AXTEL, S. A. DE C. V. AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2004

(With comparative figures for 2003 and 2002)

(With Independent Auditors' Report Thereon)

Report of Independent Registered
Public Accounting Firm

The Board of Directors and Stockholders
Axtel, S.A. de C.V.:

We have audited the accompanying consolidated balance sheets of Axtel, S.A. de C.V. and subsidiaries (the Company) as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders' equity, and changes in financial position for each of the years in the three-year period ended December 31, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) and auditing standards generally accepted in Mexico. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Axtel, S.A. de C.V. and its subsidiaries as of December 31, 2004 and 2003, and the consolidated results of their operations, the changes in their stockholders' equity and the changes in their financial position for each of the years in the three-year period ended December 31, 2004, in conformity with accounting principles generally accepted in Mexico.

Accounting principles generally accepted in Mexico vary in certain significant respects from accounting principles generally accepted in the United States of America. The application of accounting principles in the United States of America would have affected the results of operations for each of the years in the three-year period ended December 31, 2004, and the stockholders' equity as of December 31, 2004 and 2003 to the extent summarized in note 24 to the consolidated financial statements.

KPMG Cárdenas Dosal, S.C.

Rafael Gómez Eng

Monterrey, N,L., México
February 25, 2005

AXTEL, S. A. DE C. V. AND SUBSIDIARIES

Consolidated Balance Sheets

(Thousands pesos of constant purchasing power as of December 31, 2004)

		December 31	
Assets		**2004**	**2003**
Current assets:			
Cash and cash equivalents (including $4,743 of restricted cash as of December 31, 2003)	$	554,401	1,068,383
Accounts receivable, net (note 5)		507,587	423,837
Refundable taxes and other accounts receivable		82,491	20,495
Prepaid expenses (note 7)		131,875	193,944
Inventories (note 8)		58,250	22,731
Derivative financial instruments (notes 3 and 6)		-	591
Total current assets		1,334,604	1,729,981
Long-term accounts receivable		19,768	21,079
Property, systems and equipment, net (notes 9 and 13)		6,112,273	5,476,378
Telephone concession rights, net of accumulated amortization of $258,652 and $207,635 in 2004 and 2003, respectively		703,563	754,580
Pre-operating expenses, net (note 10)		202,623	211,075
Deferred income taxes (note 16)		124,083	265,769
Other assets, net (note 11)		141,020	115,226
Total assets	$	8,637,934	8,574,088
Liabilities and Stockholders' Equity			
Current liabilities:			
Accounts payable and accrued liabilities	$	596,070	327,159
Accrued interest		10,879	70,646
Taxes payable		40,748	73,038
Short-term debt (note 12)		108,427	25,313
Current maturities of long-term debt (note 13)		48,990	57,384
Other accounts payable (note 14)		200,659	204,945
Derivative financial instruments (notes 3 and 6)		935	-
Total current liabilities		1,006,708	758,485
Long-term debt, excluding current maturities (note 13)		2,026,214	2,134,697
Other long-term accounts payable		3,543	2,291
Seniority premiums (note 15)		2,394	2,109
Total liabilities		3,038,859	2,897,582
Stockholders' equity (note 17):			
Common stock		7,106,718	7,106,718
Additional paid-in capital		140,616	140,616
Deficit		(1,766,467)	(1,689,335)
Cumulative deferred income tax effect		118,507	118,507
Change in the fair value of derivative instruments (note 6)		(299)	-
Total stockholders' equity		5,599,075	5,676,506
Commitments and contingencies (note 21)			
Subsequent events (note 22)			
Total liabilities and stockholders' equity	$	8,637,934	8,574,088

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

AXTEL, S. A. DE C. V. AND SUBSIDIARIES

Consolidated Statements of Operations

(Thousands pesos of constant purchasing power as of December 31, 2004)

