

**Axtel, S. A. B. de C. V. and Subsidiaries**  
**(Subsidiary of Alfa, S. A. B. de C. V.)**

Consolidated Financial Statements as of  
and for the Years Ended December 31,  
2019 and 2018, and Independent  
Auditors' Report Dated January 31,  
2020



**Axtel, S. A. B. de C. V. and Subsidiaries**  
**(Subsidiary of Alfa, S. A. B. de C. V.)**

# **Independent Auditors' Report and Consolidated Financial Statements as of and for the years ended December 31, 2019 and 2018**

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# **Independent Auditors' Report to the Board of Directors and Shareholders of Axtel, S. A. B. de C. V.**

## **Opinion**

We have audited the consolidated financial statements of Axtel, S. A. B. de C. V. and Subsidiaries (the "Company"), which comprises the consolidated statements of financial position as of December 31, 2019 and 2018, and the consolidated statements of operations, the consolidated statements of comprehensive (loss) income, the consolidated statements of changes in shareholders' equity and the consolidated statements of cash flows for the years then ended, as well as explanatory notes to the consolidated financial statements which includes a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2019 and 2018, as well as their consolidated financial performance and their cash flows for the years then ended, in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board.

## **Basis for Opinion**

We conducted our audit in accordance with International Standards on Auditing ("ISA"). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants ("IESBA Code") together with the Code of Ethics issued by the Mexican Institute of Public Accountants ("IMCP Code"), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code and with the IMCP Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## **Key audit matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. We have determined that the matters described below are the key audit matters, which should be communicated in our report.

## **Assessment of impairment of long-lived assets and goodwill**

As described in Note 3 k) and 12 to the consolidated financial statements, the Company performs annual impairment tests to the balance of goodwill, intangible assets with an indefinite useful life and of the property, plant and equipment.

We have identified the impairment evaluation as a key audit matter, mainly due to the fact that impairment tests involve the application of judgments and significant estimates by the Company's management in determining the assumptions, premises, cash flows, budgeted income, and the selection of discount rates used to estimate the recoverable value of the cash generating units ("CGUs"), in addition to the importance of the goodwill and intangible assets balances of \$1,052 and \$1,405 million, as well as the property, plant and equipment balance of \$12,964 and \$16,106 million, as of December 31, 2019 and 2018, respectively.



Therefore, as part of our audit and with support of valuation experts, we focused our tests on the following significant assumptions that the Company considered when estimating future projections to assess the recoverability of goodwill, intangible assets and properties, plant and equipment: long-term growth rate of the industry, discount rate, estimated revenues from different segments, expected gross and operating profit margin. For this, our procedures, among others, included the following:

- We verified that the methods applied by the Company for determining the recovery value of the aforementioned assets correspond to the financial methodology used and recognized to value assets of similar characteristics.
- Performed tests on the completeness, accuracy and reasonableness of financial projections by comparing them to the business performance and historical trends, verifying the explanations of the variations with management. In addition, we assessed the internal processes used by management to make projections, including appropriate oversight levels and the analysis that was carried out at the various levels.
- Analyzed the significant assumptions used in the model for calculating the recoverable value of CGUs compared to those commonly used in the industry in which the Company operates, including the long-term growth rate, gross and operating margins and the discount rate determined based on comparable companies in the industry.
- Evaluate of discount rates used and the methodology used in the preparation of the model of the impairment test. In addition, we tested the integrity and accuracy of the impairment model and the book value of CGU.
- To determine the CGU, we considered the Company's operating cash flows, synergies that have been generated in the business, the market segments where they operate and the different lines of goods and services that they offer their clients.
- Evaluate the independent assessment of the sensitivity of the key assumptions for the impairment model, which we discussed with management estimating the degree of impact they would have on the financial statements in the face of a reasonably possible change in such key assumptions.

The results of our procedures were satisfactory, and we believe the assumptions used by management in the impairment test, are reasonable.

#### **Information other than the Consolidated Financial Statements and Auditors' Report thereon**

Management is responsible for the other information presented. The other information includes two documents, the Annual Stock Exchange Filing and the information that will be incorporated in the Annual Report that the Company must prepare pursuant to the General Provisions Applicable to Issuers and other Participants in the Mexican Stock Exchange and file it with the National Banking and Securities Commission ("CNBV" for its acronym in Spanish). The Annual Stock Exchange Filing and the Annual Report are expected to be made available to us after the date of this auditors' report.

Our opinion of the consolidated financial statements does not cover the other information and we do not express any form of assurance over it.

In connection with our audit of the consolidated financial statements, our responsibility will be to read the other information, when available, and in doing so, consider whether the other information contained therein is materially inconsistent with the consolidated financial statements or with our knowledge obtained in the audit, or otherwise appears to contain a material error. If based on the work we have performed, we conclude that there is a material misstatement therein, we are required to communicate the matter in a statement in the Annual Report required by the CNBV and those charged with governance in the Company.



## **Responsibilities of Management and those Charged with Governance for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's consolidated financial reporting process.

## ***Auditors' Responsibilities for the Audit of the Consolidated Financial Statements***

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company and subsidiaries to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision, and performance of the Company and subsidiaries audit. We remain solely responsible for our audit opinion.

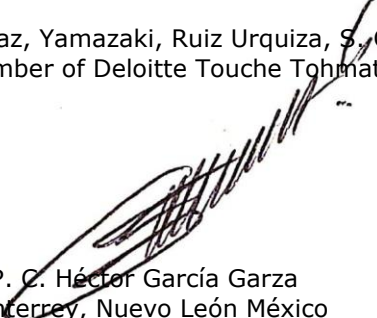


We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Galaz, Yamazaki, Ruiz Urquiza, S. C.  
Member of Deloitte Touche Tohmatsu Limited



C. P. C. Héctor García Garza  
Monterrey, Nuevo León México  
January 31, 2020



**Axtel, S. A. B. de C. V. and Subsidiaries**  
**(Subsidiary of Alfa, S. A. B. de C. V.)**

# **Consolidated Statements of Financial Position**

**As of December 31, 2019 and 2018**

**Thousands of Mexican pesos**

	<b>Note</b>	<b>2019</b>	<b>2018</b>
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	6	\$ 857,742	\$ 2,249,155
Trade and other accounts receivable, net	8	3,344,674	3,593,881
Inventories	9	93,982	104,802
Financial instruments at fair value	4	92,673	129,075
Prepayments	3.j	521,406	546,064
Derivative financial instruments	4	-	5,898
Long-lived assets held for sale	2.b	1,124,613	315,053
Total current assets		<u>6,035,090</u>	<u>6,943,928</u>
Non-current assets:			
Restricted cash	7	-	93,908
Property, plant and equipment, net	10	12,963,991	16,105,524
Right of use asset, net	11	661,246	-
Goodwill and intangible assets, net	12	1,052,258	1,405,387
Deferred income taxes	20	2,876,287	2,873,075
Other non-current assets	13	741,897	716,287
Derivative financial instruments	4	-	17,693
Total non-current assets		<u>18,295,679</u>	<u>21,211,874</u>
Total assets		<u>\$24,330,769</u>	<u>\$28,155,802</u>
<b>Liabilities and Shareholders' Equity</b>			
Current liabilities:			
Debt	17	\$ 131,632	\$ 465,828
Lease liability	18	451,775	-
Trade and other accounts payable	14	4,169,016	7,423,978
Provisions	15	220,190	312,384
Deferred income	16	153,229	536,452
Derivative financial instruments	4	51,814	39,258
Total current liabilities		<u>5,177,656</u>	<u>8,777,900</u>
Non-current liabilities:			
Debt	17	13,836,310	15,156,918
Lease liability	18	414,323	-
Accounts payable to related parties	14	703,348	4,033
Employee benefits	19	695,498	592,037
Derivative financial instruments	4	91,898	-
Deferred income taxes	20	759	4,007
Total non-current liabilities		<u>15,742,136</u>	<u>15,756,995</u>
Total liabilities		<u>20,919,792</u>	<u>24,534,895</u>
Shareholders' equity:			
Controlling interest:			
Capital stock	21	464,368	464,368
Additional paid-in capital		-	159,551
Accrued earnings		3,104,427	3,013,954
Other comprehensive loss		(157,818)	(16,972)
Total controlling interest		<u>3,410,977</u>	<u>3,620,901</u>
Non-controlling interest		-	6
Total shareholders' equity		<u>3,410,977</u>	<u>3,620,907</u>
Total liabilities and shareholders' equity		<u>\$24,330,769</u>	<u>\$28,155,802</u>

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



**Axtel, S. A. B. de C. V. and Subsidiaries**  
**(Subsidiary of Alfa, S. A. B. de C. V.)**

# **Consolidated Statements of Operations**

**For the years ended December 31, 2019 and 2018**

**Thousands of Mexican pesos**

	<b>Note</b>	<b>2019</b>	<b>2018</b>
Revenues	23	\$12,783,633	\$12,788,484
Cost of sales		(6,104,427)	(6,290,978)
Gross profit		6,679,206	6,497,506
Administration and selling expenses		(5,841,918)	(6,008,955)
Other (expenses) income, net	25	(63,453)	206,929
Operating income		773,835	695,480
Financial income	26	60,253	52,129
Financial expenses	26	(1,468,752)	(1,868,618)
Exchange fluctuation gain, net	26	290,275	186,888
Gain on changes in fair value of financial instruments		(8,919)	(35,202)
Financial result, net		(1,127,143)	(1,664,803)
Loss before taxes		(353,308)	(969,323)
Income taxes benefit (expense)	20	15,291	(37,338)
Loss from continuing operations		(338,017)	(1,006,661)
Discontinued operations	22	324,078	2,101,339
Net consolidated (loss) income		<u>\$ (13,939)</u>	<u>\$ 1,094,678</u>
(Loss) income attributable to:			
Controlling interest		\$ (13,939)	\$ 1,094,678
Non-controlling interest		-	-
		<u>\$ (13,939)</u>	<u>\$ 1,094,678</u>
Loss per basic and diluted share from continuing operations		(0.017)	(0.050)
Profit per basic and diluted share from discontinued operations		0.016	0.104
(Loss) profit per basic and diluted share		<u>(0.001)</u>	<u>0.054</u>
Weighted average common outstanding shares (thousands of shares)		<u>20,183,560</u>	<u>20,249,227</u>

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





**Axtel, S. A. B. de C. V. and Subsidiaries**  
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# **Consolidated Statements of Comprehensive (Loss) Income**

**For the years ended December 31, 2019 and 2018**

**Thousands of Mexican pesos**

	<b>Note</b>	<b>2019</b>	<b>2018</b>
Net consolidated (loss) income		\$ (13,939)	\$1,094,678
Other comprehensive (loss) income for the year:			
<i>Items that will be reclassified to the consolidated statement of operations:</i>			
Effect of currency translation	20	(2,468)	(86)
Fair value of derivative financial instruments, net of taxes		(88,940)	(8,370)
<i>Items that will not be reclassified to the consolidated statement of operations:</i>			
Remeasurements of employee benefits, net of taxes	20	<u>(49,438)</u>	<u>42,280</u>
Total other comprehensive (loss) income for the year		<u>(140,846)</u>	<u>33,824</u>
Total comprehensive (loss) income of the year		<u><u>\$(154,785)</u></u>	<u><u>\$1,128,502</u></u>
Attributable to:			
Controlling interest		<u>\$(154,785)</u>	<u>\$1,128,502</u>
Non-controlling interest		<u>-</u>	<u>-</u>
Comprehensive (loss) income of the year		<u><u>\$(154,785)</u></u>	<u><u>\$1,128,502</u></u>

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



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## **Consolidated Statements of Changes in Shareholders' Equity**

**For the years ended December 31, 2019 and 2018**

**Thousands of Mexican pesos**

			Controlling interest (Accumulated deficit)	Other comprehensive loss	Total controlling interest	Non-controlling interest	Total shareholders' equity
	Capital stock	Additional paid-in capital	retained earnings				
Balances as of January 1, 2018	\$464,368	\$159,551	\$ 1,919,276	\$ (50,796)	\$2,492,399	\$ 6	\$ 2,492,405
Net consolidated income	-	-	1,094,678	-	1,094,678	-	1,094,678
Total other comprehensive income for the year	-	-	-	33,824	33,824	-	33,824
Comprehensive income	-	-	1,094,678	33,824	1,128,502	-	1,128,502
Balances as of December 31, 2018	<u>\$464,368</u>	<u>\$159,551</u>	<u>\$ 3,013,954</u>	<u>\$ (16,972)</u>	<u>\$3,620,901</u>	<u>\$ 6</u>	<u>\$ 3,620,907</u>
Transactions with stockholders:							
Repurchase of shares	\$ -	\$(159,551)	\$ 103,015	\$ -	\$ (56,536)	\$ -	\$ (56,536)
Other	-	-	1,397	-	1,397	(6)	1,391
Total transactions with stockholders	<u>\$ -</u>	<u>\$(159,551)</u>	<u>\$ 104,412</u>	<u>\$ -</u>	<u>\$ (55,139)</u>	<u>\$ (6)</u>	<u>\$ (55,145)</u>
Net consolidated loss	-	-	(13,939)	-	(13,939)	-	(13,939)
Total other comprehensive loss for the year	-	-	-	(140,846)	(140,846)	-	(140,846)
Comprehensive loss	-	-	(13,939)	(140,846)	(154,785)	-	(154,785)
Balances as of December 31, 2019	<u>\$464,368</u>	<u>\$ -</u>	<u>\$ 3,104,427</u>	<u>\$ (157,818)</u>	<u>\$3,410,977</u>	<u>\$ -</u>	<u>\$ 3,410,977</u>

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# **Consolidated Statements of Cash Flows**

**For the years ended December 31, 2019 and 2018**

**Thousands of Mexican pesos**

	<b>2019</b>	<b>2018</b>
<b>Cash flows from operating activities</b>		
Loss before taxes	\$ (353,308)	\$ (969,323)
Depreciation and amortization	3,578,541	3,622,713
Exchange fluctuation gain, net	(290,275)	(186,888)
Allowance for doubtful accounts	8,874	114,207
Loss (gain) from sale of property, plant and equipment	5,046	(226,646)
Interest income	(60,253)	(52,129)
Interest expense	1,468,752	1,868,618
Current PTU	12,524	9,825
Provisions and others	(65,009)	129,315
Change in unrealized fair value and settlement of financial instruments	8,919	35,202
Changes in working capital:		
Trade and other accounts receivable, net	120,012	(629,388)
Inventories	131,289	84,083
Trade accounts payable, related parties and other accounts payable	(1,162,728)	395,526
Employee benefits	32,835	38,797
Paid PTU	(9,178)	(16,693)
Deferred income	(383,223)	224,331
Operating cash flows from discontinued operations	(29,633)	1,061,978
Subtotal	<u>3,013,185</u>	<u>5,503,528</u>
Income taxes paid	(56,481)	(92,478)
Net cash flows generated by operating activities	<u>2,956,704</u>	<u>5,411,050</u>
<b>Cash flows from investing activities</b>		
Acquisitions of property, plant and equipment	(1,691,354)	(1,405,494)
Disposal of property, plant and equipment	-	226,646
Acquisition of intangible assets	(70,676)	(465,207)
Interest received	60,254	52,318
Restricted cash and other assets	93,908	29,033
Investment in shares of Altán	(69,959)	(17,868)
Investing cash flows from discontinued operations	1,150,000	3,956,544
Net cash flows generated by (used in) investing activities	<u>(527,827)</u>	<u>2,375,972</u>
<b>Cash flows from financing activities</b>		
Proceeds of current and non-current debt	-	619,355
Payments of current and non-current debt	(550,000)	(5,753,342)
Lease payments	(638,067)	-
Payment of account payable to holding company	(1,237,640)	-
Interest paid and other financial expenses	(1,395,272)	(1,677,825)
Net cash flows used in financing activities	<u>(3,820,979)</u>	<u>(6,811,812)</u>
Net increase (decrease) of cash and cash equivalents	(1,392,102)	975,210
Effect of changes in exchange rates	689	16,142
Cash and cash equivalents at the beginning of the year	<u>2,249,155</u>	<u>1,257,803</u>
Cash and cash equivalents at the end of the year	<u>\$ 857,742</u>	<u>\$2,249,155</u>

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



**Axtel, S. A. B. de C. V. and Subsidiaries**  
**(Subsidiary of Alfa, S. A. B. de C. V.)**

# **Notes to the Consolidated Financial Statements**

**As of and for the years December 31, 2019 and 2018**

**Thousands of Mexican pesos, unless otherwise indicated**

## **1. General information**

Axtel, S. A. B. de C. V. and subsidiaries (“Axtel” or the “Company”) was incorporated in Mexico as a capital stock company. Axtel’s office is located at Boulevard Díaz Ordaz km 3.33 L-1, Colonia Unidad San Pedro, 66215 San Pedro Garza García, Nuevo León, Mexico.

Axtel is a publicly owned corporation, whose shares are registered at the National Securities Registry and are traded at the Mexican Stock Exchange (“Bolsa Mexicana de Valores” in Spanish) through Certificates of Participation (“CPOs”) issued under the Trust whose trustee is Nacional Financiera, S. N. C. The Company is subsidiary of Alfa, S. A. B. de C. V. (“Alfa”), direct holding and last company of the Group, which exercises control and holds 52.78% through the Trust Administration Agreement No. 2673 entered into with Banco Invex, S. A. Alfa has control over the Company’s relevant activities.

The Company is engaged in installing, operating and/or exploiting a public telecommunications network for the provision of services involving conducting voice signals, sounds, data, internet, texts and images, IT, local as well as domestic and international long-distance telephone service and restricted television service. Concessions are required to provide these services and conducting the Company’s business activities. See Note 12.

Axtel conducts its activities through subsidiary companies of which it is the owner or of which it controls directly most of the common shares representing their capital stock. See Note 3.c.

When reference is made to the controlling entity Axtel, S.A.B. de C.V. as an individual legal entity, it will be referred to as “Axtel SAB”.

In the following notes to the consolidated financial statements, references to pesos or “\$” mean thousands of Mexican pesos; additionally, reference to dollars or “US\$” mean thousands of U.S. dollars, unless otherwise indicated for both cases.

## **2. Relevant events**

### 2019

#### ***a. Sale of the rest of the massive segment***

On May 1, 2019, the Company divested its fiber optic business from the massive segment located in the cities of León, Puebla, Toluca, Guadalajara and Querétaro to Megacable Holdings, S.A.B. de C.V. and subsidiaries (“Megacable”) through the sales figure of residential customers and micro-businesses, fiber network and other assets related to the operation of the massive segment in these cities in exchange for a consideration of \$1,150 million pesos, thus concluding the sale of the fiber optic business of the massive segment, process that began with the sale to Televisa in December 2018. The Company recognized a gain of \$519 million pesos, which is presented under discontinued operations in the consolidated statement of operations. The Company did not have an impact on cash flows due to tax consequences, as it applied tax loss carryforwards of \$730,238.

Lastly, as explained in Note 22, the operations subject to the transaction are presented as discontinued operations to reflect results from January 1 to May 1, 2019, as required by IFRS. In addition, this note identifies the asset and liability balances that were disposed as of the transaction date, as well as the cash flows generated by the transaction disposed to the selling date in 2019.



