working capital increased from a deficiency of \$218,826 at September 30, 2005 to positive working capital of \$10,807,116 at September 30, 2006.

Subsequent to September 30, 2006, certain stock options and warrants were exercised, providing the Company with additional cash proceeds of \$1,318,791.

In connection with the Company's acquisition of a 76% interest in the San Jose Project, the Company issued a total of 321,750 shares and was granted a credit facility whereby it has borrowed \$4.6 million which was put towards the cash portion of the purchase price paid to the property owner (see Subsequent Events below). The use of this debt facility grants the Company financial flexibility to arrange a definitive source of funding at a suitable time in the future in terms of its needs and market conditions.

Management expects that the Company will have sufficient working capital to meet its corporate and exploration commitments in the near term but will need to raise additional capital to meet its investment budget requirements over the medium term. 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.

### **Other Data**

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

#### ***Share Position and Outstanding Warrants and Options***

The Company's outstanding share position at November 24, 2006 is 46,386,270 common shares. In addition, a total of 24,326,810 share purchase warrants and incentive stock options are currently outstanding as follows:

<b><u>Type of Security</u></b>	<b><u>Number</u></b>	<b><u>Exercise Price</u></b>	<b><u>Expiry Date</u></b>
Warrants	50,000	\$1.50	February 20, 2007
	940,912	\$1.85	September 23, 2007
	270,085	\$0.80	September 26, 2007
	8,670,000	\$1.25	September 26, 2007
	114,056	\$0.80	October 6, 2007
	1,434,333	\$1.25	October 6, 2007
	6,702,069	\$1.85	March 22, 2008
	862,117	\$0.345	June 27, 2010
	<u>1,613,238</u>	\$0.345	November 17, 2010
	20,656,810		
Options	125,000	\$2.29	March 30, 2007
	162,500	\$0.37	December 2, 2009
	72,500	\$0.72	July 13, 2010
	40,000	\$0.80	July 24, 2010
	75,000	\$1.35	November 17, 2010
	660,000	\$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
	995,000	\$1.66	July 10, 2016
	<u>225,000</u>	\$1.61	September 13, 2016
3,670,000			

### **Related Party Transactions**

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

	Twelve Month Period Ending Sept 30,	
	<u>2006</u>	<u>2005</u>
Mineral property costs – geological fees	\$118,671	\$115,468
Consulting fees	\$ 67,842	\$ 7,371
Salaries and wages	\$ 12,838	\$ 79,185
Management fees	\$ 98,316	\$ 2,629

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

At September 30, 2006, accounts payable and accrued liabilities included \$6,202 (Sept 2005: \$181,036) to an officer of the Company.

At September 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 September 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.