	Years ended December 31,		
	2004	**2003**	**2002**
Rental, installation, service and other revenues (note 18)	$ 3,861,313	3,079,210	2,586,557
Operating costs and expenses:			
Cost of sales and services	(1,229,500)	(852,647)	(645,699)
Selling and administrative expenses	(1,378,305)	(1,200,359)	(1,331,500)
Depreciation and amortization	(1,001,165)	(907,647)	(854,880)
	(3,608,970)	(2,960,653)	(2,832,079)
Operating income (loss)	252,343	118,557	(245,522)
Comprehensive financing result:			
Interest expense	(274,079)	(230,246)	(455,804)
Interest income	16,644	20,417	10,733
Foreign exchange loss, net	(7,321)	(336,916)	(652,043)
Monetary position gain	64,752	97,886	295,859
Comprehensive financing result, net	(200,004)	(448,859)	(801,255)
Other income (expenses), net (notes 13 and 20)	21,004	1,808,234	(29,100)
Special item (note 19)	-	(10,987)	(34,194)
Income (loss) before income taxes and tax on assets	73,343	1,466,945	(1,110,071)
Deferred income tax (note 16)	(150,475)	(520,442)	254,939
Net (loss) income	$ (77,132)	946,503	(855,132)

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

AXTEL, S. A. DE C. V. AND SUBSIDIARIES

Consolidated Statements of Changes in Financial Position

(Thousands pesos of constant purchasing power as of December 31, 2004)

		Years ended December 31,	
	2004	**2003**	**2002**
Operating activities:			
Net (loss) income	$ (77,132)	946,503	(855,132)
Add charges (deduct credits) to operations not requiring (providing) resources:			
Depreciation	896,743	814,820	763,367
Amortization	104,422	92,827	91,513
Accrual for seniority premiums	727	718	243
Deferred income tax and employee statutory profit sharing	150,475	520,442	(254,939)
Gain on extinguishment of debt	-	(1,960,118)	-
Resources provided by (used in) operations	1,075,235	415,192	(254,948)
Net financing from (investment in) operations	107,728	(246,795)	242,771
Resources provided by (used in) operating activities	1,182,963	168,397	(12,177)
Financing activities:			
Increase in common stock	-	2,809,463	54,783
Additional paid-in capital	-	(15,625)	(2,155)
(Payments) proceeds from loans, net	(93,530)	(1,591,004)	665,049
Deferred financing costs	-	(19,461)	28,498
Other accounts payable	(31)	(41,110)	67,329
Resources (used in) provided by financing activities	(93,561)	1,142,263	813,504
Investing activities:			
Acquisition and construction of property, systems and equipment, net	(1,532,638)	(485,292)	(596,293)
Pre-operating expenses	(28,876)	-	-
Other assets	(41,870)	(101,860)	(1,495)
Resources used in investing activities	(1,603,384)	(587,152)	(597,788)
(Decrease) increase in cash and cash equivalents	(513,982)	723,508	203,539
Cash and cash equivalents at beginning of year	1,068,383	344,875	141,336
Cash and cash equivalents at end of year	$ 554,401	1,068,383	344,875

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

AXTEL, S. A. DE C. V. AND SUBSIDIARIES

Consolidated Statements of Changes in Stockholders' Equity

(Thousands pesos of constant purchasing power as of December 31, 2004)

		Common stock	Additional paid-in capital	Deficit	Cumulative deferred income tax effect	Change in the fair value of derivative instruments	Total stockholders' equity
Balances as of December 31, 2001	$	4,242,472	158,396	(1,779,279)	118,507	-	2,740,096
Common stock contribution (note 17a)		54,783	(2,155)	-	-	-	52,628
Comprehensive loss				(855,132)	-	-	(855,132)
Balances as of December 31, 2002		4,297,255	156,241	(2,634,411)	118,507		1,937,592
Common stock contribution (note 17a)		2,809,463	(15,625)	-	-	-	2,793,838
Cumulative effect of vacations accrual		-	-	(1,427)	-	-	(1,427)
Comprehensive income		-	-	946,503	-	-	946,503
Balances as of December 31, 2003		7,106,718	140,616	(1,689,335)	118,507	-	5,676,506
Comprehensive income (notes 3 and 6)		-	-	(77,132)	-	(299)	(77,431)
Balances as of December 31, 2004	$	7,106,718	140,616	(1,766,467)	118,507	(299)	5,599,075

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

(1) Organization and description of business

Axtel, S. A. de C. V. and subsidiaries (the Company or AXTEL) is a Mexican corporation engaged in operating and/or exploiting a public telecommunication network to provide voice, sound, data, text, and image conducting services, and local, national, and international long-distance calls. To provide these services and carry out the Company's activity, a concession is required (see note 21e). In June 1996, the Company obtained a concession from the Mexican Federal Government to install, operate and exploit public telecommunication networks for an initial period of thirty years.

The Company's capital structure has Mexican majority share ownership, with 59.5% of shares with voting rights owned by Telinor Telefonía, S. de R.L. de C.V. The remaining 40.5% is distributed among other entities.