**b. *Sale of data centers in Apodaca and Querétaro***

On 3 October 2019, Axtel entered into an agreement with Equinix to strengthen its co-location, interconnection and cloud solutions by entering into two agreements subject to compliance with closing conditions. Equinix acquired a new subsidiary entity of Axtel, which will house the operations and assets of three data centers currently belonging to Axtel, two of these data centers are located in Querétaro and one in the metropolitan area of Monterrey. Axtel will maintain a non-controlling shareholding over the new subsidiary entity.

The amount of the transaction is US\$175 million, which will be settled in cash, except US\$13 that will be receivable in the short term. The rest of the data centers owned by Axtel, located in Monterrey, Nuevo León; Guadalajara, Jalisco and Tultitlán, Mexico City, are not part of this transaction.

Data centers are presented as available for sale as of December 31, 2019 and were disposed on January 8, 2020 (see Note 31).

**c. *Debt prepayment***

On May 7, 2019, the Company prepaid a portion of the syndicated loan held with HSBC as the leader of the participating financial institutions in the amount of \$250,000, and the disposed portion of the Committed Line with Export Development Canada of \$300,000. It also made payments to Alfa SAB of \$917,000 and \$320,000 for principal and interest, respectively. As a result of this prepayment, the Company immediately recognized the outstanding debt costs as of that date of \$8,250.

**2018**

**d. *Sale of massive segment***

On December 17, 2018, the Company divested a significant portion of its Massive Segment through the sale of assets, shares, inventories, receivables and telecommunications equipment to Grupo Televisa in exchange for an economic consideration of \$4,713 million pesos, recognizing a gain of \$1,950 million pesos, which is presented in discontinued operations within the consolidated statements of operations. The remainder of the Massive Segment that was not disposed of in this transaction continues to be operated by the Company as of December 31, 2018.

On December 21, 2018, with the proceeds obtained from the transaction, Axtel made a partial prepayment of the syndicated loan held with HSBC, as lead coordinator of the participating financial institutions, for \$4,350 million pesos, reducing the outstanding principal balance to \$1,570 million pesos as of December 31, 2018. Debt issuance costs of \$26,500 pending to be amortized and that corresponded to the amount of the prepayment, were recognized in results in the consolidated statement of operations.

Additionally, as explained in Note 20, the operations subject to the transaction are presented as discontinued operations for 2018 as required by IFRS. The balances of assets and liabilities associated with the transaction, as well as the cash flows generated by the disposed operation until the date of the sale in 2018 are disclosed in the corresponding Note.

**e. *Sale of towers with American Tower Corp.***

During March and June 2018, the Company reached a sale agreement with MATC Digital, S. de R.L. of C.V. ("MATC"), a subsidiary of American Tower Corporation, to sell 17 and 12 telecommunication towers, respectively, for US \$12 million. The agreement included the commitment of Axtel to use these sites from MATC for 15 years.

The transactions for the sale of telecommunication towers had a net profit of \$224,974, which is presented within operating income.

**f. *Debt proceeds from Export Development Canada***

On August 31, 2018, the Company received debt funding of \$300,000 associated with a long-term loan from Export Development Canada due in 2021 with monthly capital payments and accruing interest at a 91-day THIE rate plus 1.875 basis points. The proceeds obtained from this loan were used mainly to pay the short-term debt with BBVA Bancomer for \$200,000.



**g. Debt restructuring**

On February 22, 2018, the Company's syndicated long-term credit with HSBC Mexico was increased by \$ 291,000 from the original amount of \$5,709,000 to \$6,000,000, with the same terms as the original credit. The proceeds obtained from this additional loan were used to pay short-term debt of \$400,000 with HSBC Mexico.

On August 30, 2018, the Company entered into a debt restructuring agreement with Bancomext to exchange the original debt of US\$171,000 to a new debt of \$3,263,000. The terms of the new debt is 10 years with quarterly principal payments from the third year and with a 91-day THIE interest rate plus 2.10 basis points. The Company accounted for this transaction as an extinguishment of the liability in dollars in accordance with IFRS 9 Financial Instruments, recording an impact on the consolidated statement of operations for \$6,784 as a loss in the extinguishment.

**3. Summary of significant accounting policies**

The following are the most significant accounting policies followed by Axtel and its subsidiaries, which have been consistently applied in the preparation of their financial information in the years presented, unless otherwise indicated:

**a. Basis of preparation**

The consolidated financial statements of Axtel, S. A. B. de C. V. and subsidiaries have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB"). IFRS include International Accounting Standards ("IAS") in force and all related interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC"), including those previously issued by the Standard Interpretations Committee ("SIC").

The consolidated financial statements have been prepared on a historical cost basis, except for certain financial instruments, which are measured at fair value.

The preparation of the consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. Additionally, it requires management to exercise judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, as well as the areas where judgments and estimates are significant to the consolidated financial statements, are disclosed in Note 5.

**b. Changes in accounting policies and disclosures**

**i. New standards and changes adopted by the Company.**

The Company adopted IFRS 16, *Leases*, and IFRIC 23, *Interpretation on Uncertainty over Income Tax Treatments*, all new standards and interpretations in effect as of January 1, 2019, including the annual improvements to IFRS, as described below:

**IFRS 16, Leases**

IFRS 16, *Leases*, supersedes IAS 17, *Leases*, and the related interpretations. This new standard brings most leases on balance sheet for lessees under a single model, eliminating the distinction between operating and financial leases, while the model for lessees remains without significant changes. IFRS 16 is effective beginning January 1, 2019, and the Company decided to adopt it with the recognition of all the effects as of that date, without changing prior years.

Under IFRS 16, lessees will recognize a right-of-use asset and the corresponding lease liability. The right of use will be depreciated based on the contractual term or, in some cases, on its economic useful life. On the other hand, the financial liability will be measured at initial recognition, discounting future minimum lease payments at present value according to a term, using the discount rate that represents the lease funding cost; subsequently, the liability will accrue interest through maturity.

The Company applied the exemptions to not to recognize an asset and a liability as described above, for lease agreements with a term of less than 12 months (provided that they do not contain purchase or term renewal options) and for those agreements where the acquisition of an individual asset of the contract was less than USD\$5,000 (five thousand dollars). Therefore, payments for such leases will continue to be recognized as expenses within operating income.



The Company adopted IFRS 16 on January 1, 2019; therefore, it recognized a right-of-use asset and a lease liability of approximately \$680,405.

The weighted average incremental rate on which the minimum payments of the lease agreements within the scope of IFRS 16 were discounted at present value was 11.74%.

In addition, the Company adopted and applied the following practical expedients provided by IFRS 16:

- Account for as leases the payments made in conjunction with the rent, and that represent services (for example, maintenance and insurance).
- Create portfolios of contracts that are similar in terms, economic environment and characteristics of assets, and use a funding rate by portfolio to measure leases.
- For leases classified as financial leases as of December 31, 2018, and without elements of minimum payment updating for inflation, maintain the balance of the right-of-use asset, and its corresponding lease liability on the date of adoption of IFRS 16.
- Not to revisit the previously reached conclusions for service agreements, which were analyzed to December 31, 2018 under the IFRIC 4, *Determining Whether a Contract Contains a Lease*, and where it had been concluded that there was no implicit lease.
- For operating leases that, as of December 31, 2018, contain direct costs to obtain a lease, maintain the recognition of such costs, that is, without capitalizing them to the initial value of the right-of-use assets.

The Company took the required steps to implement the changes that the standard represents in terms of internal control, tax and systems affairs, from the adoption date.

The following is a reconciliation of the total commitments of operating leases as of December 31, 2018 and the lease liability at the date of initial adoption:

	<b>2019</b>
Operating lease commitments as of December 31, 2018	\$834,651
Amount discounted using the incremental borrowing rate as of January 1, 2019	680,405
Lease liabilities as of December 31, 2018	
(-): Short-term leases not recognized as lease liabilities	-
(-): Low value assets not recognized as lease liabilities	-
(+/-): Adjustments by extension of terms and others	-
(+/-): Adjustments related to changes in the index of variable payment	-
	<u>\$680,405</u>
Lease liability as of January 1, 2019	<u>\$680,405</u>

### **IFRIC 23, *Uncertainty over Income Tax Treatments***

This new Interpretation clarifies how to apply the recognition and measurement requirements in IAS 12, *Income Taxes*, when there is uncertainty over income tax treatments. Uncertain tax treatments are a tax treatment for which there is uncertainty over whether the relevant taxation authority will accept the tax treatment under tax law. In such a circumstance, an entity shall recognize and measure its current or deferred tax asset or liability by applying the requirements in IAS 12 based on taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates determined applying this Interpretation.

The Company applied IFRIC 23 from January 1, 2019. As a method of initial adoption, the Company determined that the impacts of the implementation of this Interpretation as of January 1, 2019 are not material considering the prevailing conditions of the tax positions that it has taken at the date of adoption and the faculties of the competent authorities to assess tax positions held by the Company at the same date.



ii. New standards and interpretation, not in force in the reporting period

The Company has reviewed the following new IFRS and improvements issued by IASB not yet effective for the reporting period, and in its evaluation process did not visualize potential impacts due to its adoption, considering that they are not of significant applicability:

- IFRS 17 – Insurance contracts <sup>(1)</sup>
- Amendments to IFRS 3 – Definition of a business <sup>(2)</sup>
- Amendments to IAS 1 e IAS 8 – Definition of material <sup>(2)</sup>
- Amendments to IFRS 9, IAS 39 e IFRS 7 – Interest rate benchmark reform <sup>(2)</sup>

*(1) Effective for annual periods beginning January 1, 2021*

*(2) Effective for annual periods beginning January 1, 2020*

**c. Consolidation**

i. Subsidiaries

The subsidiaries are all the entities over which the Company has control. The Company controls an entity when it is exposed, or has the right to variable returns from its interest in the entity and it is capable of affecting the returns through its power over the entity. When the Company's interest in subsidiaries is less than 100%, the interest attributed to external shareholders is recorded as non-controlling interest. Subsidiaries are consolidated in full from the date on which control is transferred to the Company and up to the date it loses such control.

The accounting method used by the Company for business combinations is the acquisition method. The Company defines a business combination as a transaction in which it gains control of a business, and through which it is able to direct and manage the relevant activities of the set of assets and liabilities of such business with the purpose of providing a return in the form of dividends, smaller costs or other economic benefits directly to shareholders.

The consideration transferred for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Company. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable acquired assets and liabilities and contingent liabilities assumed in a business combination are initially measured at their fair values at the acquisition date. The Company recognizes any non-controlling interest in the acquiree based on the share of the non-controlling interest in the net identifiable assets of the acquired entity.

The Company accounts for business combinations using the predecessor method in a jointly controlled entity. The predecessor method involves the incorporation of the carrying amounts of the acquired entity, which includes the goodwill recognized at the consolidated level with respect to the acquiree. Any difference between the transferred consideration and the carrying amount of the net assets acquired at the level of the subsidiary are recognized in equity.

The acquisition-related costs are recognized as expenses when incurred.

Goodwill is initially measured as excess of the sum of the consideration transferred and the fair value of the non-controlling interest in the subsidiary acquired over the net identifiable assets and liabilities assumed. If the consideration transferred is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognized directly in the consolidated statement of operations.

If the business combination is achieved in stages, the book value at the acquisition date of the interest previously held by the Company in the acquired entity is remeasured at its fair value at the acquisition date. Any loss or gain resulting from such remeasurement is recorded in results of the year.

Transactions and intercompany balances, as well as unrealized gains on transactions between Axtel companies are eliminated in preparing the consolidated financial statements. In order to ensure consistency with the policies adopted by the Company, the amounts reported by subsidiaries have been modified where it was deemed necessary.





As of December 31, 2019 and 2018, the main subsidiary companies of Axtel were as follows:

	Country	Shareholding interest (%)		Functional currency
		2019	2018	
Axtel, S. A. B. de C. V. (Holding company) <sup>(3)(5)</sup>	Mexico			Mexican peso
Servicios Axtel, S. A. de C. V. <sup>(1)</sup>	Mexico	100	100	Mexican peso
Alestra Innovacion Digital, S. de R. L. de C. V. <sup>(3)</sup>	Mexico	100	100	Mexican peso
Avantel, S. de R. L. de C. V. ("Avantel") <sup>(3)(5)</sup>	Mexico	-	100	Mexican peso
Axes Data, S. A. de C. V. <sup>(1)</sup>	Mexico	100	100	Mexican peso
Contacto IP, S. A. de C. V. <sup>(1)</sup>	Mexico	100	100	Mexican peso
Instalaciones y Contrataciones, S. A. de C. V. <sup>(1)</sup>	Mexico	100	100	Mexican peso
Servicios Alestra, S. A. de C. V. <sup>(1)(5)</sup>	Mexico	-	99.98	Mexican peso
Ingeniería de Soluciones Alestra, S. A. de C. V. <sup>(1)</sup>	Mexico	100	100	Mexican peso
Alestra USA, Inc. <sup>(2)</sup>	USA	100	100	U.S. dollar
S&C Constructores de Sistemas, S. A. de C. V. ("S&C")	Mexico	100	100	Mexican peso
Alesre Insurance Pte, Ltd. <sup>(4)</sup>	Singapore	-	100	U.S. dollar
Estrategias en Tecnología Corporativa, S. A. de C. V. ("Estratel") <sup>(3)</sup>	Mexico	100	100	Mexican peso
Servicios Alestra TI, S. A. de C. V. <sup>(1)</sup>	Mexico	100	100	Mexican peso
Alestra Procesamiento de Pagos, S.A. de C.V. <sup>(3)</sup>	Mexico	100	-	Mexican Peso
Administradora de Centros de Datos México, S.A. de C.V. <sup>(1)</sup>	Mexico	100	-	Mexican Peso
Servicios Administrativos de Centro de Datos México, S.A. de C.V. <sup>(3)</sup>	Mexico	100	-	Mexican Peso
La Nave del Recuerdo, S.A. de C.V. <sup>(6)</sup>	México	100	-	Mexican Peso
Contacto IP FTTH de México, S.A. de C.V. <sup>(6)</sup>	México	100	-	Mexican Peso
Alestra Servicios Móviles, S.A. de C.V. <sup>(6)</sup>	México	100	-	Mexican Peso

(1) Provider of administrative services.

(2) Leasing of telecommunications and infrastructure equipment.

(3) Provider of telecommunication services.

(4) Company with no primary operations, disposed of in August 2019

(5) At the General Extraordinary Stockholders' Meeting held on February 26, 2019, the stockholders agreed to merge Avantel, S. de R.L. de C.V. and Servicios Alestra, S.A. de C.V. (as absorbed companies) with Axtel, S. A. B. de C.V. (as absorbing company); this merger took effect on June 22, 2019 and has no impact on the operation of the Company at the consolidated level.

(6) Legally created companies with no operations.

As of December 31, 2019 and 2018, there are no significant restrictions for the investment in shares of the subsidiary companies mentioned above.

## ii. Absorption (dilution) of control in subsidiaries

The effect of absorption (dilution) of control in subsidiaries, that is, an increase or decrease in the percentage of control, is recorded in shareholders' equity, directly in retained earnings, in the period in which the transactions that cause such effects occur. The effect of absorption (dilution) of control is determined by comparing the book value of the investment in shares before the event of dilution or absorption against the book value after the relevant event. In the case of loss of control, the dilution effect is recognized in income.

When the Company issues a call option on certain non-controlling interests in a consolidated subsidiary and the non-controlling shareholders retain the risks and benefits over such interests in the consolidated subsidiary, these are recognized as financial liabilities at the present value of the amount to be reimbursed from the options, initially recorded with the corresponding reduction in equity and subsequently accruing through financial charges in results during the contractual period.



iii. Sale or disposal of subsidiaries

When the Company ceases to have control, any retained interest in the entity is remeasured at fair value, and the change in the carrying amount is recognized in the consolidated statement of operations. The fair value is the initial carrying amount for purposes of accounting for any subsequent retained interest in the associate, joint venture or financial asset. Any amount previously recognized in comprehensive (loss) income in respect of that entity is accounted for as if the Company had directly disposed of the related assets and liabilities. This results in the amounts previously recognized in comprehensive (loss) income being reclassified to income for the year.

iv. Associates

Associates are all entities over which the Company has significant influence but not control. Generally, an investor must hold between 20% and 50% of the voting rights in an investee for it to be an associate. Investments in associates are accounted for using the equity method and are initially recognized at cost. The Company's investment in associates includes goodwill identified at acquisition, net of any accumulated impairment loss.

If the equity in an associate is reduced but significant influence is maintained, only a portion of the amounts previously recognized in the comprehensive (loss) income are reclassified to income for the year, where appropriate.

The Company's share of profits or losses of associates, post-acquisition, is recognized in the consolidated statement of operations and its share in the other comprehensive (loss) income of associates is recognized as other comprehensive (loss) income. When the Company's share of losses in an associate equals or exceeds its interest in the associate, including unsecured receivables, the Company does not recognize further losses unless it has incurred obligations or made payments on behalf of the associate.

The Company assesses at each reporting date whether there is objective evidence that the investment in the associate is impaired. If so, the Company calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognizes it in "Equity in income of associates recognized using the equity method" in the consolidated statement of operations.

Unrealized gains on transactions between the Company and its associates are eliminated to the extent of the Company's interest in such gains. Unrealized losses are also eliminated unless the transaction provides evidence that the transferred asset is impaired. In order to ensure consistency with the policies adopted by the Company, the accounting policies of associates have been modified. When the Company ceases to have significant influence over an associate, any difference between the fair value of the remaining investment, including any consideration received from the partial disposal of the investment, and the book value of the investment is recognized in the consolidated statement of operations.

As of December 31, 2019 and 2018, the Company has no associates.

**d. Foreign currency translation**

i. Functional and presentation currency

The amounts included in the financial statements of each of the Company's subsidiaries should be measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Mexican pesos, which is the Company's presentation currency. Note 3c describes the functional currency of the Company and its subsidiaries.

When there is a change in the functional currency of one of the subsidiaries, according to International Accounting Standard 21, *Effects of Changes in Foreign Currency Exchange Rates* ("IAS 21"), this change is accounted for prospectively, translating at the date of the functional currency change, all assets, liabilities, equity and income items at the exchange rate of that date.



ii. Transactions and balances

Transactions in foreign currencies are translated into the functional currency using the foreign exchange rates prevailing at the transaction date or valuation date when the amounts are remeasured. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies at the closing exchange rates are recognized as foreign exchange gain or loss in the consolidated statement of operations, except for those which are deferred in comprehensive (loss) income and qualify as cash flow hedges.

The exchange differences in monetary assets classified as financial instruments at fair value with changes through profit or loss are recognized in the consolidated statement of operations as part of the gain or loss in fair value.