AXTEL offers different access technologies, including fixed wireless access, point-to-point, point-to-multipoint, fiber optic radio links and copper technology, depending on the communication needs of the clients.

The Company has been granted the following licenses over the spectrum of frequencies necessary to provide the services:

- 60MHz for Point-to-Multi-Point in the 10.5GHz band to cover each one of the nine regions of the Mexican territory. The acquisition of these twenty-year concessions, with an extension option, represented an investment of $144,298 for the Company.

- 112MHz for Point-to-Point in the 15GHz band and a 100MHz in the 23GHz band with countrywide coverage. The acquisition of these twenty-year concessions, with an extension option, represented an investment of $72,772 for the Company.

- 50MHz in the 3.4GHz. The licenses obtained allow coverage in the nine regions of the country, and the investment was $745,145 for a period of twenty years with an extension option.

The Company has commercial services in Monterrey, Mexico City, Guadalajara, Puebla, Toluca, Leon, Tijuana, Cd. Juarez, Saltillo, Aguascalientes, Queretaro and San Luis Potosi.

(Thousands pesos of constant purchasing power as of December 31, 2004)

(2) Summary of significant accounting policies

The accounting policies and practices followed by the Company in the preparation of the consolidated financial statements are described below:

(a) Financial statement presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Mexico (Mexican GAAP), which include the recognition of the effects of inflation on the financial information, and are expressed in Mexican pesos of constant purchasing power as of December 31, 2004 based on the National Consumer Price Index (NCPI) published by Banco de Mexico.

The following national consumer price indexes (NCPI) were used to recognize the effects of inflation:

	NCPI	Inflation %
December 2004	411.648	5.47
December 2003	390.299	3.99
December 2002	375.324	5.70
December 2001	355.084	5.00

For purposes of disclosure in the notes to the financial statements, references to pesos or “$”, are to Mexican pesos; likewise, references to dollars, are to dollars of the United States of America.

(b) Principles of consolidation

The consolidated financial statements include the assets, liabilities, equity and results of operations of the subsidiaries listed below. The balances and transactions between companies have been eliminated in the preparation of the consolidated financial statements.

	% ownership
Instalaciones y Contrataciones, S. A. de C. V.	99.998%
Impulsora e Inmobiliaria Regional, S. A. de C. V.	99.998%
Servicios Axtel, S. A. de C. V.	99.998%

(c) Cash equivalents

Cash equivalents are expressed at the lower of acquisition cost plus accrued interest as of the most recent balance sheet date or net estimated realizable value. Interest and foreign currency exchange fluctuation are included in the statements of operations as part of the comprehensive financing result.

(d) Inventories

Inventories are carried at the lower of restated cost and net realizable value. The restated cost is determined by application of the NCPI factor to current costs.

(e) Property, systems and equipment

Property, systems and equipment are recorded at acquisition cost and restated by NCPI factors.

Comprehensive financing results incurred up to June 1999 during construction or installation periods was capitalized as part of the cost of the assets that were incurred during the pre-operating stage. Since that date, comprehensive financing results have been recognized as part of the results of year in which they are incurred.

Depreciation of property, systems and equipment is calculated using the straight-line method, based on useful lives estimated by management. Useful lives are described in note 9.

Leasehold improvements are amortized over the shorter of the useful life of the improvement and the term of the lease.

Maintenance and minor-repair expenses are expensed as incurred.

(f) Telephone concession rights

Telephone concession rights are restated by NCPI factors and amortized under the straight-line method over a period of 20 years (the initial term of the concession).

(g) Pre-operating expenses

Pre-operating expenses include administrative services, technological advice and comprehensive financing results incurred through June 1999 and also the expenses incurred during 2000 and 2004 in opening offices in other cities throughout the country. The Company started providing business services beginning in 2001. These expenses were capitalized, and restated by NCPI factors and are amortized under the straight-line method over a period of 10 years (see note 10).

(h) Other assets

Other assets mainly include costs from Telmex/Telnor infrastructure special projects, guarantee deposits, and notes issuance costs (see note 11).

(i) Seniority premiums

The accumulated seniority premium benefits to which employees are entitled by law are recognized in the results of each period at the current value of the obligation, based on actuarial calculations prepared by independent experts.

Other benefits to which employees may be entitled, principally severance benefits, are recognized as an expense in the year in which they are paid (see note 23b).

(j) Derivative financial instruments

To reduce the risks resulting from foreign exchange rate fluctuations of the peso with respect to the dollar, the Company enters into a Cross Currency Swap agreement (CCS) that meet the characteristics of derivative financial instruments. The CCS involve the exchange of cash flows originated by the exchange of interest rates and currencies fluctuations. Net amounts paid or received are reflected as adjustments to interest expense.

Changes in the fair value of hedging derivative financial instruments are recognized within the comprehensive result account in stockholders' equity, before being offset to assets or liabilities whose risks will be hedged and/or offset. The non-effective portions (portions not hedging or that stop hedging the designated risks) are recognized in results of the period (see notes 3 and 6).

(k) Income tax (IT) tax on assets (TA) and employee's statutory profit sharing (ESPS)

IT is accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Deferred ESPS is recognized for timing differences arising from the reconciliation of book income to income for profit sharing purposes with respect to which it may reasonably be estimated that a future liability or benefit will arise and there is no indication that the liabilities or benefits will not materialize.

(l) Inflation adjustment of common stock, other contributions and deficit

This adjustment is determined by multiplying stockholder contributions and deficit by NCPI factors, which measure accumulated inflation from the dates contributions were made and losses arising through the most recent year end. The resulting amounts represent the constant value of stockholders' equity.

(m) Comprehensive income (loss)

The comprehensive income (loss) represents the net income or loss for the year plus the effect of those items reflected directly in stockholders' equity, other than capital contributions, reductions and distributions.

(n) Cumulative deferred income tax effect

The Company adopted Bulletin D-4, "Accounting for income tax, tax on assets and employee statutory profit sharing" effective January 1, 2000, which required the adoption of the asset and liability method for determining deferred income taxes. The cumulative effect represents the cumulative previously unrecognized deferred taxes as of the date of adoption.

(o) Comprehensive financing result (CFR)

The CFR includes interest, currency exchange differences and the monetary effect, less the amounts capitalized, as part of fixed assets and preoperating expenses.

Foreign currency transactions are recorded at the rate of exchange prevailing on the date of execution or settlement. Foreign currency assets and liabilities are translated at the exchange rate in force at the balance sheet date. Exchange differences arising from assets and liabilities denominated in foreign currencies are recognized in the results of operations.

Monetary position gains and losses are determined by multiplying the difference between monetary assets and liabilities at the beginning of each month, including the deferred taxes, by inflation factors through year-end. The aggregate of these results represents the monetary gain or loss for the year arising from inflation, which is recognized in the CFR.

(p) Revenue recognition

The Company's revenues are recognized when earned, as follows:

- Telephone service – Based on monthly service fees, measured usage charges based on the number of calls made and other service charges to customers.
- Activation – At the time the equipment is installed.
- Equipment – At the time of sale and the customer takes ownership and assumes risk of loss.

(q) Business and risk concentration

The Company rendered services to one client that represents approximately 17%, 18% and 16% of total net revenues during 2004, 2003 and 2002, respectively. This client's accounts receivable balances as of December 31, 2004 and 2003 represent approximately 1% of total accounts receivable in both years. The Company provides an allowance for doubtful accounts based on management's analyses and estimations. The allowance expense is included as selling and administrative expenses in the consolidated statement of operations.

(r) Contingencies

Liabilities for loss contingencies are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated. When a reasonable estimation can not be made, qualitative disclosure is provided in the notes to the consolidated financial statements. Contingent revenues, earnings or assets are not recognized until their realization is virtually assured.

(s) Impairment of property, systems and equipment and other non-current assets

The Company evaluates periodically the adjusted values of its property, systems and equipment and other non-current assets to determine whether there is an indication of potential impairment. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net revenues expected to be generated by the asset. If such assets are considered to be impaired, the impairment is measured by the amount by which the carrying amount of the asset exceeds the expected net revenues. Assets to be disposed of are reported at the lower of the carrying amount or realizable value.

(t) Use of estimates

The preparation of financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying amount of property, plant and equipment valuation allowances for receivables, inventories and deferred income tax assets; valuation of financial instruments; and assets and obligations related to employee benefits. Actual results could differ from these estimates and assumptions.