*Translation of subsidiaries with recording currency other than the functional currency.*

The financial statements of foreign subsidiaries, having a recording currency different from their functional currency were translated into the functional currency in accordance with the following procedure:

- a. The balances of monetary assets and liabilities denominated in the recording currency were translated at the closing exchange rate.
- b. To the historical balances of monetary assets and liabilities and shareholders' equity translated into the functional currency the movements that occurred during the period were added, which were translated at historical exchange rates. In the case of the movements of non-monetary items recognized at fair value, which occurred during the period stated in the recording currency, these were translated using the historical exchange rates in effect on the date when the fair value was determined.
- c. Revenues, costs and expenses of the periods, expressed in the recording currency, were translated at the historical exchange rates of the date they were accrued and recognized in the consolidated statement of operations, except when they arose from non-monetary items, in which case the historical exchange rate of the non-monetary items was used.
- d. The exchange differences arising in the translation were recognized in the consolidated statement of operations in the period they arose.

The primary exchange rates in the different translation procedures are listed below:

Country	Local currency	Local currency to Mexican pesos			
		Closing exchange rate as of December 31,		Average annual exchange rate	
		2019	2018	2019	2018
United States	U.S. dollar	18.85	19.68	19.27	19.24

e. **Cash and cash equivalents**

Cash and cash equivalents include cash on hand, bank deposits available for operations and other short-term investments of high credit-quality and liquidity with original maturities of three months or less, all of which are subject to insignificant risk of changes in value.

f. **Restricted cash**

Cash whose restrictions cause them not to comply with the definition of cash and cash equivalents given above, are presented in a separate line in the consolidated statement of financial position and are excluded from cash and cash equivalents in the consolidated statement of cash flows.

g. **Financial instruments**

Financial assets

The Company classifies and measures its financial assets based on the Company's business model to manage financial assets, and on the characteristics of the contractual cash flows of such assets. This way financial assets can be classified at amortized cost, at fair value through other comprehensive (loss) income, and at fair value through profit or loss. Management determines the classification of its financial assets upon initial recognition. Purchases and sales of financial assets are recognized at settlement date.



Financial assets are entirely written off when the right to receive the related cash flows expires or is transferred, and the Company has also substantially transferred all the risks and rewards of its ownership, as well as the control of the financial asset.

***Classes of financial assets under IFRS 9, in effect beginning January 1, 2018.***

*i. Financial assets at amortized cost*

Financial assets at amortized cost are those that i) are held within a business model whose objective is to hold said assets in order to collect contractual cash flows and ii) the contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest on the amount of outstanding principal.

*ii. Financial assets at fair value through other comprehensive (loss) income*

Financial assets at fair value through other comprehensive (loss) income are those whose business model is based in obtaining contractual cash flows and sell the financial assets; and the contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest on the amount of outstanding principal. As of December 31, 2019 and 2018, the Company does not have financial assets to be measured at fair value through other comprehensive (loss) income.

*iii. Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss, in addition to those described in point *i* in this section, are those that do not meet the characteristics to be measured at amortized cost or fair value through other comprehensive (loss) income, since i) they have a business model different to those that seek to collect contractual cash flows, or collect contractual cash flows and sell the financial assets, or otherwise ii) the generated cash flows are not solely payments of principal and interest on the amount of outstanding principal.

Despite the above classifications, the Company can make the following irrevocable choices in the initial recognition of a financial asset:

- a. Disclose the subsequent changes in the fair value of an equity instrument in other comprehensive (loss) income, only if such investment (in which no significant influence, joint control or control is maintained) is not held for trading purposes, that is, a contingent consideration recognized as a result of a business combination.
- b. Assign a debt instrument to be measured at fair value in profit or loss, if as a result it eliminates or significantly reduces an accounting mismatch that would arise from the measurement of assets or liabilities or the recognition of profits and losses on them in different bases.

As of December 31, 2019 and 2018, the Company has not made any of the irrevocable designations described above.

***Impairment of financial assets***

The Company uses a new impairment model based on expected credit losses rather than losses incurred, applicable to financial assets subject to such assessment (i.e. financial assets measured at amortized cost and at fair value through other comprehensive (loss) income), as well as lease receivables, contract assets, certain written loan commitments, and financial guarantee contracts. The expected credit losses on these financial assets are estimated from the initial recognition of the asset at each reporting date, using as a reference the past experience of the Company's credit losses, adjusted for factors that are specific to the debtors or groups of debtors, the general economic conditions and an assessment of both, the current management and the forecast of future conditions.

*a. Trade accounts receivables*

The Company adopted a simplified expected loss calculation model, through which expected credit losses during the accounts payable's lifetime are recognized.



The Company does an analysis of its portfolio of accounts receivable from clients, in order to determine if there are significant clients for whom it requires an individual evaluation; on the other hand, customers with similar characteristics that share credit risks (participation in the portfolio of accounts receivable, market type, sector, geographic area, etc.), are grouped to be evaluated collectively.

In its impairment assessment, the Company may include indications that the debtors or a group of debtors are experiencing significant financial difficulties, as well as observable data indicating that there is a significant decrease in the estimate of the cash flows to be received, including delays.

For purposes of the previous estimate, the Company considers that the following constitutes an event of default, since historical experience indicates that financial assets are not recoverable when they meet any of the following criteria:

- the debtor incompletes the financial agreements; or
- the information developed internally or obtained from external sources indicates that it is unlikely that the debtor will pay its creditors, including the Company, completely (without considering any guarantee held by the Company)

The Company is defined as the breach threshold the period from which the recovery of the account receivable subject to analysis is marginal; in this case, 120 days for the business segment and 150 days for the government segment, which is in line with the management of internal risks.

#### *b. Other financial instruments*

The Company recognizes credit losses expected during the asset's lifetime of all financial instruments for which credit risk has significantly increased since its initial recognition (assessed on a collective or individual basis), considering all the reasonable and sustainable information, including the one referring to the future. If as of the date of presentation of the credit risk a financial instrument has not significantly increased since its initial recognition, the Company calculates the loss allowance for that financial instrument as the amount of expected credit losses in the following 12 months.

In both cases, the Company recognizes in profit or loss of the period the decrease or increase in the expected credit loss allowance at the end of the period, as an impairment gain or loss.

Management assesses the impairment model and the inputs used therein at least once every year, in order to ensure that they remain in effect based on the current situation of the portfolio.

#### *Financial liabilities*

Financial liabilities that are not derivatives are initially recognized at fair value and subsequently valued at amortized cost using the effective interest rate method. Liabilities in this category are classified as current liabilities if they are expected to be settled within the following 12 months; otherwise, they are classified as non-current liabilities.

Payables are obligations to pay for goods or services that have been purchased or received from suppliers in the ordinary course of business. Loans are initially recognized at fair value, net of transaction costs incurred. Loans are subsequently recognized at amortized cost; any difference between the resources received (net of transaction costs) and the settlement value is recognized in the consolidated statement of operations during the loan's term using the effective interest method.

#### *Derecognition of financial liabilities*

The Company derecognizes financial liabilities if, and only if, the obligations of the Company are met, canceled or have expired. The difference between the carrying value of the financial liability derecognized and the consideration paid and payable is recognized in profit or loss.

Additionally, when the Company carries out a refinancing transaction and the previous liability qualifies to be derecognized, the costs incurred in the refinancing are recognized immediately in results as of the date of termination of the previous financial liability.



### *Offsetting of financial assets and liabilities*

Financial assets and liabilities are offset and the net amount is presented in the consolidated statement of financial position when the right to offset the recognized amounts is legally enforceable, and there is an intention to settle them on a net basis or to realize the asset and pay the liability simultaneously.

### ***h. Derivative financial instruments and hedging activities***

All derivative financial instruments are identified and classified as fair value hedges or cash flow hedges, for trading or market risk hedging and are recognized in the consolidated statement of financial position as assets and/or liabilities at fair value and similarly measured subsequently at fair value. Fair value is determined based on recognized market prices and when non-quoted in an observable market, it is determined using valuation techniques accepted in the financial sector.

Fair value of hedging derivatives is classified as a non-current asset or liability if the remaining maturity of the hedged item is more than 12 months and as a current asset or liability if the remaining maturity of the hedged item is less than 12 months.

Derivative financial instruments classified as hedges are contracted for risk hedging purposes and meet all hedging requirements; their designation at the beginning of the hedging operation is documented, describing the objective, primary position, risks to be hedged and the effectiveness of the hedging relationship, characteristics, accounting recognition and how the effectiveness is to be measured, applicable to that operation.

#### *Fair value hedges*

Changes in the fair value of derivative financial instruments are recorded in the consolidated statements of operations. The change in fair value hedges and the change in the primary position attributable to the hedged risk are recorded in the consolidated statement of operations in the same line item as the hedged position. As of December 31, 2019 and 2018, the Company has no derivative financial instruments classified as fair value hedges.

#### *Cash flow hedges*

The changes in the fair value of derivative instruments associated to cash flow hedges are recorded in shareholders' equity. The effective portion is temporarily recorded in comprehensive (loss) income, within shareholders' equity and is reclassified to profit or loss when the hedged position is affected; the ineffective portion is immediately recorded in profit or loss. As December 31, 2019 and 2018, the Company does not have derivative financial instruments designated as cash flow hedges.

#### *Suspension of hedge accounting*

The Company suspends hedge accounting when the derivative financial instrument or the non-derivative financial instrument has expired, is cancelled or exercised, when the derivative or non-derivative financial instrument is not highly effective to offset the changes in the fair value or cash flows of the hedged item. The substitution or successive renewal of a hedge instrument by another is not an expiration or resolution if said replacement or renewal is part of the Company's documented risk management objective and is consistent with it.

On suspending hedge accounting, in the case of fair value hedges, the adjustment to the carrying amount of a hedged amount for which the effective interest rate method is used, is amortized to profit or loss over the maturity period. In the case of cash flow hedges, the amounts accumulated in equity as part of comprehensive (loss) income remain in equity until the time when the effects of the forecasted transaction affect profit or loss. In the event the forecasted transaction is not likely to occur, the gain or loss accumulated in comprehensive (loss) income are immediately recognized in profit or loss. When the hedge of a forecasted transaction appears satisfactory and subsequently does not meet the effectiveness test, the cumulative effects in comprehensive (loss) income in shareholders' equity are transferred proportionally to profit or loss, to the extent the forecasted transaction impacts it.

Fair value of derivative financial instruments reflected in the Company's consolidated financial statements, is a mathematical approximation of their fair value. It is computed using proprietary models of independent third parties using assumptions based on past and present market conditions and future expectations at closing date.



**i. Inventories**

Inventories are shown at the lesser of its cost and net realization value. The cost is determined using the weighted average cost method. The cost of the finished products and products in process includes the product design cost, raw material, direct labor, other direct costs and overhead costs (based in the normal operation capacity). Excludes borrowing costs. The net realization value is the estimated sales price in the ordinary course of the business, less variable sale expenses applicable.

**j. Prepayments**

Prepayments mainly comprise insurance and prepayments to service providers. The amounts are recorded on the basis of contractual values and are recorded monthly in the consolidated statement of operations every month over the lifetime of the corresponding prepayment: the amount corresponding to the proportion to be considered over the following 12 months is shown under current assets and the remaining amount is shown under non-current assets.

**k. Property, plant and equipment**

Items of property, plant and equipment are recorded at cost less accumulated depreciation and any accrued impairment losses. Cost includes expenses directly attributable to the asset acquisition.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be reliably measured. The carrying amount of the replaced part is derecognized. Repairs and maintenance are recognized in the consolidated statement of operations during the year they are incurred. Major improvements are depreciated over the remaining useful life of the related asset.

When the Company carries out major repairs or maintenance of its property, plant and equipment assets, cost is recognized in the carrying amount of the corresponding asset as a replacement, provided that the recognition criteria are met. The remaining portion of any major repair or maintenance is derecognized. The Company subsequently depreciates the recognized cost in the useful life assigned to it, based on its best estimate of useful life.

Depreciation is calculated using the straight-line method, considering separately each of the asset's components, except for land, which is not subject to depreciation. The estimated useful lives of assets classes are as follows:

	<b>Years</b>
Buildings	40 - 60
Computers	3 - 5
Vehicles	4
Office equipment	10
Telecommunications network	6 to 28

Spare parts to be used after one year and attributable to specific machinery are classified as property, plant and equipment in other fixed assets.

Borrowing costs related to financing of property, plant and equipment whose acquisition or construction relates to qualifying assets, that require a substantial period of time to be ready for their use or sale, are capitalized as part of the cost of acquiring such qualifying assets, up to the moment when they are suitable for their intended use or sale.

Assets classified as property, plant and equipment are subject to impairment tests whenever events or circumstances occur indicating that the carrying amount of the assets may not be recoverable. An impairment loss is recognized for the amount by which the carrying amount of the asset exceeds its recoverable amount in the consolidated statement of operations in other expenses, net. The recoverable amount is the higher of its fair value less costs to sell and its value in use.

Residual value, useful lives and depreciation method of assets are reviewed at least at the end of each reporting period and, if expectations differ from previous estimates, the changes are accounted for as a change in accounting estimate.

Gains and losses on disposal of assets are determined by comparing the sale value with the carrying amount and are recognized in other expenses, net, in the consolidated statement of operations.



## **I. Leases**

### ***Classification and valuation of leases under IAS 17, in effect through December 31, 2018***

#### ***The Company as lessee***

As of December 31, 2018, the classification of leases as finance or operating depended on the substance of the transaction rather than the form of the contract.

Leases in which a significant portion of the risks and rewards relating to the leased property are retained by the lessor were classified as operating leases. Payments made under operating leases (net of incentives received by the lessor) were recognized in the consolidated statement of operations based on the straight-line method over the lease period.

Leases where the Company assumes substantially all the risks and rewards of ownership were classified as finance leases. Finance leases were capitalized at the beginning of the lease, at the lower of the fair value of the leased property and the present value of the future minimum lease payments. If its determination was practical, in order to discount the future minimum lease payments to present value, the interest rate implicit in the lease was used; otherwise, the incremental borrowing rate of the lessee was used. Any initial direct costs of the leases were added to the original amount recognized as an asset. Each lease payment was allocated between the liability and finance charges to achieve a constant rate on the outstanding balance. The corresponding rental obligations were included in non-current debt, net of finance charges. The interest element of the finance cost was charged to the income for the year during the period of the lease, so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. Property, plant and equipment acquired under finance leases were depreciated over the shorter of the asset's useful life or the lease term.

#### ***The Company as lessor***

Leases for which the Company is considered a lessor were classified as financial or operating. As long as the lease terms transfer substantially all the risks and rewards of ownership to the lessee, the contract was classified as a finance lease. The other leases were classified as operating leases.

Revenues arising from operating leases were recognized in straight-line over the term of the corresponding lease. The initial direct costs incurred in the negotiation and the organization of an operating lease were added to the book value of the leased asset and were recognized in a straight line over the term of the lease. Revenues arising from financial leases were recognized as accounts receivable for the amount of the net investment of the Company in the leases.

### ***Classification and valuation of leases under IFRS 16, in effect beginning January 1, 2019***

#### ***The Company as lessee***

The Company evaluates whether a contract is or contains a lease agreement at inception of a contract. A lease is defined as an agreement or part of an agreement that conveys the right to control the use of an identified asset for a period of time in exchange for a consideration. The Company recognizes an asset for right-of-use and the corresponding lease liability, for all lease agreements in which it acts as lessee, except in the following cases: short-term leases (defined as leases with a lease term of less than 12 months); leases of low-value assets (defined as leases of assets with an individual market value of less than US\$5,000 (five thousand dollars)); and, lease agreements whose payments are variable (without any contractually defined fixed payment). For these agreements, which exempt the recognition of an asset for right-of-use and a lease liability, the Company recognizes the rent payments as an operating expense in a straight-line method over the lease period.

The right-of-use asset comprises all lease payments discounted at present value; the direct costs to obtain a lease; the advance lease payments; and the obligations of dismantling or removal of assets. The Company depreciates the right-of-use asset over the shorter of the lease term or the useful life of the underlying asset; therefore, when the lessee will exercise a purchase option, the lessee shall depreciate the right-of-use asset from the commencement date to the end of the useful life of the underlying asset. Depreciation begins on the lease commencement date.





The lease liability is initially measured at the present value of the future minimum lease payments that have not been paid at that date, using a discount rate that reflects the cost of obtaining funds for an amount similar to the value of the lease payments, for the acquisition of the underlying asset, in the same currency and for a similar period to the corresponding contract (incremental borrowing rate). When lease payments contain non-lease components (services), the Company has chosen, for some class of assets, not to separate them and measure all payments as a single lease component; however, for the rest of the class of assets, the Company measures the lease liability only considering lease payments, while all of the services implicit in the payments, are recognized directly in the consolidated statement of operations as operating expenses.

To determine the lease term, the Company considers the non-cancellable period, including the probability to exercise any right to extend and/or terminate the lease term.

Subsequently, the lease liability is measured increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and reducing the carrying amount to reflect the lease payments made.

When there is a modification in future lease payments resulting from changes in an index or a rate used to determine those payments, the Company remeasures the lease liability when the adjustment to the lease payments takes effect, without reassessing the discount rate. However, if the modifications are related to the lease term or exercising a purchase option, the Company reassesses the discount rate during the liability's remeasurement. Any increase or decrease in the value of the lease liability subsequent to this remeasurement is recognized as an adjustment to the right-of-use asset to the same extent.

Finally, the lease liability is derecognized when the Company fulfills all lease payments. When the Company determines that it is probable that it will exercise an early termination of the contract that leads to a cash disbursement, such disbursement is accounted as part of the liability's remeasurement mentioned in the previous paragraph; however, in cases in which the early termination does not involve a cash disbursement, the Company cancels the lease liability and the corresponding right-of-use asset, recognizing the difference immediately in the consolidated statement of operations.

#### *The Company as lessor*

As of January 1, 2019, the Company, in those cases where it acts as a lessor, maintains its accounting policy consistent with that in effect during the year ended December 31, 2018, considering the new definition of leases established by IFRS 16.

#### **m. Intangible assets**

Intangible assets are recognized when they meet the following conditions: they are identifiable, they provide future economic benefits and the Company has control over such benefits.

Intangible assets are classified as follows:

##### **i. Finite useful life**

These assets are recognized at cost less accumulated amortization and accrued impairment losses. They are amortized on a straight-line basis over their estimated useful life, determined based on the expectation of generating future economic benefits, and are subject to impairment tests when triggering events of impairment are identified.

The estimated useful lives of intangible assets with finite useful lives are summarized as follows:

	<b>Years</b>
Software and licenses	3 - 7
Concessions	20 - 30
Capacity of communications network	13
Other	4
To do and not to do obligations	3
Trademarks	5
Relationships with customers	15



*a. Trademarks*

Trademarks acquired in a separate transaction are recorded at acquisition cost. Trademarks acquired in a business combination are recognized at fair value at the acquisition date.

Trademarks are amortized according to their useful life based on the Company's evaluation; if in this evaluation the useful life proves to be indefinite, then trademarks are not amortized but subject to annual impairment tests.

*b. Licenses*

Licenses acquired in a separate transaction are recorded at acquisition cost. Licenses acquired in a business combination are recognized at fair value at acquisition date.

Licenses that have a definite useful life are presented at cost less accumulated amortization. Amortization is recorded on a straight-line basis over its estimated useful life.

The acquisition of software licenses is capitalized based on the costs incurred to acquire and use the specific software.

*ii. Indefinite useful life*

These intangible assets are not amortized and are subject to annual impairment assessment. As of December 31, 2019 and 2018, intangible assets with an indefinite life corresponds to goodwill.