(3) Accounting changes

Derivative financial instruments

The Mexican Institute of Public Accountant (IMCP) issued Bulletin C-10 “Derivative financial instruments and hedging operations”, effective January 1, 2005, with an early adoption encouragement. One of the main provision of this new standard is the classification of hedging through derivative financial instruments according to the exposure to be hedged, in three accounting models: on fair values, on cash flows and on net investments of subsidiaries located abroad. This Bulletin C-10 requires that all derivative instruments be recorded on the balance sheet at their respective fair value.

For all hedging relationships the Company formally documents the hedging relationship and its risk-management objective and strategy for undertaking the hedge, the hedging instrument, the item, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed, and a description of the method of measuring ineffectiveness. This process includes linking all derivatives that are designated as fair-value or cash-flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company does also formally assesses when appropriate, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a fair-value hedge, along with the loss or gain on the hedged asset or liability or unrecognized firm commitment of the hedged item that is attributable to the hedged risk, are recorded in earnings. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash-flow hedge are recorded in other comprehensive income to the extent that the derivative is effective as a hedge, until earnings are affected by the variability in cash flows of the designated hedged item. The ineffective portion of the change in fair value of a derivative instrument that qualifies as cash-flow hedge is reported in earnings.

The Company discontinues hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting changes cash flows of the hedged item, the derivative expires or is sold, terminated, or exercised, the derivative is designated as a hedging instrument, because it is unlikely that a forecasted transaction will occur, a hedged firm commitment no longer meets the definition of a firm commitment, or management determines that designation of the derivative as a hedging instrument is no longer appropriate. When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur, the Company continues to carry the derivative on the balance sheet at its fair value with subsequent changes in fair value included in earnings, and gains and losses that were accumulated in other comprehensive income are recognized immediately in earnings. In all other situations in which hedge accounting is discontinued, the Company continues to carry the derivative at its fair value on the balance sheet and recognizes any subsequent changes in its fair value in earnings.

The Company decided on the early adoption of Bulletin C-10 for 2004. As a result of this early adoption, the Company recognized a loss from effective hedging amounts for cross currency swaps derivative financial instruments as a decrease to stockholders' equity accounts, for $299, which corresponds to the unrealized loss on these derivative financial instruments (see note 6).

(4) Foreign currency exposure

Monetary assets and liabilities denominated in dollars as of December 31, 2004 and 2003 are as follows:

	(Thousands of dollars)	
	2004	**2003**
Current assets	62,351	85,048
Current liabilities	(73,384)	(36,146)
Long-term liabilities	(180,121)	(180,266)
Foreign currency liability position, net	(191,154)	(131,364)

The U.S. dollar exchange rates as of December 31, 2004 and 2003 were $11.2648 and $11.2360 respectively. As of February 25, 2004, the exchange rate was $11.0807.

As of December 31, 2004, the Company had foreign exchange derivative instruments (see note 6).

As of December 31, 2004 and 2003, the Company had the following non-monetary assets of foreign origin, the replacement cost of which may only be determined in dollars:

	(Thousands of dollars)	
	2004	**2003**
Inventories	2,798	1,029
Systems and equipment, gross	732,181	663,225
	734,979	664,254

Following is a summary for the years ended December 31, 2004, 2003 and 2002, of transactions carried out with foreign entities, excluding imports and exports of systems and equipment:

	(Thousands of dollars)		
	2004	**2003**	**2002**
Interest expense	21,429	14,926	38,475
Commissions	471	11,174	1,978
Administrative and technical advisory services	1,004	243	3,325
	22,904	26,343	43,778

(Thousands pesos of constant purchasing power as of December 31, 2004)

(5) Accounts receivable

Accounts receivable consist of the following:

		2004	2003
Trade	$	607,806	494,205
Less allowance for doubtful accounts		100,219	70,368
Accounts receivable, net	$	507,587	423,837

The activity in the allowance for doubtful accounts for the years ended December 31, 2004, 2003 and 2002 was as follows:

		2004	2003	2002
Balances at beginning of year	$	66,719	232,316	73,461
Bad debt expense		33,500	57,658	158,855
Write-offs		-	(223,255)	-
Balances at end of year not adjusted for inflation		100,219	66,719	232,316
Effects of inflation		-	3,649	22,483
Balances at year end at constant pesos	$	100,219	70,368	254,799

(6) Hedging

On March 29, 2004, the Company entered into a derivative Cross Currency Swaps (CCS) transactions denominated “Coupon Swap” agreements to hedge 65% of their US dollar foreign exchange exposure resulting from the issuance of the U.S. $175 million 11% senior notes which mature in 2013. Under the CCS transactions, Axtel will receive semiannual payments calculated based on the aggregate notional amount of U.S.$ 113.75 million at an annual U.S. rate of 11%, and the Company will make semiannual payments calculated based on the aggregate of $1,270,019 (nominal value) at annual Mexican rate of 12.30%. The CCS will expire in December 2008. During the life of the contracts, the cash flows originated by the exchange of interest rates under the CCS match in interest payment dates and conditions those of the underlying debt. The Company does not enter into derivative instruments for any purpose other than cash-flow-hedging purposes. That is, the Company does not speculate using derivative instruments.