*n. Goodwill*

Goodwill represents the excess of the acquisition cost of a subsidiary over the Company's interest in the fair value of the identifiable net assets acquired, determined at the date of acquisition, and is not subject to amortization. Goodwill is shown under goodwill and intangible assets and is recognized at cost less accumulated impairment losses, which are not reversed. Gains or losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

*o. Impairment of non-financial assets*

Assets that have an indefinite useful life, for example goodwill, are not depreciable or amortizable and are subject to annual impairment tests. Assets that are subject to amortization are reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels at which separately identifiable cash flows exist (cash generating units). Non-financial long-term assets other than goodwill that have suffered impairment are reviewed for a possible reversal of the impairment at each reporting date.

*p. Income tax*

The amount of income taxes in the consolidated statement of operations represents the sum of current and deferred income taxes.

The amount of income taxes included in the consolidated statement of operations represents the current tax of the year and the effects of deferred income tax determined in each subsidiary by the assets and liabilities method, applying the rate established by the legislation enacted or substantially enacted at the statement of financial position date, wherever the Company operates, and generates taxable income on the total temporary differences resulting from comparing the accounting and tax bases of assets and liabilities, and that are expected to be applied when the deferred tax asset is realized or the deferred tax liability is expected to be settled, considering, when applicable, any tax-loss carryforwards, prior to the recovery analysis. The effect of a change in current tax rates is recognized in profit or loss of the period in which the rate change is determined.

Management periodically evaluates positions taken in tax returns with respect to situations in which the applicable law is subject to interpretation. Provisions are recognized when appropriate based on the amounts expected to be paid to the tax authorities.

Deferred tax assets are recognized only when it is probable that future taxable profits will exist against which the deductions for temporary differences can be taken.



Deferred income tax on temporary differences arising from investments in subsidiaries, associates and joint agreements is recognized, unless the period of reversal of temporary differences is controlled by Axtel and it is probable that the temporary differences will not revert in the near future.

Deferred tax assets and liabilities are offset when a legal right exists and when the taxes are levied by the same tax authority.

**q. *Employee benefits***

*i. Pension plans*

Defined contribution plans:

A defined contribution plan is a pension plan under which the Company pays fixed contributions to a separate entity. The Company has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to their service in the current and past periods. The contributions are recognized as employee benefit expense on the date that the contribution is required.

Defined benefit plans:

A defined benefit plan is a plan which specifies the amount of the pension an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation.

The liability recognized in the consolidated statement of financial position in respect of defined benefit plans is the present value of the defined benefit obligation at the consolidated statement of financial position date less the fair value of plan assets. The defined benefit obligation is calculated annually by independent third parties using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using discount rates in conformity with IAS 19, *Employee Benefits*, that are denominated in the currency in which the benefits will be paid, and have maturities that approximate the terms of the pension liability.

Actuarial remeasurements arising from adjustments and changes in actuarial assumptions are recognized directly in other items of the comprehensive (loss) income in the year as they occur, and there will be no reclassified to profit or loss of the period.

The Company determines the net finance expense (income) by applying the discount rate to the liability (asset) from net defined benefits.

Past-service costs are recognized immediately in the consolidated statement of operations.

*ii. Post-employment medical benefits*

The Company provides medical benefits to retired employees after termination of employment. The right to access these benefits usually depends on the employee having worked until retirement age and completing a minimum of years of service. The expected costs of these benefits are accrued over the period of employment using the same criteria as those described for defined benefit pension plans.

*iii. Termination benefits*

Termination benefits are payable when employment is terminated by the Company before the normal retirement date or when an employee accepts voluntary termination of employment in exchange for these benefits. The Company recognizes termination benefits on the following dates, whichever occurs first: (a) when the Company can no longer withdraw the offer of these benefits, and (b) when the Company recognizes the costs from restructuring within the scope of the IAS 37 and it involves the payment of termination benefits. If there is an offer that promotes the termination of the employment relationship voluntarily by employees, termination benefits are valued based on the number of employees expected to accept the offer. The benefits that will be paid in the long term are discounted at their present value.



*iv. Short-term benefits*

The Company provides benefits to employees in the short term, which may include wages, salaries, annual compensation and bonuses payable within 12 months. The Company recognizes an undiscounted provision when it is contractually obligated or when past practice has created an obligation.

*v. Statutory employee profit sharing (PTU in Spanish) and bonuses*

The Company recognizes a liability and an expense for bonuses and statutory employee profit sharing when it has a legal or assumed obligation to pay these benefits and determines the amount to be recognized based on the tax profit for the year after certain adjustments.

**r. Provisions**

Liability provisions represent a present legal obligation or a constructive obligation as a result of past events where an outflow of resources to meet the obligation is likely and where the amount has been reliably estimated. Provisions are not recognized for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the value of money over time and the risks specific to the obligation. The increase in the provision due to the passage of time is recognized as interest expense.

When there are similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

A restructuring provision is recorded when the Company has developed a formal detailed plan for the restructure, and a valid expectation for the restructure has been created between the people affected, possibly for having started the plan implementation or for having announced its main characteristics to them.

**s. Share-based payments**

The Company has compensation plans that are based on the market value of shares of Alfa and Axtel, granted to certain senior executives of the Company. The conditions for granting such compensation to the eligible executives includes compliance with certain financial metrics such as level of profit achieved and remaining in the Company for up to 5 years, among other requirements. Alfa's Board of Directors has appointed a Technical Committee to manage the plan, and it reviews the estimated cash settlement of this compensation at the end of the year. The payment of the plan is always subject to the discretion of Alfa's senior management. Adjustments to this estimate are charged or credited to the consolidated statement of operations.

Fair value of the amount payable to employees in respect of share-based payments, which are settled in cash, is recognized as an administrative expense in the consolidated statement of operations, with a corresponding increase in liabilities, over the period of service required. The liability is included within other liabilities and is adjusted at each reporting date and at settlement date. Any change in the fair value of the liability is recognized as an expense in the consolidated statement of operations.

**t. Treasury shares**

The Company's stockholders periodically authorize a maximum amount for the acquisition of the Company's own shares. Upon the occurrence of a repurchase of its own shares, they become treasury shares and the amount is presented as a reduction to stockholders' equity at the purchase price. These amounts are stated at their historical value.

**u. Capital stock**

Axtel's common shares are classified as capital stock within shareholders' equity. Incremental costs directly attributable to the issuance of new shares are included in equity as a reduction from the consideration received, net of tax.



**v. *Comprehensive (loss) income***

Comprehensive (loss) income is comprised of net (loss) income plus the annual effects of other reserves, net of taxes, which include the translation of foreign subsidiaries, actuarial remeasurements, the effects of the change in the fair value of derivative financial instruments which are designated to cash flow hedges, and other items specifically required to be reflected in shareholders' equity, and which do not constitute capital contributions, reductions and distributions.

**w. *Segment reporting***

Segment information is presented consistently with the internal reporting provided to the Chief Executive Officer, who is the highest authority in operational decision-making, resource allocation and assessment of operating segment performance.

**x. *Revenue recognition***

Revenues comprise the fair value of the consideration received or for the sale of goods and services in the ordinary course of the transactions, and are presented in the consolidated statement of operations, net of the amount of variable considerations, which comprise the estimated amount of returns from customers, rebates and similar discounts and payments made to customers so that goods are accommodated in attractive and favorable spaces at their facilities.

To recognize revenues from contracts with customers, the comprehensive model for revenue accounting is used, which is based on a five-step approach consisting of the following: (1) identify the contract; (2) identify performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to each performance obligation in the contract; and (5) recognize the revenue when the company satisfies a performance obligation.

The Company maintains managed service agreements with customers from Government and business segments, which may include multiple deliverables mainly consisting of the delivery of equipment and provision of telecommunications services and information technologies. The Company evaluates certain agreements, in which it identifies more than one separable performance obligation, which consists of the equipment used to provide the service and that is installed in the facilities of the customers. In addition to the equipment, telecommunications and information technologies are identified as another separable performance obligation.

Where the equipment delivered to the customer is a separable performance obligation of the service, the Company assigns the price of managed service agreements to the performance obligations identified and described in the preceding paragraph according to independent market values and related discounts.

The Company recognizes the revenue derived from managed services agreements, as follows:

- Revenues from equipment installed in the facilities of customers is recognized upon transfer of control or right to use them; i.e., at some point in time. This performance obligation has a significant financial component; therefore, revenues are recognized in accordance with the effective interest rate method over the term of the agreement.
- Revenues from services are recognized as they are provided; i.e. as the customer consumes them in relation to services of voice, data and general telecommunications.

Dividend income from investments is recognized once the rights of shareholders to receive this payment have been established (when it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured).

Interest income is recognized when it is likely that the economic benefits will flow to the entity and the amount of revenue can be reliably measured by applying the effective interest rate.

Costs of acquiring new contracts are recognized as contractual assets and are amortized over the period of those contracts in profit or loss, which is when they will generate economic benefits.

**y. *Advances from customers***

Customer prepayments for cable, interconnection, data transmission, internet and local services are billed monthly and applied to profit or loss as revenue for the period as the services are provided. The Company's deferred income are recorded based on the commitment to provide a service to the customers, and the service is recognized in profit or loss as it is provided.



**z. Earnings per share**

Earnings per share are calculated by dividing the profit attributable to the shareholders by the weighted average number of common shares outstanding during the year.

**4. Financial instruments and financial risk management**

The Company's activities expose it to various financial risks: market risk (including exchange rate risks, interest rate risk on cash flows and interest rate risk on fair values), credit risk and liquidity risk.

The Company has a general risk management program focused on the unpredictability of financial markets, and seeks to minimize the potential adverse effects on its financial performance.

The objective of the risk management program is to protect the financial health of the businesses, taking into account the volatility associated with foreign exchange and interest rates. Sometimes, regarding market risks, the Company uses derivative financial instruments to hedge certain exposures to risks.

Alfa (holding company) has a Risk Management Committee (RMC), comprised of the Board's Chairman, the Chief Executive Officer ("CEO"), Chief Financial Officer ("CFO") of Alfa and the Risk Management Officer ("RMO") of Alfa acting as technical secretary. The RMC reviews derivative transactions proposed by the subsidiaries of Alfa, including Axtel, in which a potential loss analysis surpasses US\$1 million. This committee supports both the CEO and the Board's Chairman of the Company. All new derivative transactions, which the Company proposes to enter into, as well as the renewal or cancellation of derivative arrangements, must be approved by both the Company and Alfa's CEO, in accordance to the following schedule of authorizations:

	<b>Maximum Possible Loss US\$1 million</b>	
	<b>Individual transaction</b>	<b>Annual cumulative transactions</b>
Chief Executive Officer of Alfa	1	5
Risk Management Committee of Alfa	30	100
Finance Committee	100	300
Board of Directors of Alfa	>100	>300

The proposed transactions must meet certain criteria, including that the hedges are lower than established risk parameters, and that they are the result of a detailed analysis and properly documented. Sensitivity analysis and other risk analyses should be performed before the transactions are entered into.

**Capital management**

The Company's objectives when managing capital is to safeguard its ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits to other stakeholders, as well as maintaining an optimal capital structure to reduce the cost of capital.

To maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, return equity to shareholders, issue new shares or sell assets to reduce debt.

Axtel monitors capital based on a leverage ratio. This percentage is calculated by dividing total liabilities by total equity.

The financial ratio of total liabilities / total equity was 6.13 times and 6.78 times as of December 31, 2019 and 2018, respectively, resulting on a leverage ratio that meets the Company's management and risk policies.



### *Financial instruments per category*

Below are the Company's financial instruments by category:

	<b>As of December 31,</b>	
	<b>2019</b>	<b>2018</b>
Cash and cash equivalents	\$ 857,742	\$ 2,249,155
Restricted cash	-	93,908
Financial assets at amortized cost:		
Trade and other accounts receivable	3,310,000	2,908,133
Financial assets at fair value with changes through profit or loss <sup>(1)</sup>		
Financial instruments (zero strike call)	92,673	129,075
Derivative financial instruments <sup>(1)</sup>	-	23,591
<b>Total financial assets</b>	<b>\$ 4,260,415</b>	<b>\$ 5,403,862</b>
Financial liabilities at amortized cost:		
Current debt	\$ 131,632	\$ 465,828
Lease liability	866,098	-
Trade payables, related parties and sundry creditors	2,905,871	5,412,913
Non-current debt	13,836,310	15,156,918
Other non-current accounts payable	703,348	4,033
Financial liabilities measured at fair value with changes in results:		
Derivative financial instruments <sup>(1)</sup>	143,712	39,258
<b>Total financial liabilities</b>	<b>\$18,586,971</b>	<b>\$21,078,950</b>

(1) The Company designated the derivative financial instruments that comprise this balance, as hedges for accounting purposes, in accordance with what is described later in Note 4.

### *Fair value of financial assets and liabilities valued at amortized cost*

The amount of cash and cash equivalents, trade and other accounts receivable, other current assets, trade payables and other accounts payable, current debt, current provisions and other current liabilities approximate their fair value since their maturity date is less than twelve months. The net carrying amount of these accounts represents the expected cash flow at December 31, 2019 and 2018.

The carrying amount and estimated fair value of financial assets and liabilities valued at amortized cost is presented below:

	<b>As of December 31, 2019</b>		<b>As of December 31, 2018</b>	
	<b>Carrying amount</b>	<b>Fair value</b>	<b>Carrying amount</b>	<b>Fair value</b>
Financial liabilities:				
Debt (*)	\$14,006,129	\$14,737,276	\$14,974,979	\$14,212,680
Accounts payable to related parties	703,348	631,017	-	-

(\*) The carrying amount of debt, for purposes of calculating its fair value, is presented gross of interest payable and issuance costs.

The estimated fair values as of December 31, 2019 and 2018 were determined based on discounted cash flows, using rates that reflect a similar credit risk depending on the currency, maturity period and country where the debt was acquired, regarding financial liabilities with financial institutions, finance leases, other liabilities and related parties. The primary rates used are the Interbank Equilibrium Interest Rate ("TIIE" for its acronym in Spanish) for instruments in Mexican pesos and London Interbank Offer Rate ("LIBOR") for instruments in U.S. dollars. In the case of Senior Notes issued in international markets, the Company uses the market price of such Notes at the date of the consolidated financial statements. For purposes of disclosure, measurement at fair value of financial assets and liabilities valued at amortized cost is deemed within Level 1 and 2 of the fair value hierarchy.



### Market risk

#### *(i). Exchange rate risk*

The Company is exposed to the exchange risk arising from exposure of its currency, mainly with respect to the U.S. dollar. Axtel's indebtedness and part of its accounts payable are stated in U.S. dollars, which means that it is exposed to the risk of variations in the exchange rate.

The Company's interest expense on the dollar debt, stated in Mexican pesos in the Axtel consolidated financial statements, varies with the movements in the exchange rate. Depreciation of the peso gives rise to increases in the interest expense recorded in pesos.

The Company records exchange gains or losses when the Mexican peso appreciates or depreciates against the U.S. dollar. Due to the fact that the Company's monetary liabilities denominated in dollars have exceeded (and are expected to continue exceeding) Axtel's monetary assets stated in that same currency, depreciation of the Mexican peso to the U.S. dollar will give rise to exchange losses.

The Company has the following assets and liabilities in foreign currency in relation to the functional currency of its subsidiaries, translated to thousands of Mexican pesos at the closing exchange rate as of December 31, 2019:

	<b>USD (translated to thousands of MXP)</b>
Financial assets	\$ 701,548
Financial liabilities	<u>(11,019,701)</u>
Foreign exchange monetary position	<u>\$(10,318,153)</u>

During 2019 and 2018, Axtel contracted several derivative financial instruments, mainly forwards, to hedge this risk. These derivatives have been designated at fair value with changes through profit or loss for accounting purposes as explained in the next section of this note.

Based on the financial positions in foreign currency maintained by the Company, a hypothetical variation of 10% in the MXN/USD exchange rate and keeping all other variables constant, would result in an effect of \$1,031,815 on the consolidated statement of operations and shareholders' equity.

#### *Financial instruments and derivative financial instruments*

##### Financial instruments

As of December 31, 2019 and 2018, the Company has entered into Over the Counter (OTC) transaction agreements with Bank of America Merrill Lynch (BAML) and Corporativo GBM, S. A. B. de C. V. (GBM) denominated "Zero Strike Call" or options, at a price closely resembling zero. The asset underlying these instruments is the market value of Axtel's CPOs. The contracts signed prior to October 2016 can only be settled in cash. As from that date, the term of the contracts yet to be settled was extended and as a result of this negotiation, the settlement method can be in cash or in shares, as decided by the Company. The original term of these contracts is 6 months and can be extended by mutual agreement between the parties; however, as this is an American type option, the Company can exercise it at any given time prior to the date of maturity.

According to the contracts, in case of deciding for payment in cash, the amount to be settled will be calculated as per the following formula: *Number of options per option right per (reference price - exercise price)*.

Where:

Number of options = defined in the contract

Right of option = defined as 1 "share" per option, defining "share" as Bloomberg Code AxtelCPO MM.

Reference price = "The price per share that GBM receives upon settling the position of the hedges thereof, under commercially reasonable terms, discounting commissions and taxes".

Exercise price = 0.000001 pesos





The Company determined the classification and measurement of these contracts as financial assets at fair value with changes through profit or loss.

As of December 31, 2019 and 2018, the lending position of the options represents the maximum amount of its credit exposure, as showed below:

Counterparty	Notional amount	Agreement beginning date	Type of underlying asset	Fair value	
				2019	2018
Bank of America Merrill Lynch	30,384,700	2010 y 2009	CPO's Axtel	\$92,673	\$ 90,243
Corporativo GBM, S. A. B. de C. V. <sup>(1)</sup>	13,074,982	2015 y 2014	CPO's Axtel	-	38,832
				<u>\$92,673</u>	<u>\$129,075</u>

For the year ended December 31, 2019, the changes in fair value of the Zero Strike Calls gave rise to an unrealized loss of \$8,919 (unrealized loss of \$35,202 for the year ended December 31, 2018), recognized in the consolidated statement of operations within financial income and expenses.

<sup>(1)</sup> The financial instrument was exercised in May and June 2019.

#### Derivative financial instruments

Beginning on January 1, 2018, the Company designated its derivative financial instruments contracted during the year as cash flow accounting hedges. As of December 31, 2019 and 2018, the Company maintained the following derivative financial instruments:

- Interest Rate Swap (IRS) with the purpose of mitigating risks associated with the variability of its interest rates. The Company maintains interest-bearing liabilities at variable rates, which is why it is exposed to the variability of the reference interest rate (TIE). Therefore, the Company entered into an IRS and hedged the interest payments associated with two debt instruments; the conditions of the derivative financial instrument and the considerations of its valuation as a hedging instrument are mentioned below:

Characteristics	2019	2018
Currency	MXN	MXN
Notional	\$3,380,000	\$3,380,000
Coupon	TIE28	TIE28
Coupon	8.355%	8.355%
Maturity	December 15, 2022	December 15, 2022
Swap book value	\$(137,177)	\$ 23,591
Change in the fair value of the swap to measure ineffectiveness	\$(135,329)	\$ 24,477
Reclassification from OCI to income	\$653	\$214
Recognized in OCI net of reclassifications	\$136,524	\$(23,804)
Ineffectiveness recognized in income	-	-
Change in the fair value of the hedged item to measure ineffectiveness	\$147,478	\$(25,031)
Change in the fair value DFI vs. 2018	\$(160,768)	-

For accounting purposes, the Company has designated the IRS described above as a cash flow hedge to mitigate interest rate volatility of two financial liabilities, formally documenting the relationship, establishing the objectives, management's strategy to hedge the risk, the hedging instrument identified, the hedged item, the nature of the risk to be hedged and the methodology of used to evaluate the hedge effectiveness.

As of December 31, 2019 and 2018, the results of the effectiveness of this hedge confirms that the hedge relationship is highly effective, given that the changes in the fair value and cash flows of the hedged item are compensated in the range of effectiveness established by the Company. The prospective effectiveness test resulted in 100% and 99%, in 2019 and 2018, respectively, confirming that there is an economic relationship between the hedging instruments and the hedged instrument. The method used by the Company is to offset cash flows using a hypothetical derivative, which consists of comparing the changes in the fair value of the hedging instrument with the changes in the fair value of the hypothetical derivative that would result in a perfect coverage of the covered item.



According to the amount described and the way in which the derivative cash flows are exchanged, for this hedging strategy, the average hedge ratio is 93% and 95%, in 2019 and 2018, respectively. In this hedge relationship, the source of ineffectiveness is mainly credit risk.

- b. Forwards of accounting hedge with the objective of covering the exposure to the USD / MXN exchange rate variability.

Because the Company has the Mexican peso (MXN) as the functional currency and maintains obligations in USD, it is exposed to foreign exchange risk. Therefore, it has designated forward contracts as accounting hedges, where the hedged item is represented by obligations in USD and by the exchange fluctuation of the bond; the conditions of the derivative financial instruments and the considerations of their valuation as hedging instruments are mentioned below:

	Characteristics	2019 USD	2018 USD
Currency			
Total notional		US\$15,900	US\$93,868
		19.6560	
Average strike		MXN/USD	20.54 MXN/USD
Maturity		May 12, 2020	Jan-July 2019
Forward's book value		\$(6,535)	\$(39,258)
Change in the fair value of the forwards to measure ineffectiveness		\$(6,535)	\$(39,258)
Reclassification from OCI to income		\$4,043	\$ 4,316
Recognized in OCI net of reclassifications		\$2,492	\$35,762
Ineffectiveness recognized in income		-	-
Change in the fair value of the hedged item to measure ineffectiveness		\$6,535	\$39,258
Change in the fair value FDI vs 2018		\$32,723	-

In measuring the effectiveness of these hedges, the Company determined that they are highly effective because the changes in the fair value and cash flows of each hedged item are offset within the range of effectiveness established by management. The prospective effectiveness test for the USD / MXN exchange rate ratio resulted in 100%, confirming that there is an economic relationship between the hedging instruments and the instruments hedged. In addition, both the credit profile of the Company and the counterparty are good and are not expected to change in the medium term; therefore, the credit risk component is not considered to dominate the hedging relationship. The method that was used to evaluate the effectiveness is through a qualitative evaluation comparing the critical terms between the hedging instrument and the hedged instrument.

According to the notional amounts described and the way in which the flows of the derivatives are exchanged, the average hedging ratio for the USD / MXN exchange rate is 100% for USD obligations in 2019 and 46% for 2018. If necessary, a rebalancing will be performed to maintain this relationship for the strategy.

The source of ineffectiveness can be mainly caused by the difference in the settlement date of the hedging instruments and the hedged items, and that the budget becomes less than the hedging instruments. For the year ended December 31, 2019 and 2018, no ineffectiveness was recognized in gain or loss.

#### *Interest rate and cash flow risk*

The Company's interest rate risk arises from long-term loans. Loans at variable rates expose the Company to interest rate risks in cash flows that are partially offset by cash held at variable rates. Loans at fixed rates expose the Company to interest rate risk at fair value.

As of December 31, 2019, 33% of Axtel's total debt generates variable interest rates while the remaining 67% generates fixed interest rates.

The Company analyzes its exposure to interest rate risk on a dynamic basis. Several scenarios are simulated, taking into account the refinancing, renewal of existing positions, financing and alternative coverage. Based on these scenarios, the Company calculates the impact on the annual result of a change in the interest rate defined for each simulation, using the same change in the interest rate for all currencies. The scenarios are produced only for liabilities that represent the main positions that generate the highest interest.



Axtel's results and cash flows can be impacted if additional financing is required in the future when interest rates are high in relation to the Company's current conditions.

As of December 31, 2019, if the interest rates on variable rate loans were increased or decreased by 100 basis points, the interest expense would affect the results and stockholders' equity by \$45,835 and \$(45,835) respectively.

### Credit risk

Credit risk represents the risk of financial loss for the Company, if a customer or counterpart of a financial instruments defaults on its contractual obligations, mainly in connection with accounts receivable from customers, as well as from investment instruments.

#### Account receivables

The Company evaluates and aggregates groups of clients that share a credit risk profile, in accordance with the service channel in which they operate, in line with business management and internal risk management.

The Company is responsible for managing and analyzing the credit risk for each of its new customers prior to establishing the terms and conditions of payment to offer. Credit risk arises from exposure of credit to customers, including accounts receivable. If there is no independent rating in place, the Company evaluates the credit risk pertaining to its customers, taking into account the financial position, past experience and other factors such as historical lows, net recoveries and an analysis of accounts receivable balances aging with reserves that are usually increased to the extent the accounts receivable increases in age. The credit risk concentration is moderate due to the number of unrelated clients.

Axtel determines its allowance for impairment of accounts receivable taking into account the probability of recovery, based on past experiences, as well as current collection trends and overall economic factors. Accounts receivable are entirely reserved when there are specific collection problems; based on past experience. Moreover, collection problems such as bankruptcy or catastrophes are also taken into account.

Accounts receivable are analyzed monthly, and the allowance for impairment of accounts receivable is adjusted in profit or loss.

Additionally, the Company performs a qualitative evaluation of economic projections, in order to determine the possible impact on probabilities of default and the recovery rate assigned to its customers. Finally, in the evaluation of the derecognition of an account receivable, the Company evaluates whether there is any current expectation of recovery of the asset, before proceeding to execute the corresponding derecognition.

During the year ended December 31, 2019, there have been no changes in estimation techniques or assumptions.

Axtel conducts an economic evaluation of the efforts necessary to initiate legal proceedings for the recovery of past-due balances.

Other than Companies A and B, which are the Company's main customers, the Company has no significant exposure to credit risk involving a single customer or group of customers with similar characteristics. A group of customers is considered to have similar characteristics when they are related parties. The credit risk concentration of companies A and B must not exceed 20% of the gross amount of financial assets at any given moment during the year. The credit risk concentration of any other customer must not exceed 5% of the gross amount of monetary assets at any given moment during the year.

Company A accounts for 4% and 3% of the Company's total accounts receivable as of December 31, 2019 and 2018, respectively. Additionally, revenues associated to Company A for the years ended December 31, 2019 and 2018 was 2% and 2%, respectively.

Company B accounts for 4% and 5% of the Company's total accounts receivable as of December 31, 2019 and 2018, respectively. Additionally, revenues related to Company B for the years ended December 31, 2019 and 2018 was 3% and 2%, respectively.

As of December 31, 2019 and 2018, the allowance for impairment totaled \$1,208,739 and \$2,172,343 respectively. Axtel considers this allowance to be sufficient to cover for the probable loss of accounts receivable; however, it cannot ensure that it will not need to be increased.



## Investments

The Company's policies for managing cash and temporary cash investments are conservative, which allows for minimizing risk in this type of financial asset, taking into account also that operations are only conducted with financial institutions with high credit ratings.

The Company's maximum exposure to credit risk is equivalent to the total carrying amount of its financial assets.

## Liquidity risk

The Company's finance department continuously monitors the cash flows' projections and the Company's liquidity requirements, ensuring that cash and investments in marketable securities are sufficient to meet operating needs.

The Company regularly monitors and makes its decisions based on not violating its limits or covenants established in its debt contracts. Projections consider the Company's financing plans, compliance with covenants, compliance with minimum internal liquidity ratios and legal or regulatory requirements.

Management's responsibility with respect to liquidity risk corresponds to the Company's board of directors, which has established a general framework for proper handling of liquidity risk in the short, medium and long term. The Company manages liquidity risks, maintaining a proper level of reserves, use of credit lines from banks, and is vigilant of real and projected cash flows.

The following table includes the Company's derivative and non-derivative financial liabilities grouped according to maturity from the reporting date to the contractual maturity date. Derivative financial liabilities are included in the analysis if their contractual maturities are required to understand the terms of the Company's cash flows.

The figures shown in the chart are the non-discounted contractual cash flows.

	<b>Less than 1 year</b>	<b>Between 1 and 5 years</b>	<b>More than 5 years</b>
December 31, 2019			
Current debt	\$ 131,632	\$ -	\$ -
Trade payable, related parties and creditors	4,288,038	-	-
Derivative financial instruments	51,814	91,898	-
Non-current debt	-	11,355,748	2,630,602
Lease liability	451,775	401,335	12,988
Non-accrued interest payable	1,094,108	3,953,055	706,960
December 31, 2018			
Current debt	\$ 123,847	\$ -	\$ -
Trade payable, related parties and creditors	7,938,944	-	-
Derivative financial instruments	39,258	-	-
Non-current debt	-	2,275,469	12,699,510
Finance leases	341,981	398,133	-
Non-accrued interest payable	1,222,225	4,410,428	1,629,496

The Company expects to meet its obligations with the cash flows provided by operations and/or cash flows provided by its main shareholders. Furthermore, the Company has access to credit lines as mentioned in Note 17.

As of December 31, 2019, the Company has short-term uncommitted, unused lines of credit of more than US\$16,000 (\$301,600). Additionally, as of December 31, 2019, Axtel has medium-term committed lines of credit of US\$50,000 (\$942,500).

## *Fair value hierarchy*

The following is an analysis of financial instruments measured in accordance with the fair value hierarchy. Three different levels are used as presented below:

- Level 1: Quoted prices for identical instruments in active markets.
- Level 2: Other valuations including quoted prices for similar instruments in active markets, which are directly or indirectly observable.
- Level 3: Valuations made through techniques where one or more of their significant data inputs are unobservable.



The following table presents the Company's assets and liabilities that are measured at fair value as of December 31, 2019 and 2018:

	As of December 31, 2019			Total
	Level 1	Level 2	Level 3	
Financial assets:				
Zero strike calls	\$ 92,673	\$ -	\$ -	\$ 92,673
Forwards	-	(6,535)	-	(6,535)
Interest rate swap	-	(137,177)	-	(137,177)
	<u>\$ 92,673</u>	<u>\$(143,712)</u>	<u>\$ -</u>	<u>\$(51,039)</u>
	As of December 31, 2018			Total
	Level 1	Level 2	Level 3	
Financial assets:				
Zero strike calls	\$129,075	\$ -	\$ -	\$129,075
Forwards	-	(39,258)	-	(39,258)
Interest rate swap	-	23,591	-	23,591
	<u>\$129,075</u>	<u>\$ (15,667)</u>	<u>\$ -</u>	<u>\$113,408</u>

There were no transfers between Level 1 and 2 or between Level 2 and 3 during the period.

The specific valuation techniques used to value financial instruments include:

- Market quotations or quotations for similar instruments.
- The fair value of forward exchange agreements is determined using exchange rates at the closing balance date, with the resulting value discounted at present value.
- Other techniques such as the analysis of discounted cash flows, which are used to determine fair value of the remaining financial instruments.

## 5. Critical accounting estimates and significant judgments

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below:

### a. Long-lived assets

The Company estimates the useful lives of long-lived assets in order to determine the depreciation and amortization expenses to be recorded during the reporting period. The useful life of an asset is calculated when the asset is acquired and is based on past experience with similar assets, considering anticipated technological changes or any other type of changes. Were technological changes to occur faster than estimated, or differently than anticipated, the useful lives assigned to these assets could have to be reduced. This would lead to the recognition of a greater depreciation and amortization expense in future periods. Alternatively, these types of technological changes could result in the recognition of a charge for impairment to reflect the reduction in the expected future economic benefits associated with the assets.

The Company reviews depreciable and amortizable assets on an annual basis for signs of impairment, or when certain events or circumstances indicate that the book value may not be recovered during the remaining useful life of the assets. For intangible assets with an indefinite useful life, the Company performs impairment tests annually and at any time that there is an indication that the asset may be impaired.



To test for impairment, the Company uses projected cash flows, which consider the estimates of future transactions, including estimates of revenues, costs, operating expenses, capital expenditures and debt service. In accordance with IFRS, discounted future cash flows associated with an asset or CGU are compared to the book value of the asset or CGU being tested to determine if impairment exists whenever the aforementioned discounted future cash flows are less than its book value. In such case, the carrying amount of the asset or group of assets is reduced to its value in use, unless its fair value is higher.

***b. Estimated impairment of goodwill and intangible assets with indefinite useful lives***

The Company conducts annual tests to determine whether goodwill and intangibles assets with indefinite useful lives have suffered any impairment (Note 11). For impairment testing, goodwill and intangibles assets with indefinite lives is allocated with those cash generating units (CGUs) of which the Company has considered that economic and operational synergies of the business combinations are generated. The recoverable amounts of the groups of CGUs were determined based on the calculations of their value in use, which require the use of estimates, within which, the most significant are the following:

- Estimation of future gross and operating margins according to the historical performance and expectations of the industry for each CGU group.
- Discount rate based on the weighted cost of capital (WACC) of each CGU or CGU group.
- Long-term growth rates.

***c. Recoverability of deferred tax assets***

The Company has applicable tax-loss carryforwards, which can be used in the following years until maturity expires (see Note 18). Based on the projections of income and taxable income that the Company will generate in the following years through a structured and robust business plan, management has considered that current tax losses will be used before they expire and, therefore, it was considered appropriate to recognize a deferred tax asset for such losses.

***d. Commitments and contingencies***

The Company exercises its judgment in measuring and recognizing provisions and the exposures to contingent liabilities related to pending litigation or other pending claims subject to negotiation for liquidation, mediation, arbitration or government regulation, as well as other contingent liabilities. The Company applies its judgment to evaluate the probability that a pending claim is effective, or results in recognition of a liability, and to quantify the possible range of the liquidation. Due to the uncertainty inherent to this evaluation process, actual losses could differ from the provision originally estimated.

Contingencies are recorded as provisions when a liability has probably been incurred and the amount of the loss can be reasonably estimated. It is not practical to conduct an estimate regarding the sensitivity to potential losses, of all other assumptions have been made to record these provisions, due to the number of underlying assumptions and to the range of reasonable results possible, in connection with the potential actions of third parties, such as regulators, both in terms of probability of loss and estimates of said loss.

***e. Default probability and recovery rate to apply the expected credit losses model in the impairment measurement of financial assets***

The Company assigns to customers with whom it has an account receivable at each reporting date, either individually or as a group, an allowance for the probability of default in the account receivable and the estimated recovery rate, in order to reflect the cash flows expected to be received from the outstanding balances as of that date.

***f. Estimation of the discount rate to calculate the present value of future minimum lease payments***

The Company estimates the discount rate to use in the determination of the lease liability, based on the incremental borrowing rate ("IBR").



The Company uses a three-tier model, with which it determines the three elements that comprises the discount rate: (i) reference rate, (ii) credit risk component and (iii) adjustment for characteristics of the underlying asset. In this model, management also considers its policies and practices to obtain financing, distinguishing between the one obtained at the corporate level (that is, the holding company), or at the level of each subsidiary. Finally, for real estate leases, or in which there is significant and observable evidence of their residual value, the Company estimates and evaluates an adjustment for characteristics of the underlying asset, based on the possibility that said asset is granted as collateral or guarantee against the risk of default.

g. ***Estimation of the lease term***

The Company defines the lease term as the period for which there is a contractual payment commitment, considering the non-cancelable period of the contract, as well as the renewal and early termination options that are probable to be exercised. The Company participates in lease contracts that do not have a defined non-cancellable term, a defined renewal period (in case it contains a renewal clause), or automatic annual renewals, so, to measure the lease liability, it estimates the contracts term considering their contractual rights and limitations, their business plan, as well as management's intentions for the use of the underlying asset.

Additionally, the Company considers the clauses of early termination of its contracts and the probability of exercising them, as part of its estimate of the lease term.

**6. Cash and cash equivalents**

Cash and cash equivalents presented in the consolidated statement of financial position consist of the following:

	<b>2019</b>	<b>2018</b>
Cash on hand and in banks	\$139,197	\$ 488,987
Short-term investments	718,545	1,760,168
Total cash and cash equivalents	<u>\$857,742</u>	<u>\$2,249,155</u>

**7. Restricted cash**

Alestra filed a complaint with the Federal Telecommunications Institute (IFT from Spanish) in connection with a dispute on the resale interconnection rates established between Alestra and Telmex and Teléfonos del Norte ("Telnor", a subsidiary of Telmex).

The restricted cash as of December 31, 2018 of \$93,908 represents the trust balance over applicable disputes for 2008 and 2010 and is shown in the consolidated statement of financial position as a non-current asset. On May 10, 2018, Alestra was granted a favorable ruling and the withdrawal of the amounts contributed to the trust and their corresponding returns, obtaining the proceeds of \$59,005 and \$19,874 in November 2018.

As of December 31, 2019, the restricted cash balance is \$0 because on February 28, 2019, a ruling was handed down in favor of Alestra allowing the withdrawal of the outstanding balance of the amounts contributed to the trust and its corresponding returns.

**8. Trade and other accounts receivable, net**

Trade and other accounts receivable are comprised as follows:

	<b>2019</b>	<b>2018</b>
Current:		
Trade accounts receivable	\$3,634,751	\$4,832,433
Allowance for impairment of accounts receivable <sup>(1)</sup>	(1,208,739)	(2,172,343)
Trade accounts receivable, net	2,426,012	2,660,090
Recoverable taxes	34,674	685,748
Notes and other accounts receivable	850,528	192,938
Related parties	23,460	\$55,105
	<u>\$3,344,674</u>	<u>\$3,593,881</u>



(1) Movements of the allowance for impairment of accounts receivables are as follows:

	<b>2019</b>	<b>2018</b>
Initial balance	\$2,172,343	\$2,089,484
Write-off of doubtful accounts	45,631	114,207
Allowance for doubtful accounts for the year <sup>(2)</sup>	<u>(1,009,235)</u>	<u>(31,348)</u>
Ending balance	<u>\$1,208,739</u>	<u>\$2,172,343</u>

(2) The increases in the allowance in 2019 are mainly due to the increase in the probability of default assigned to certain customers with respect to the beginning of the year, in which the new methodology for impairment of financial assets was applied. In addition, they consider the reversals of impairment that arise when an account receivable, which had previously been impaired, becomes recoverable because the customer settled the outstanding balance.