AXTEL, S. A. DE C. V. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Thousands pesos of constant purchasing power as of December 31, 2004)

By using derivative financial instruments to hedge exposures to changes in currency exchange rates fluctuations, the Company exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Company, which creates credit risk for the Company. When the fair value of a derivative contract is negative, the Company owes the counterparty and, therefore, it does not possess credit risk. The Company minimizes the credit risk in derivative instruments by entering into transactions with high-quality foreign financial counterparties

The *CCS* information is as follows:

(Amounts in charts are expressed in millions, except exchange rates which are expressed in pesos)

	Currencies		**Interest Rates**		
Maturity date	**Notional amount**	**Notional amount (nominal value)**	**Axtel receives**	**Axtel pays**	**Estimated fair value**
December 15, 2008	U.S.$ 113.75	$ 1,270	11.00%	12.30%	U.S.$(0.1)

For the year ended December 31, 2004, the change in net unrealized losses “mark to market” for derivatives designated as cash flow hedges was US $(0.1) million. No hedge ineffectiveness on cash flow hedges was recognized during 2004.

As of December 31, 2003, the Company had an European-Style-type option contract, (option) which established a floor and a ceiling exchange rate between the peso and the U.S. dollar at specified dates on specified notional amounts. In the first quarter of 2004 this derivative instruments was settled and thus the Company recognized a loss of $551 from this transaction. As of December 31, 2003, the position of the option was as follows:

Inception and expiration dates	**Notional amount/exchange rate - floor**	**Notional amount/exchange rate - ceiling**	**Changes in the fair value recorded within the CFR earnings item**
Sept 23, 2003/March 17, 2004	$ 55.4/11.08	$ 56.5/11.30	$ 0.6

(Thousands pesos of constant purchasing power as of December 31, 2004)

The estimated fair values of derivative instruments used for the exchange of interest rates and/or currencies fluctuate over time and will be determined by future interest rates and currency prices. These values should be viewed in relation to the fair values of the underlying transactions and as part of the overall Company's exposure to fluctuations in interest rates and foreign exchange rates.

(7) Prepaid expenses

Prepaid expenses consist of the following:

		2004	2003
Airspan Communications Limited	$	92,826	-
Nortel Networks de México		3,467	3,262
Nortel Networks Limited		2,112	166,706
Maxcom Telecomunicaciones		290	8,756
Other		33,180	15,220
Total prepaid expenses	$	131,875	193,944

In accordance with the debt-restructuring agreement (See note 13b) all new purchases from Nortel should be either secured through the issuance of a letter of credit or prepaid.

The payment terms for Airspan requires a 50% downpayment with the remaining balance payable upon shipments of goods (see note 21i).

(8) Inventories

Inventories consist of the following:

		2004	2003
Telephones and caller identification devices	$	17,304	4,319
Installation material		7,622	4,389
Tools		2,937	1,384
Network spare parts		16,353	8,251
Other		14,034	4,388
Total inventories	$	58,250	22,731

(Thousands pesos of constant purchasing power as of December 31, 2004)

(9) Property, systems and equipment

Property, systems and equipment are analyzed as follows:

	2004	2003	Useful lives
Land	$ 38,020	37,810	
Building	123,959	122,927	25 years
Computer and electronic equipment	1,049,672	893,766	3 years
Transportation equipment	18,920	15,229	4 years
Furniture and fixtures	99,763	93,281	10 years
Network equipment	6,661,326	6,082,434	6 to 28 years
Leasehold improvements	151,072	139,066	
Construction in progress	1,185,141	435,989	
	9,327,873	7,820,502	
Less accumulated depreciation	3,215,600	2,344,124	
Property, systems and equipment, net	$ 6,112,273	5,476,378	

As of December 31, 2004 the Company has capitalized CFR as a component of the acquisition cost of property, systems and equipment aggregating $2,290.