The following describes the probability ranges of default and recovery rates allocated to the main customer segments with which the company has balances receivable in its different businesses:

<b>As of December 31, 2019</b>		
<b>Clients or group of clients</b>	<b>Probability range of default</b>	<b>Severity of loss</b>
Carriers	1.0% - 100.0%	85.74%
Business	1.6% - 100.0%	85.74%
Government	0.3% - 100.0%	68.78%

<b>As of December 31, 2018</b>		
<b>Clients or group of clients</b>	<b>Probability range of default</b>	<b>Severity of loss</b>
Massive	5.6% - 100.0%	96.00%
Carriers	0.9% - 100.0%	87.50%
Business	1.0% - 100.0%	87.50%
Government	2.9% - 100.0%	70.00%

## 9. Inventories

As of December 31, 2019 and 2018, inventories of \$93,982 and \$104,802, respectively, were composed by materials and consumables.

The cost of inventories recognized as an expense and included in the cost of sales amounted to \$141,649 and \$161,390 for 2019 and 2018, respectively. As of December 31, 2019 and 2018, there were no inventories pledged as collateral.





## 10. Property, plant and equipment

	Depreciable assets					Non-depreciable assets			Total
	Buildings	Telecommunications network	Office equipment	Computers	Vehicles	Leasehold improvements	Land	Investments in process	
For the year ended December 31, 2018									
Net opening balance	\$1,055,169	\$ 14,677,418	\$100,880	\$ 388,607	\$ 31,901	\$ 92,862	\$481,905	\$2,447,068	\$19,275,810
Translation effect	-	(143)	-	-	-	-	-	-	(143)
Additions	-	173,668	90	3,284	2,740	13	-	2,371,685	2,551,480
Transfers	29,319	3,459,853	15,809	133,509	3,147	27,232	-	(3,668,869)	-
Transfers held for sale	-	(300,307)	(49)	(1,188)	(344)	(102)	-	(5,845)	(307,835)
Disposals	-	(1,432,324)	(1,376)	(3,950)	(1,290)	(572)	-	(74,201)	(1,513,713)
Depreciation charge recognized in the year	(28,305)	(3,604,028)	(21,878)	(207,955)	(15,160)	(22,749)	-	-	(3,900,075)
Ending balance	<u>\$1,056,183</u>	<u>\$ 12,974,137</u>	<u>\$ 93,476</u>	<u>\$ 312,307</u>	<u>\$ 20,994</u>	<u>\$ 96,684</u>	<u>\$481,905</u>	<u>\$1,069,838</u>	<u>\$16,105,524</u>
As of December 31, 2018									
Cost	\$1,458,435	\$ 53,888,456	\$519,966	\$4,961,739	\$192,885	\$ 630,384	\$481,905	\$1,069,838	\$63,203,608
Accumulated depreciation	(402,252)	(40,914,319)	(426,490)	(4,649,432)	(171,891)	(533,700)	-	-	(47,098,084)
Net carrying amount as of December 31, 2018	<u>\$1,056,183</u>	<u>\$ 12,974,137</u>	<u>\$ 93,476</u>	<u>\$ 312,307</u>	<u>\$ 20,994</u>	<u>\$ 96,684</u>	<u>\$481,905</u>	<u>\$1,069,838</u>	<u>\$16,105,524</u>
For the year ended December 31, 2019									
Reclassifications to the right of use	\$ -	\$ (217,449)	\$ (721)	\$ (51,092)	\$ (6,862)	\$ -	\$ -	-	\$ (276,124)
Net opening balance	1,056,183	12,974,137	93,476	312,307	20,994	96,684	481,905	1,069,838	16,105,524
Translation effect	-	(944)	-	-	-	-	-	-	(944)
Additions	-	9,431	109	6,413	175	-	-	1,443,097	1,459,225
Transfers	6,230	1,589,353	2,162	36,278	677	9,900	-	(1,644,600)	-
Transfers held for sale	(761,495)	(337,571)	(4,786)	(205)	-	-	(20,556)	-	(1,124,613)
Disposals	-	(116,063)	(33)	(4,882)	(963)	(156)	-	(75,008)	(197,105)
Depreciation charges recognized in the year	(28,468)	(2,790,819)	(17,623)	(130,305)	(9,047)	(25,710)	-	-	(3,001,972)
Ending balance	<u>\$ 272,450</u>	<u>\$ 11,110,075</u>	<u>\$ 72,584</u>	<u>\$ 168,514</u>	<u>\$ 4,974</u>	<u>\$ 80,718</u>	<u>\$461,349</u>	<u>\$ 793,327</u>	<u>\$12,963,991</u>
As of December 31, 2019									
Cost	\$ 626,382	\$ 53,703,112	\$503,650	\$4,162,306	\$149,149	\$ 640,387	\$461,349	\$ 793,327	\$61,039,662
Accumulated depreciation	(353,932)	(42,593,037)	(431,066)	(3,993,792)	(144,175)	(559,669)	-	-	(48,075,671)
Net carrying amount as of December 31, 2019	<u>\$ 272,450</u>	<u>\$ 11,110,075</u>	<u>\$ 72,584</u>	<u>\$ 168,514</u>	<u>\$ 4,974</u>	<u>\$ 80,718</u>	<u>\$461,349</u>	<u>\$ 793,327</u>	<u>\$12,963,991</u>

Of the total depreciation expense, \$2,879,263 and \$2,896,444 were charged to cost of sales, \$122,709 and \$157,938 to selling and administrative expenses, and \$162,780 and \$845,693 in discontinued operations in 2019 and 2018, respectively.

Projects in process mainly include telecommunications network equipment to extend the Company's infrastructure and the capitalization period is approximately twelve months.

For the years ended December 31, 2019 and 2018, the Company capitalized \$15,434 and \$27,216, respectively, of borrowing costs related to qualifying assets of \$410,323 and \$495,455, respectively. These amounts were capitalized based on an interest rate of 7.63% and 8.98%, respectively.



# 11. Right of use asset

The Company leases a different set of fixed assets including, buildings, machinery and equipment, vehicles, and computer equipment. The average term of the lease contracts is from 3 to 6 years.

- i. The right of use recognized in the consolidated statement of financial position as of December 31, 2019, is integrated as follows:

	Land & buildings	Telecommunications equipment and networks	Furniture and office equipment	Computer equipment	Vehicles	Total
Net book value						
Adoption effect	\$ 680,405	\$ -	\$ -	\$ -	\$ -	\$680,405
Property, plant and equipment reclassification	-	217,449	721	51,092	6,862	276,124
Initial balances as of January 1, 2019	680,405	217,449	721	51,092	6,862	956,529
Final balances as of December 31, 2019	440,826	187,192	642	28,324	4,263	661,246
Accumulated depreciation	<u>\$(238,408)</u>	<u>\$ (30,256)</u>	<u>\$ (79)</u>	<u>\$(22,768)</u>	<u>\$(2,599)</u>	<u>\$(294,110)</u>

- ii. Expenses recognized in the consolidated statement of operations for the year ended December 31, 2019.

Rent expenses from low-value asset leases	\$ -
Rent expenses from short-term leases	\$892,752

The Company has not signed lease contracts, which at the date of the consolidated financial statements have not started.

During the year, the Company did not realize significant extensions to the term of its lease contracts.



## 12. Goodwill and intangible assets

			Definite life				Indefinite life	
	Concessions	Trademarks	Relationships with customers	Non-compete agreements	Software and licenses	Other	Goodwill	Total
As of January 1, 2018	\$ 36,339	\$ 48,920	\$ 149,416	\$ 325,687	\$ 378,836	\$ 149,778	\$419,536	\$1,508,512
Additions	-	-	-	-	228,145	237,062	-	465,207
Transfers	-	-	-	-	(572)	572	-	-
Amortization charges recognized in the year	(29,131)	(15,196)	(19,240)	(265,055)	(158,791)	(80,919)	-	(568,332)
Ending balance as of December 31, 2018	<u>\$ 7,208</u>	<u>\$ 33,724</u>	<u>\$ 130,176</u>	<u>\$ 60,632</u>	<u>\$ 447,618</u>	<u>\$ 306,493</u>	<u>\$419,536</u>	<u>\$1,405,387</u>
Cost	\$ 797,142	\$ 258,904	\$ 516,600	\$ 809,793	\$1,751,440	\$ 709,484	\$419,536	\$5,262,899
Accumulated amortization	(789,934)	(225,180)	(386,424)	(749,161)	(1,303,822)	(402,991)	-	(3,857,512)
Ending balance as of December 31, 2018	<u>\$ 7,208</u>	<u>\$ 33,724</u>	<u>\$ 130,176</u>	<u>\$ 60,632</u>	<u>\$ 447,618</u>	<u>\$ 306,493</u>	<u>\$419,536</u>	<u>\$1,405,387</u>
As of January 1, 2019	\$ 7,208	\$ 33,724	\$ 130,176	\$ 60,632	\$ 447,618	\$ 306,493	\$419,536	\$1,405,387
Additions	23,733	-	-	-	70,246	1,026	-	95,005
Disposals	-	-	-	-	(2,895)	-	-	(2,895)
Transfers	-	-	-	-	-	-	-	-
Amortization charges recognized in the year	(2,200)	(22,392)	(18,765)	(50,271)	(206,466)	(145,146)	-	(445,239)
Ending balance as of December 31, 2019	<u>\$ 28,741</u>	<u>\$ 11,332</u>	<u>\$ 111,411</u>	<u>\$ 10,361</u>	<u>\$ 308,503</u>	<u>\$ 162,373</u>	<u>\$419,536</u>	<u>\$1,052,258</u>
Cost	\$ 693,405	\$ 258,904	\$ 516,600	\$ 809,793	\$1,811,138	\$ 710,411	\$419,536	\$5,219,787
Accumulated amortization	(664,664)	(247,572)	(405,189)	(799,432)	(1,502,634)	(548,038)	-	(4,167,529)
Ending balance as of December 31, 2019	<u>\$ 28,741</u>	<u>\$ 11,332</u>	<u>\$ 111,411</u>	<u>\$ 10,361</u>	<u>\$ 308,504</u>	<u>\$ 162,373</u>	<u>\$419,536</u>	<u>\$1,052,258</u>

The intangible assets with indefinite life of the Company include only goodwill, which has been assigned to the Business segment. The rest of the intangible assets are of definite life.

Of the total amortization expense, \$2,131 and \$37,417 were charged to cost of sales, \$443,108 and \$530,915 to selling and administrative expenses in 2019 and 2018, respectively.



### Company concessions

Axtel has a Single Concession for commercial use, under which it is authorized to provide any telecommunications and/or broadcasting service, including, but not limited to local fixed and mobile telephony; national and international long distance, SMS (short message service), purchase or rental of network capacity for the generation, transmission or reception of data, signals, writings, images, voice, sounds and other information of any nature; rental of digital circuits, etc.

Through another subsidiary called Alestra Innovación Digital, S. de R.L. de C.V. (previously Alestra Comunicación), there will be another Single Concession for commercial use, with three associated concessions to use, leverage and exploit frequency bands for specific use at frequencies of 7 GHz (1 concession) and 10 GHz (2 concessions).

The Company's main commercial use concessions are as follows:

<b>Service</b>	<b>Period</b>	<b>Expiration</b>
Single concession for commercial use <sup>(1)</sup>	30 years	2046
Various radio spectrum frequencies for the provision of point-to-point and point-to-multipoint microwave links <sup>(2) (3)</sup>	20 years	2038
Fixed wireless access <sup>(4)</sup>	20 years	2038

(1) Concession valid for 30 years and renewable up to equal terms, provided that the Company is in compliance with all its obligations of the concession, as well as those contained in the legal, regulatory and administrative provisions.

(2) The Plenary of the Federal Telecommunications Institute (IFT for its Spanish initials), at its XXV Ordinary Session held on October 16, 2019, approved the Resolution by Agreement P/IFT/161019/515, authorizing Axtel, S.A.B. de C.V. the extension of the term for 30 (thirty) concessions to use, leverage and exploit frequency bands of the radio spectrum for specific use in the frequency bands of 10 GHz., 15 GHz., 23 GHz. and 38 GHz.

(3) The Plenary of the Federal Telecommunications Institute, at its XXV Ordinary Session held on October 16, 2019, approved the Resolution by Agreement P/IFT/161019/514, authorizing Alestra Innovación Digital, S. de R.L. de C.V. the extension of the term for 30 (thirty) concessions to use, leverage and exploit frequency bands of the radio spectrum for specific use in the frequency bands of 7 GHz. and GHz.

On January 13, 2020, we expressed the IFT our acceptance of the new conditions. The term of 30 business days to pay the consideration, which will expire on February 25, 2020, is running. However, this term is subject to be extended for 15 more business days. This did not represent any adjustment to the consolidated financial statements as of December 31, 2019.

(4) The Plenary of the Federal Telecommunications Institute, at its XXII Ordinary Session held on September 18, 2019, approved the Resolution by Agreement P/IFT/180919/463, authorizing Axtel, S.A.B. de C.V. the extension of the term for 9 (nine) concessions to use, leverage and exploit frequency bands of the radio spectrum for specific use in the frequency band 3.5 GHz.

On January 15, 2020, we expressed the IFT our acceptance of the new conditions. The term of 30 business days to pay the consideration, which will expire on February 27, 2020, is running. However, this term is subject to be extended for 15 more business days. This did not represent any adjustment to the consolidated financial statements as of December 31, 2019.

### *Impairment testing of goodwill*

Goodwill is comprised of the amount paid in excess of the carrying amount of net assets and liabilities of \$419,536, which were allocated to the business segment.

At the date of issuance of these consolidated financial statements, no impairment has been identified.

### Impairment sensitivity analysis for goodwill and intangibles

As of December 31, 2019, the Company carries out a sensitivity analysis on the impact of a possible increase of one percentage point in the discount rate and a decrease in the long-term growth rate, and no impairment loss resulted from this sensitivity analysis.



The following describes the discount rates and long-term growth rates used for the years ended December 31, 2019 and 2018:

	2019	2018
Discount rate, after tax	10.5%	10.5%
Long-term growth rate	3.6%	3.9%

### 13. Other non-current assets

	2019	2018
Investments of shares	\$294,530	\$294,535
Prepaid connection leases	21,238	34,000
Guarantee deposits	41,192	83,850
Prepaid maintenance	301,242	220,150
Other	83,695	83,752
Total other non-current assets	<u>\$741,897</u>	<u>\$716,287</u>

### 14. Trade and other accounts payable

Trade and other accounts payable are analyzed as follows:

	2019	2018
Current:		
Trade accounts payable	\$2,897,853	\$3,547,032
Related parties	8,018	1,865,881
Value added tax and other federal and local taxes payable	880,277	1,556,036
Accrued expenses payable	207,603	186,116
Other	175,265	268,913
	<u>\$4,169,016</u>	<u>\$7,423,978</u>
Non-current:		
Related parties	<u>\$ 703,348</u>	<u>\$ 4,033</u>

### 15. Provisions

	Litigation	Restructuring <sup>(1)</sup>	Total
As of January 1, 2018	\$18,391	\$ 99,517	\$117,908
Additions	6,238	288,755	294,993
Payments	(1,000)	(99,517)	(100,517)
	<u>\$23,629</u>	<u>\$ 288,755</u>	<u>\$312,384</u>
As of December 31, 2018	14,187	86,070	100,257
Additions	(9,325)	(183,125)	(192,451)
Payments			
	<u>\$28,491</u>	<u>\$ 191,700</u>	<u>\$220,190</u>
As of December 31, 2019			

(1) Provisions due to restructuring include indemnities to obtain operational efficiencies.

Provisions as of December 31, 2019 and 2018 are short-term.

### 16. Deferred income

Deferred income movements during the year are shown as follows:

	2019	2018
Beginning balance	\$ 536,452	\$ 312,121
Increases	1,054,418	1,308,057
Recognized income of the year	<u>(1,437,641)</u>	<u>(1,083,726)</u>
Ending balance	<u>\$ 153,229</u>	<u>\$ 536,452</u>



## 17. Debt

	2019	2018
Banco Nacional de Comercio Exterior, S.N.C	\$ 3,263,529	\$ 3,263,529
Syndicated loan	1,320,000	1,570,000
Senior Notes <sup>(1)</sup>	9,422,600	9,841,450
Export Development Canada (EDC)	-	300,000
Other finance leases <sup>(2)</sup>	-	740,113
Accrued interest payable	111,853	123,847
Issuance costs	(150,040)	(216,193)
Total debt	13,967,942	15,622,746
Current portion of debt	(131,632)	(465,828)
Non-current debt	<u>\$13,836,310</u>	<u>\$15,156,918</u>

<sup>(1)</sup> Non-bank borrowings.

<sup>(2)</sup> Finance leases entered into with banking institutions at approximate rates of 6% for those denominated in U.S. dollars and the interbank interest rate (TIIE) plus 3% and 5.5% for those denominated in Mexican pesos, with maturities ranging between 1 and 3 years. As of January 1, 2019, these financial leases are part of the balance of lease liabilities. See note 18.

The terms, conditions and carrying amounts of debt are as follows:

Interest rate							As of December 31,	
	Country	Currency	Contractual	Effective	Maturity date	Interest payment periodicity	2019	2018
Bancomext <sup>(1)</sup>	Mexico	MXP	TIIE + 2.10%	10.34%	30/08/2028	Quarterly	\$ 3,263,529	\$ 3,263,529
Syndicated loan	Mexico	MXP	TIIE+2.75%	11.04%	15/12/2022	Monthly	1,320,000	1,570,000
Senior Notes	International	USD	6.38%	6.64%	14/11/2024	Semi-annually	9,422,600	9,841,450
EDC	Canada	MXP	TIIE + 1.19%	10.51%	01/06/2021	Monthly	-	300,000
Total bank loans							14,006,129	14,974,979
Current portion of Bancomext debt							(19,779)	-
Debt issuance costs							(150,040)	(216,193)
Finance leases and other							-	398,132
Total non-current debt							<u>\$13,836,310</u>	<u>\$15,156,918</u>
Current maturities of financial leases <sup>(2)</sup> and others							<u>131,632</u>	<u>465,828</u>
Total Debt							\$13,967,942	\$15,622,746

<sup>(1)</sup> Debt restructuring agreement to exchange the original debt of US\$171,000 to a new debt of \$3,263,000. See Note 2g.

<sup>(2)</sup> As of January 1, 2019, these financial leases are part of the balance of lease liabilities. See note 18.

As of December 31, 2019, annual maturities of non-current debt are as follows:

	2021	2022	2023	2024 onwards	Total
Bank loans	\$89,005	\$1,448,564	\$168,121	\$ 2,858,060	\$ 4,563,750
Senior Notes	-	-	-	9,422,600	9,422,600
	<u>\$89,005</u>	<u>\$1,448,564</u>	<u>\$168,121</u>	<u>\$12,280,660</u>	<u>\$13,986,350</u>

Issuance costs of debentures and financings are directly attributable to issuance of the Company's debt and are amortized according to the effective interest rate over the lifetime of the debt.



Fair value of non-current debt is disclosed in Note 4. Estimated fair values as of December 31, 2019 and 2018 were determined using rates that reflect a similar credit risk depending on the currency, maturity period and country where the debt was acquired, regarding financial liabilities with financial institutions, finance leases, other liabilities and related parties. In the case of Senior Notes placed in international markets, the Company uses the market price of such Notes at the date of the consolidated financial statements. Measurement at fair value of such financial liabilities valued at amortized cost is deemed within Level 1 and 2 of the fair value hierarchy.

#### Covenants:

Loan and debt issuance agreements currently in effect contain restrictions for the Company, mainly to comply with certain financial ratios, delivery of financial information, keeping accounting records, compliance with applicable laws, rules and provisions. Failure to comply with these requirements within a specific term to the satisfaction of the creditors could be considered a cause for early termination.

Financial ratios to be fulfilled include the following:

- a. Interest coverage ratio: which is defined as adjusted EBITDA (see Note 28) divided by financial expenses for the last four quarters of the period analyzed. This factor cannot be less than 2.75 times from the execution date of the contract until the second quarter of 2019 and cannot be less than 3.0 times from there on.
- b. Leverage ratio: which is defined as net consolidated debt (current and non-current debt, net of debt issuance costs, less unrestricted cash and cash equivalents) divided by adjusted EBITDA (see Note 28) for each quarter.

As of December 31, 201, this factor cannot exceed 4.25 times. For each quarter of 2019, this factor cannot exceed 4.00 times; from the first quarter of 2020 and from there on this factor cannot exceed 3.50 times.

\* For Senior Notes, the leverage ratio cannot exceed 4.25 times.

Covenants contained in credit agreements establish certain obligations, conditions and exceptions that require or limit the capacity of the Company to:

- Grant liens on assets;
- Enter into transactions with affiliates;
- Conduct a merger in which the Company is dissolved, unfavorable sale of assets; and
- Pay dividends.

As of December 31, 2019 and as of the date of issuance of these consolidated financial statements, the Company and its subsidiaries complied satisfactorily with the covenants established in the credit agreements.

## 18. Lease liability

	<b>As of December 31, 2019</b>
<u>Current portion -</u>	
USD:	\$186,801
MXN:	264,974
	<u>\$451,775</u>
Current lease liability	
<u>Non-current portion -</u>	
USD:	\$233,049
MXN:	633,049
	<u>866,098</u>
Less; Current portion of lease liability	<u>451,775</u>
Non-current lease liability	<u><u>\$414,323</u></u>



As of December 31, 2019 and 2018, changes in the lease liability related to the finance activities in accordance with the statement of cash flow are integrated as follows:

<b>Initial balance</b>	\$ 680,405
Financial lease reclassification	740,113
Beginning balance	<u>1,420,518</u>
New contracts	7,103
Write-offs	-
Adjustment to liability balance	-
Interest expense from lease liability	99,072
Lease payments	(638,067)
Exchange (loss) gain	<u>(22,528)</u>
<b>Ending balance</b>	<u><u>\$ 866,098</u></u>

The total of future minimum payments of leases that include non-accrued interest is analyzed as follows:

	<b>December 31, 2019</b>
Less than 1 year	\$473,476
Over 1 year and less than 5 years	415,759
Over 5 years	<u>12,989</u>
<b>Total</b>	<u><u>\$902,224</u></u>

## 19. Employee benefits

Defined contributions plans:

The Company has a defined contribution plan. According to the structure of this plan, the reduction on labor liabilities is reflected progressively. The Company has established irrevocable trust funds for payment of the defined contribution plan. Due to the changes made in the 2014 tax reform, the Company interrupted the deposits to the trust; however, it has maintained this benefit and recognized labor obligations of \$282,312 and \$246,145 as of December 31, 2019 and 2018, respectively.

Defined benefit plans:

The valuation of employee benefits for retirement plans is based primarily on their years of service, current age and estimated salary at retirement date.

Following is a summary of the primary financial data of these employee benefits:

	<b>2019</b>	<b>2018</b>
Obligations in the consolidated statement of financial position:		
Pension benefits	\$405,110	\$341,510
Post-employment medical benefits	8,076	4,382
Defined contribution additional liability	<u>282,312</u>	<u>246,145</u>
Liability recognized in the consolidated statement of financial position	<u><u>\$695,498</u></u>	<u><u>\$592,037</u></u>
Charge in the consolidated statement of operations for:		
Pension benefits	\$ 57,093	\$ 49,936
Medical benefits to retirement	<u>447</u>	<u>502</u>
	<u><u>\$ 57,540</u></u>	<u><u>\$ 50,438</u></u>
Remeasurements for accrued employee benefit obligations recognized in other comprehensive income for the year	<u><u>\$ 70,625</u></u>	<u><u>\$ 60,405</u></u>





### *Pension and post-employment medical benefits*

The Company operates defined benefit pension plans based on employees' pensionable remuneration and length of service. Most of the plans are externally funded. The Company operates post-employment medical benefit plans. The accounting method, assumptions and frequency of the valuations are similar to those used for defined benefits in pension schemes. These plans are not funded.

The amounts recognized in the consolidated statement of financial position are determined as follows:

	<b>2019</b>	<b>2018</b>
Present value of obligations equal to the liability in the consolidated statement of financial position	<u>\$695,498</u>	<u>\$592,037</u>

The movement in the defined benefit obligation during the year was as follows:

	<b>2019</b>	<b>2018</b>
As of January 1	\$345,892	\$346,489
Current service cost	25,023	25,489
Financial cost	32,517	24,949
Actuarial remediations	70,625	(60,405)
Past service cost	7,343	28,018
Benefits paid	(7,893)	(7,241)
Reductions	(60,321)	(11,407)
As of December 31	<u>\$413,186</u>	<u>\$345,892</u>

The primary actuarial assumptions were as follows:

	<b>2019</b>	<b>2018</b>
Discount rate	7.00%	9.50%
Future wage increase	4.50%	4.50%
Medical inflation rate	6.50%	6.50%

The sensitivity analysis of the main assumptions for defined benefit obligations were as follows:

	<b>Impact on defined benefit obligations</b>		
	<b>Change in assumption</b>	<b>Increase in assumption</b>	<b>Decrease in assumption</b>
Discount rate	1%	\$(26,304)	\$29,631
Medical inflation rate	1%	\$ 8,369	\$ 5,952

The above-mentioned sensitivity analyses are based on a change in an assumption, while all other assumptions remain constant. In practice, this is not likely to happen, and there may be changes in other correlated assumptions. When calculating the sensitivity of pension plans to principal actuarial assumptions, the same method has been used as if it involved calculation of liabilities pertaining to pension benefit plans recorded in the consolidated statement of financial position. The methods and type of assumptions used in preparing the sensitivity analysis suffered no changes with respect to the prior period.

## **20. Income taxes**

a) Income taxes recognized in the consolidated statement of operations:

	<b>2019</b>	<b>2018</b>
Current income tax	\$(73,606)	\$(65,148)
Deferred income tax	86,766	33,815
Prior years' adjustment	<u>2,131</u>	<u>(6,005)</u>
Income tax benefit (expense)	<u>\$ 15,291</u>	<u>\$(37,338)</u>



- b) The reconciliation between the statutory and the effective income tax rates was as follows:

	<b>2019</b>	<b>2018</b>
(Loss) before taxes	\$(353,309)	\$(969,323)
Statutory rate	30%	30%
Taxes at statutory rate	<u>105,993</u>	<u>290,797</u>
(Plus) less tax effect on:		
Tax effects of inflation	(145,179)	207,404
Non-deductibles	(43,483)	(593,250)
Other differences, net	<u>97,960</u>	<u>57,711</u>
Total income tax benefit (expense) charged to income	<u>\$ 15,291</u>	<u>\$ (37,338)</u>
Effective rate	<u>(4)%</u>	<u>4%</u>

- c) The detail of deferred income tax asset (liability) is as follows:

	<b>2019</b>	<b>2018</b>
Tax loss carryforwards	\$1,274,483	\$1,420,015
Allowance for doubtful accounts	626,165	602,503
Property, plant and equipment	719,079	463,368
Provisions and other	262,916	363,087
Intangible assets and other	<u>(6,356)</u>	<u>24,102</u>
Deferred tax asset	<u>\$2,876,287</u>	<u>\$2,873,075</u>
Property, plant and equipment	\$ (3,489)	\$ (3,753)
Intangible assets and other	<u>2,730</u>	<u>(254)</u>
Deferred tax liability	<u>\$ (759)</u>	<u>\$ (4,007)</u>

Deferred income tax assets are recognized over tax loss carryforwards to the extent the realization of the related tax benefit through future tax income is likely. Tax losses as of December 31, 2019 for which a tax asset was recognized amount to \$4,248,278. The Company reduced tax losses by \$201,500 as their realization was not considered probable.

Tax losses as of December 31, 2019 expire in the following years:

<b>Year of expiration</b>	<b>Amount</b>
2021	\$ 364,493
2022	71,953
2023	143,522
2024 onwards	<u>3,869,810</u>
	<u>\$4,449,778</u>

- d) The tax charge/(credit) related to other comprehensive (loss) income is as follows:

	<b>2019</b>			<b>2018</b>		
	<b>Before taxes</b>	<b>Tax charged (credited)</b>	<b>After taxes</b>	<b>Before taxes</b>	<b>Tax charged (credited)</b>	<b>After taxes</b>
Effect of currency translation	\$ (2,468)	\$ -	\$ (2,468)	\$ (86)	\$ -	\$ (86)
Derivative financial instruments of hedging	(127,057)	38,117	(88,940)	(11,958)	3,588	(8,370)
Remeasurements of employee benefits	<u>(70,625)</u>	<u>21,187</u>	<u>(49,438)</u>	<u>60,403</u>	<u>(18,123)</u>	<u>42,280</u>
	<u>\$(200,150)</u>	<u>\$59,304</u>	<u>\$(140,846)</u>	<u>\$48,359</u>	<u>\$(14,535)</u>	<u>\$33,824</u>



## 21. Shareholders' equity

At the General Ordinary Stockholders' Meeting held on February 26, 2019, a fund for the repurchase of shares of \$150 million pesos was approved. It was also approved to reclassify the share issue premium to accrued results of \$159,551 as a step prior to the creation of a stock repurchase reserve. The stock repurchase reserve balance is \$93,464 as of December 31, 2019.

After the above-mentioned events, the Company's capital stock as of December 31, 2019 was \$464,368 and was comprised of 20,074,913,404 Class "I", Series "B" common nominative shares, with no par value, entirely subscribed and paid in. As of that date, all series "B" shares issued by the Company were placed in a trust (CPO Trust).

Movements on the number of common shares of the Company during the year was as follows:

	<b>Number of shares</b>
Beginning balance January 1, 2018	20,249,227,481
Ending balance December 31, 2018	20,249,227,481
Repurchase of shares	<u>174,314,077</u>
Shares as of December 31, 2019	<u>20,074,913,404</u>

Net income for the year is subject to the legal provision requiring at least 5% of the profit for each period to be set aside to increase the legal reserve until it reaches an amount equivalent to one fifth of the capital stock.

In accordance with the new Mexican Income Tax Law effective on January 1, 2014, a 10% tax on income generated starting 2014 on dividends paid to foreign residents and Mexican individual tax payers, when these correspond to taxable income generated starting 2014. It also establishes that for fiscal years 2001 to 2013, net taxable income will be determined as established in the Income Tax Law that was effective in the corresponding fiscal year.

Dividends paid are not subject to income tax if paid from the Net Tax Profit Account (CUFIN from Spanish). Dividends exceeding CUFIN will generate income tax at the applicable rate of the period in which they are paid. This tax incurred is payable by the Company and may be credited against income tax in the same year or the following two years. Dividends paid from previously taxed profits are not subject to tax withholding or additional tax payments. As of December 31, 2019, the tax value of the CUFIN and tax value of the Capital Contribution Account (CUCA from Spanish) amounted to \$224,985 and \$25,256,564, respectively.

In case of capital reduction, the procedures established by the Income Tax Law provide that any surplus of shareholders' equity be given over the balances of the fiscal accounts of the capital contributed, the same tax treatment applicable to dividends.

## 22. Discontinued operations

### Masive Segment Disposition

On May 1, 2019, the Company entered into a final agreement for the divestiture of the last phase of its fiber optic business (FTTx) from the massive segment located in León, Puebla, Toluca, Guadalajara and Querétaro in the amount of \$1,150 million pesos to Megacable Holdings, S.A.B. de C.V. and subsidiaries ("Megacable"). Axtel transferred to Megacable 55 thousand residential customers and micro-businesses, 1,370 km of fiber network and other assets related to the operation of the massive segment in these cities.

On December 17, 2018, the Company signed a definitive agreement for the divestment of its fiber segment (FTTx) of the mass segment located in Monterrey, San Luis Potosí, Aguascalientes, Mexico City, Ciudad Juárez and the municipality of Zapopan, for an amount of \$4,713 million pesos to Grupo Televisa SAB and subsidiaries ("Televisa"). Axtel transferred to Televisa 227,802 residential and micro-business customers, 4,432 km of fiber optic network and other assets related to the operation of the mass segment in these cities.



Condensed information related to the consolidated statement of operations of the discontinued operation for the year ended December 31, 2018 and for the period ended May 1, 2019:

	<b>2019</b>	<b>2018</b>
Revenues	\$302,367	\$2,772,752
Cost of sales	(263,283)	(1,315,779)
Gross profit	<u>39,084</u>	<u>1,456,973</u>
Administration and selling expenses	(317,567)	(1,240,689)
Operating income	<u>(278,483)</u>	<u>216,284</u>
Income before taxes	(278,483)	216,284
Income taxes	83,545	(64,885)
Net income	<u>(194,938)</u>	<u>151,399</u>
Gain on sale of the discontinued operation	<u>519,016</u>	<u>1,949,940</u>
Income from discontinued operations, net of income taxes	<u>\$324,078</u>	<u>\$2,101,339</u>

As of the date of the transaction held in 2019, the gain on sale of discontinued operations for \$519,016, net of taxes, was determined by comparing the sale price of \$1,150,000, less the net assets sold, transaction costs and tax effects for a total of \$630,984.

As of the date of the transaction held in 2018, the gain on sale of discontinued operations for \$1,949,940, net of taxes, was determined by comparing the sale price of \$4,712,821, less the net assets sold, transaction costs and tax effects for a total of \$2,762,881.

Condensed information regarding the cash flows of the discontinued operation for the year ended December 31, 2018 and for the period ended May 1, 2019:

	<b>2019</b>	<b>2018</b>
Cash flows from operating activities	\$ (29,633)	\$1,061,978
Cash flows from investment activities	1,150,000	3,956,544

## 23. Revenues

### a. Income for services:

	<b>2019</b>	<b>2018</b>
Voice	\$ 1,873,716	\$ 2,121,360
Managed networks	4,513,604	4,194,997
Internet data	3,962,505	3,859,259
Administrative applications	360,404	381,961
Hosting	740,579	752,241
System integration	557,797	562,400
Security	410,300	539,591
Cloud services	269,069	233,115
Other services	95,659	143,560
Total	<u>\$12,783,633</u>	<u>\$12,788,484</u>

### b. Income by geographical areas:

	<b>2019</b>	<b>2018</b>
Mexico	\$12,743,540	\$12,731,680
Outside Mexico	40,093	56,804
Total	<u>\$12,783,633</u>	<u>\$12,788,484</u>



## 24. Expenses classified by their nature

Total cost of sales and selling and administrative expenses, classified by nature of the expense, were as follows:

	2019	2018
Service cost <sup>(1)</sup>	\$ 3,353,046	\$ 3,357,117
Employee benefit expenses (Note 27)	2,456,136	2,452,171
Maintenance	797,674	855,109
Depreciation and amortization	3,578,541	3,622,713
Advertising expenses	63,864	62,680
Energy and fuel consumption	351,402	336,061
Travel expenses	53,864	53,828
Lease expenses	892,752	1,101,378
Technical assistance, professional fees and administrative services	250,946	60,688
Other	148,120	398,188
Total	<u>\$11,946,345</u>	<u>\$12,299,933</u>

- (1) Service cost consists mainly of interconnection costs and costs related to implementation of IT solutions, including:
- Charges related to leased lines, normally paid on a per-circuit basis per month to Telmex and to other suppliers of last-mile access.
  - Interconnection costs, including charges for local and resale access, paid on a per-minute basis mainly to Telmex.
  - International payments to foreign operators on a per-minute basis to complete international calls originating in Mexico.

## 25. Other (expenses) income, net

	2019	2018
Disposals of property, plant and equipment due to damage and obsolescence	\$(113,462)	\$(74,574)
(Loss) gain on sale of property, plant and equipment <sup>(**)</sup>	(5,046)	226,568
Other income, net	55,055	54,935
Total other (expenses) income, net	<u>\$ (63,453)</u>	<u>\$206,929</u>

- (\*) As of December 31, 2018, corresponds mainly to \$224,974 gain on the sale of telecommunication towers to MATC Digital, S. de R. L. de C. V., subsidiary of American Tower Corporation.

## 26. Financial result, net

	2019	2018
Financial income:		
Interest income on short-term bank deposits	\$ 54,679	\$ 41,297
Other financial income	5,574	10,832
Total financial income	<u>\$ 60,253</u>	<u>\$ 52,129</u>
Financial expenses:		
Interest expense on bank loans	\$ (562,108)	\$ (952,172)
Interest expense on senior notes	(644,331)	(728,052)
Interest expense on leases	(99,072)	-
Expenses related to other interest and commissions	(1,626)	(437)
Financial expenses related to employee benefits	(32,517)	(24,949)
Other financial expenses	(129,098)	(163,008)
Total financial expenses	<u>\$(1,468,752)</u>	<u>\$(1,868,618)</u>
Exchange fluctuation gain (loss), net:		
Gain on exchange fluctuation	\$ 2,855,976	\$ 3,334,378
Loss on exchange fluctuation	(2,565,701)	(3,147,490)
Exchange fluctuation gain, net	<u>\$ 290,275</u>	<u>\$ 186,888</u>



## 27. Employee benefit expenses

	2019	2018
Salaries, wages and benefits	\$2,028,983	\$2,010,260
Social security fees	335,709	358,557
Employee benefits	25,023	25,489
Other fees	66,421	57,865
Total	<u>\$2,456,136</u>	<u>\$2,452,171</u>

## 28. Transactions with related parties

Balances with related parties as of December 31, 2019 and 2018, were as follows:

December 31, 2019							
Loans received from related parties							
	Accounts receivable	Accounts payable	Amount	Interest	Currency	Expiration date MM/DD/YY	Interest rate
Holding company	\$ -	\$ -					
Holding company	-	-	\$ 219,600	\$ 1,881	MXP	02/28/19	THIE + 2.25%
Holding company <sup>(1)</sup>	-	-	483,748	4,144	MXP	02/28/21	THIE + 2.25%
Affiliates	23,460	8,018	-	-			
Total	<u>\$23,460</u>	<u>\$ 8,018</u>	<u>\$ 703,348</u>	<u>\$ 6,025</u>			

December 31, 2018							
Loans received from related parties							
	Accounts receivable	Accounts payable	Amount	Interest	Currency	Expiration date MM/DD/YY	Interest rate
Holding company	\$ -	\$ 4,924					N/A
Holding company	-	-	\$ 424,561	\$ 5,944	USD	15/07/19	3%
Holding company <sup>(1)</sup>	-	-	287,300	56,780	MXP	28/02/19	THIE + 2.25%
Holding company <sup>(1)</sup>	-	-	287,300	56,780	MXP	28/02/19	THIE + 2.25%
Holding company <sup>(1)</sup>	-	-	204,574	40,434	USD	28/02/19	THIE + 2.25%
Holding company <sup>(1)</sup>	-	-	204,574	40,434	USD	28/02/19	THIE + 2.25%
Holding company	-	-	219,600	22,752	MXP	28/02/19	THIE + 2.25%
Affiliates	55,105	9,318	4,033	585	USD		LIBOR 3M + 2.75%
Total	<u>\$55,105</u>	<u>\$14,242</u>	<u>\$1,631,941</u>	<u>\$223,709</u>			

(1) Indemnification (see Note 2).

Transactions with related parties for the years ended December 31, 2019 and 2018, which were carried out in terms similar to those of arm's-length transactions with independent third parties, were as follows:

Year ended December 31, 2019			
Income		Costs and expenses	
Telecommunication services		Interests	Others
Holding company	\$ -	\$ -	\$ 84,935
Affiliates	165,087	5,803	-
Total	<u>\$ 165,087</u>	<u>\$ 5,803</u>	<u>\$ 84,935</u>

Year ended December 31, 2018			
Income		Costs and expenses	
Telecommunication services		Interests	Others
Holding company	\$ -	\$ (136,976)	\$ -
Affiliates	169,445	(281)	(35,695)
Total	<u>\$ 169,445</u>	<u>\$ (137,257)</u>	<u>\$ (35,695)</u>



For the year ended December 31, 2019, compensation and benefits paid to the Company's main officers totaled \$106,080 (\$97,139 in 2018), comprised of base salary and benefits required by law, complemented by a program of variable compensation basically based on the Company's results and the market value of Alfa's shares.

## **29. Contingencies and commitments**

As of December 31, 2019, there are the following commitments and contingencies with respect to Axtel and subsidiaries:

### **I. Contingencies**

Interconnection Disagreements with other Mobile Operators.

#### **a. Radiomóvil Dipsa, S.A. de C.V. (Telcel).**

In January 2018, the Company was notified of two writs of amparo (one in which Axtel is a stakeholder and another one by Alestra Comunicación), filed by Telcel against the rates for the 2018 period determined by the IFT in compliance with the amparo judgment issued by the Second Chamber of the Supreme Court of Justice of the Nation (SCJN for its Spanish initials) within the file 1100/2015 (Zero Rate).

These cases are being appealed; however, they are currently suspended on the SCJN's instruction at the request of the IFT, since they are related to a Telcel lawsuit (A.R. 329/2019) which the SCJN is attending; therefore, they are currently awaiting a decision.

In addition, in January 2019, the Company (where Axtel is the stakeholder) was notified of a writ of amparo filed by Telcel against the rates settled in 2018 (also as a Virtual Mobile Operator) for the 2019 period by the IFT, which is currently pending, like the 2018 rate trial; this matter was also suspended until the SCJN resolves a related matter.

As of the date of issuance of the consolidated financial statements, the Company and its advisors believe that the rates will prevail on the basis of the decisions obtained before Ifetel, since it is considered that the most adverse scenario is forwarding the matter to that Institute for the creation of a specific regulation for 2018 and 2019 rates, within which the current rate could be ratified. Therefore, to date, the Company has recognized and paid the cost on the basis of these rates and there are no provisions associated with this contingency.

#### **b. Telefónica Group.**

In January 2018, the Company was notified of the writ of amparo (where Axtel is the stakeholder) filed by Telefónica against the rates for the 2018 period by the IFT in compliance with the judgment of the amparo 1100/2015 (Zero Rate).

In addition, in June 2018, the Company (where Axtel is the stakeholder) was notified of a writ of amparo filed by Telefónica against the rates decided in 2017 (as Virtual Mobile Operator) for the 2018 period by the IFT.

In January 2019, the Company (where Axtel is the stakeholder) was notified of a writ of amparo filed by Pegaso against the rates decided in 2018 (as Virtual Mobile Operator) for the 2019 period by the IFT.

These cases are now suspended on the SCJN's instruction at the request of the IFT, since they are related to a Telcel lawsuit (A.R. 329/2019), which SCJN is attending; therefore, they are currently awaiting a decision.

As of the date of issuance of the consolidated financial statements, to the present day, the Company and its advisors believe that the rates will prevail on the basis of the decisions obtained before Ifetel, since it is considered that the most adverse scenario is forwarding the matter to that Institute for the creation of a specific regulation for the AEP for 2018 and 2019 rates, within which the current rate could be ratified. Therefore, to date, the Company has recognized and paid the cost on the basis of these rates and there are no provisions associated with this contingency.



c. Grupo Iusacell (today AT&T).

In January 2018, the Company was notified (where Axtel is the stakeholder) of the writ of amparo filed by ATT against the rates for the 2018 period by the IFT, this matter was finally resolved in favor of the Company.

As the rates prevailed; therefore, it has paid and recognized the cost based on such rates, and there are no provisions associated with this contingency.

In January 2019, the Company (where Axtel is the stakeholder) was notified of a writ of amparo filed by ATT against the rates determined by the IFT for the 2019 period (as Virtual Mobile Operator).

This case is suspended on the SCJN's instruction at the request of the IFT, since they are related to a Telcel lawsuit (A.R. 329/2019), which the SCJN is attending; therefore, it is currently awaiting a decision.

As of the date of issuance of the consolidated financial statements, the Company and its advisors believe that the rates will prevail on the basis of the decisions obtained before Ifetel, since it is considered that the most adverse scenario is forwarding the matter to that Institute for the creation of a specific regulation for the AEP for 2018 and 2019 rates, within which the current rate could be ratified. Therefore, to date, the Company has recognized and paid the cost on the basis of these rates and there are no provisions associated with this contingency.

d. Interconnection disagreements with Telmex & Telnor.

i. With regard to the lawsuits filed by Telmex-Telnor with the Federal Court of Administrative Justice (TFJA for its Spanish initials) for 2010 rates, these have been decided in favor of the Axtel-Avantel, Alestra, and only the direct amparo against the compliance with the judgment issued by the TFJA filed by Telmex against the rates determined for Avantel for the same year is pending a decision.

ii. In May 2011, Cofetel also approved a reduction in long-distance call termination rates for that year.

Telmex challenged this decision before the SCT, but that appeal was dismissed. Telmex has challenged the Federal Court of Administrative Justice, which ruled in favor of the Company (Axtel-Avantel, Alestra); however, Telmex filed a writ of amparo against that judgment, which is pending.

In addition, a final favorable judgment was obtained for the lawsuit filed by Telnor (and Axtel-Avantel-Alestra as stakeholders) against 2011 rates.

iii. With regard to the lawsuit filed for the period 2012, having Alestra as a stakeholder, it was decided in favor by the TFJA, and Telmex filed a direct amparo, which is under appeal.

iv. In July 2019 and with the last payment of 97.5 million pesos, the trust agreement with BBVA Bancomer was terminated, having recovered a total of \$566.1 million corresponding to amounts objected and deposited on the Trust (including returns), arising from 2008, 2009 and 2010 interconnection disagreements.

v. Under the Federal Telecommunications and Broadcasting Act ("LFTR" for its Spanish initials), from August 13, 2014 to December 31, 2018, the Predominant Economic Agent (AEP for its Spanish initials) in the telecommunications sector, Telmex is prohibited from charging the interconnection fees for termination of calls ending in its network. Telmex challenged that condition, which was resolved by the Second Chamber of the Supreme Court of Justice of the Nation in the amparos under review 1306/2017 (Telmex) and 1307/2017 (Telnor), granting the protection to those companies.

The effect of such amparos is that during the period from August 13, 2014 to December 31, 2018, the free "zero" rate prevails, resolving the SCJN that the Federal Telecommunications Institute should decide a fee for Telmex/Telnor calls ending on another concessionaire's network beginning 2019.





- vi. In January 2017, the Company was notified of a writ of amparo filed by Telmex-Telnor (having Alestra, Axtel-Avantel and Alestra Comunicación as stakeholders) against the rates decided for 2017 period by IFT, which today is finally resolved in favor of the Company.

As the rates prevailed based on the decisions obtained in favor of the Company; therefore, it has recognized the cost on the basis of such rates, and there are no provisions associated with this contingency.

- vii. In December 2017, the Company was notified of a writ of amparo filed by (Axtel-Avantel as stakeholders) against the rates decided for the 2016 period by IFT (in compliance with an amparo judgment), this matter is under appeal.

The Company and its advisors believe that the rates will prevail on the basis of the decisions obtained in favor of the Company; therefore, it has recognized the cost on the basis of these rates and there are no provisions associated with this contingency.

- viii. In addition, in January 2018, the Company (Axtel, Alestra Comunicación, and Axtel as VMO) was notified of several writs of amparo against the rates decided (for VMO) for the 2018 period by the IFT.

One of the amparos is at a trial level (OMV), while the other one is under appeal; note that the latter is likely to be suspended on the SCJN's instruction, since it is related to a Telcel lawsuit (A.R. 329/2019) attracted by the SCJN.

The writ of amparo filed by Telnor (and Alestra Comunicación) for 2018 rates, was finally decided in favor of the Company.

As of the date of issuance of the consolidated financial statements, the Company and its advisors believe that the rates will prevail on the basis of the decisions obtained before Ifetel, since it is considered that the most adverse scenario is forwarding the matter to that Institute for the creation of a specific regulation for the AEP for 2018 and 2019 rates, within which the current rate could be ratified. Therefore, to date, the Company has recognized and paid the cost on the basis of these rates and there are no provisions associated with this contingency.

- ix. In January 2019, the Company (Axtel) was notified of a writ of amparo against the rates decided for the 2019 period by IFT, which is suspended by SCJN's instructions.

As of the date of issuance of the consolidated financial statements, the Company and its advisors believe that the rates will prevail on the basis of the decisions obtained before Ifetel, since it is considered that the most adverse scenario is forwarding the matter to that Institute for the creation of a specific regulation for the AEP for 2018 and 2019 rates, within which the current rate could be ratified. Therefore, to date, the Company has recognized and paid the cost on the basis of these rates and there are no provisions associated with this contingency.

- x. In 2016, the IFT initiated a process of reviewing the preponderance measures imposed on América Móvil as a holding company of Telmex and Telcel. As a result of this review, the agreement P/IFT/EXT/270217/119 was issued, whereby the IFT plenary amends and adds the measures imposed on the AEP in 2014, which tend to generate a sector where there are competition conditions in the telecommunications sector. As of December 31, 2019, the predominant agent status of Telmex, Telnor and Telcel has not been changed.

- xi. As of the date of issuance of the consolidated financial statements, the Company and its advisors believe that the rates of the IFT and Cofetel judgments will prevail based on the judgments obtained in favor of the Company; therefore, it has recognized the cost on the basis of these rates, and there are no book provisions associated with this contingency. Similarly, the process of reviewing preponderance measures continues.

#### Lawsuits between Axtel and Solution Ware Integración, S. A. de C. V. ("Solution Ware")

- i. Axtel and Solution Ware participated in seven projects with the Government of Nuevo León, Secretariat of Labor and Social Welfare, Secretariat of Social Development, National Population Registry, National Forestry Commission, Seguros Monterrey and the Government of Tamaulipas.



To date, Solution Ware has filed various ordinary commercial lawsuits in which it claims Axtel to pay for some purchase orders for managed services, as well as interest, damages and lost profits in addition to legal expenses and costs; as of the date of these consolidated financial statements, Solution Ware has required payment of \$91,776 and \$US12,701 through a public broker.

Lawsuits concerning the Government of Nuevo León, the National Population Registry and the Government of Tamaulipas are currently at a trial level, while the lawsuits concerning the Secretariat for Social Development are under appeal.

With regard to the lawsuits concerning the Merger Opposition agreements, the Secretariat of Labour and Social Welfare and CONAFOR definitively concluded in favor of the Company.

At the date of issuance of the consolidated financial statements, the Company and its advisors believe that there is no real likelihood that these claims will succeed and, therefore, there are no book provisions associated with this contingency.

Lawsuit between Axtel and Comercializadora Vedoh, S. A. de C. V.

- i. Axtel contracted from Comercializadora Vedoh sponsorship given by the Team to Axtel in automotive equipment in the NASCAR series. In 2018, Comercializadora Vedoh filed a commercial ordinary lawsuit whereby it demanded a payment of \$1,065 from Axtel for team sponsorships in 2014 and 2015.

In connection with this case, a court settlement agreement was made in June 2019, whereby the Company made a payment of US\$800.

Compensatory Procedures in the Federal Superior Auditors ("ASF" for its Spanish initials)

- i. In June 2018, S&C Constructores de Sistemas was notified of a compensatory procedure processed at the ASF, claiming the total amount of \$63,320, the foregoing resulted from an audit conducted to the Secretariat for Social Development (SEDESOL) and the Autonomous University of the State of Mexico.

By May 2019, the ASF determined a compensation liability of \$34,118, which was challenged and is pending.

Notwithstanding the foregoing, the Company paid \$36,768, according to the optical character recognition granted by the Tax Administration Service.

In addition to the payment made, in December 2019, the SAT notified S&C of an update and surcharges of \$38,024, a determination that will be challenged.

The administrative enforcement procedure is suspended by the Administrative Court, and the guarantee of the tax liability is pending.

In this regard, the Company and its advisors consider an average possibility of obtaining a favorable result from the administrative-law action or, where appropriate, from the appeal.

- ii. In August 2018, Axtel was notified of a compensating procedure processed at the ASF, claiming the total amount of \$5,219, the foregoing resulted from an audit conducted to the Ministry of Health for the provision of telephone service; said case was challenged and won in accordance with the interests of the Company at the trial level, the judgment was challenged by the administrative authority; therefore, the trial is in an appealing process.

In this regard, the Company and its advisors consider an average possibility of a favorable judgment for the Company.

## II. Commitments

The Company has contractual commitments related to office space and telecommunication tower agreements. The aggregate minimum future payments corresponding to these contractual commitments are as follows:

- Less than 1 year	\$ 770,232
- Between 1 and 5 years	4,320,858
- More than 5 years	-
Total	<u>\$5,091,090</u>



### 30. Segment information

The information historically used to make strategic decisions is reported to the CEO based on two operating segments. The focus of the two operating segments is described below.

The Business operating segment offers communication services and value-added services, such as information, data and Internet technologies, managed through the Company's network and infrastructure for both multinational companies, as well as for international and national businesses.

The Government operating segment offers communication services and value-added services, such as information, data and Internet technologies, administered through the Company's network and infrastructure, for the federal, state and municipal governments.

In 2019, the Company entered into a final agreement resulting in the total divestment of the massive segment, which is presented as a discontinued operation described in Note 22.

In addition to the two operating segments focused on the client, the remaining operations of the Company are included in the "Unallocated expenses" category to be included in the consolidated results of the Company. This category includes expenses associated with centralized functions, including procurement, supply chain and the Company's senior management.

These operating segments are managed separately since the products and services offered and the markets in which they are focused are different. The resources are allocated to the operational segments considering the strategies defined by the Company's Management. Transactions between the operating segments are carried out at market values.

The performance of the operating segments is measured based on the Business Unit Contribution (BUC), defined as the operating profit of each segment, including sales, costs per segment and direct segment expenses, as included, in internal financial reports reviewed by the Director General.

The Company defines Adjusted EBITDA as the result of adding to the operating profit (loss), depreciation and amortization, the impairment of non-current assets and the adjusted EBITDA of the massive segment that is presented as a discontinued operation in accordance with IFRS; it is considered a useful measure of the operational performance of the business since it provides a significant analysis of commercial performance by excluding specific items reported separately due to their nature or incidence. Income or interest expenses are not allocated to reportable segments, since this activity is handled globally by Alfa's central treasury

When projects are not directly attributed to a particular operating segment, capital expenditure is allocated to each segment based on the rate of future economic benefits estimated as a result of capital expenditure.

The following is the consolidated financial information of the information segments:

#### I. Financial information by segments:

	<b>Business</b>	<b>2019 Government</b>	<b>Total</b>
Sales by segment	\$10,624,856	\$2,158,777	\$12,783,633
Service cost	(2,200,298)	(1,152,748)	(3,353,046)
Expenses	(831,651)	(212,003)	(1,043,654)
Business unit contribution (BUC)	7,592,907	794,026	8,386,933
	71%	37%	66%
Unallocated expenses			(3,921,096)
EBITDA			4,465,837
EBITDA of discontinued operations			625,749
Adjusted EBITDA			5,091,586
Impairment of non-current assets			(113,462)
Depreciation and amortization			(3,578,541)
Depreciation and amortization of discontinued operations			(162,780)
Less the effects of discontinued operations <sup>(1)</sup>			(462,968)
Operating income			773,835
Financial result, net			(1,127,143)
Financial result, net of discontinued operations			-
Loss before tax			\$ (353,308)



		2018	
	Business	Government	Total
Sales by segment	\$10,313,312	\$ 2,475,172	\$12,788,484
Service cost	(1,913,099)	(1,444,018)	(3,357,117)
Expenses	(863,090)	(164,926)	(1,028,016)
Business unit contribution (BUC)	7,537,123	866,228	8,403,351
	73%	35%	66%
Unallocated expenses			(4,010,584)
Adjusted EBITDA without merger expenses			4,392,767
EBITDA of discontinued operations			3,847,605
Adjusted EBITDA			8,240,372
Impairment of non-current assets			(74,574)
Depreciation and amortization			(3,622,713)
Depreciation and amortization of discontinued operations			(845,693)
Less the effects of discontinued operations <sup>(1)</sup>			(3,001,912)
Operating income			695,480
Financial result, net			(1,664,803)
Financial results of discontinued operations, net			-
Loss before tax			\$ (969,323)

- <sup>(1)</sup> The items of the discontinued operation are comprised of the operating income of the massive segment plus the gain on sale of the discontinued operation of \$519,016 and \$1,949,940 for 2019 and 2018, respectively, presented in Note 22, gross of the corresponding taxes. Additionally, the effects reflected in the results by segment of 2018, consider the operating profit generated by the massive segment in that year.

### 31. Subsequent events

In preparing the consolidated financial statements, the Company has evaluated the events and transactions for recognition or disclosure subsequent to December 31, 2019 and through January 31, 2020, (issuance date of the consolidated financial statements), and identified the following:

- Given what is disclosed in Note 2b, on January 8, 2020, the Company announced the final closure of the strategic agreement with Equinix to strengthen its IT and cloud solutions offering. The valuation of this transaction is US\$175 million, while Axtel holds a minority stake in the new entity. Excluding operating expenses and the balance in custody, the resources of approximately US\$157 million will be used to strengthen the Company's financial structure. The Company did not have an impact on cash flows due to tax consequences, as it applied tax loss carryforwards of \$2,644,367.

No event or transaction represented adjustments to the amounts reported as of December 31, 2019.

### 32. Authorization to issue the financial statements

On January 31, 2020, the issuance of the accompanying consolidated financial statements was authorized by Sergio Rolando Zubirán Shetler, Chief Executive Officer, Adrián de los Santos Escobedo, Chief Financial Officer, and José Salvador Martín Padilla, Corporate Controller.

These consolidated financial statements are subject to the approval of the Company's ordinary shareholders' meeting.

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