(10) Pre-operating expenses, net

The capitalized pre-operating expenses incurred up to June 1999 and expenses incurred during 2000 and 2004 in opening operations in new cities are as follows:

	2004	2003
Salaries	$ 196,709	185,631
Legal and financial advisory	106,017	106,017
Operating expenses	75,485	57,687
Depreciation	9,213	9,213
Comprehensive financing result	(23,250)	(23,250)
Service and other revenues	(13,142)	(13,142)
Other	36,640	36,640
	387,672	358,796
Less accumulated amortization	185,049	147,721
Pre-operating expenses, net	$ 202,623	211,075

(Thousands pesos of constant purchasing power as of December 31, 2004)

(11) Other assets

Other assets consist of the following:

		2004	2003
Notes issuance costs	$	70,677	63,123
Telmex / Telnor infrastructure costs		55,906	35,317
Guarantee deposits		18,872	14,905
Other		12,508	2,747
		157,963	116,092
Less accumulated amortization		16,943	866
Other assets, net	$	141,020	115,226

Notes issuance costs

Notes issuance costs mainly consists of legal and audit fees, documentation, advising, printing, rating agencies, registration fees and out of pocket expenses incurred in relation to the issuance of notes payable and are amortized over the life of the related debt.

Telmex / Telnor infrastructure costs

As part of the opening of the telecommunications market in Mexico, new telecommunications companies must have interconnection with Telefonos de Mexico (Telmex) and Telefonos del Noroeste (Telnor). These two companies made agreements with the new entrants by which they must compensate the investment in infrastructure that Telmex / Telnor were forced to make in order to provide interconnection for the new entrants.

In the case of Axtel, the agreement signed with Telmex / Telnor indicated, that the Company is obligated to make such compensation as follows which ever comes first:

a) December 31, 2003 or 2004 depending the invested infrastructure or
b) Certain amount minutes of calls terminated by Telmex / Telnor.

After one of these events is met, the Company is not longer obligated to make further compensations in this regard. These costs will be amortized under the straight line method over a period of fifteen years.

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(Thousands pesos of constant purchasing power as of December 31, 2004)

(12) Short-term debt

Short-term debt as of December 31, 2004 and 2003 and their main characteristics are as follows:

		2004	2003
Revolving line of credit with SR Telecom Canada Inc. denominated in U.S. dollars. The payments are made 50% net 30 days and 50% net 360 days. The interest rate is LIBOR plus 6.25 percent points applicable only to the 360-day portion	$	-	4,400
Revolving line of credit with Banco Mercantil del Norte, S.A. (Banorte) used for letters of credit, denominated in U.S. dollars up to 360 days		84,810	14,869
Revolving lines of credit with different institutions used for letters of credit denominated in U.S. dollars up to 360 days		23,617	6,044
Total short-term notes payable	$	108,427	25,313

(13) Long-term debt

Long-term debt as of December 31, 2004 and 2003 and its main characteristics is as follows:

		2004	2003
U.S. $175,000,000 in aggregate principal amount of 11% Senior Notes due 2013. Interest is payable semi-annually in arrears on June 15, and December 15 of each year which began on June 15, 2004.	$	1,971,340	2,073,855
Hewlett Packard de Mexico, S. de R. L. de C.V. denominated in U.S. dollars, payable in 36 monthly installments with a six- month grace period maturing in 2005. The interest rate was 9.8%. This debt was pre-paid in full during 2004.		-	4,708
Promissory Notes with Hewlett Packard Operations Mexico, S. de R.L. de C.V. denominated in U.S. dollars, payable in 12 quarterly installments maturing in December 2007. The interest rate is 7.0%		53,542	22,749
Line of credit with Siemens Financial Services Inc. denominated in U.S. dollars. The payments were made in six semiannual installments through 2005. The interest rate was LIBOR plus 5.5 percentage points. Interest was payable semiannually. This debt was pre-paid in full during 2004		-	54,343
Other long-term financing with several credit institutions with interest rates fluctuating between 6% and 9% for those denominated in dollars and TIIE (Mexican average interbank rate) plus six percentage points for those denominated in pesos		50,322	36,426
Total long-term debt		2,075,204	2,192,081
Less current maturities		48,990	57,384
Long-term debt, excluding current maturities	$	2,026,214	2,134,697

(Thousands pesos of constant purchasing power as of December 31, 2004)

Annual installments of long-term debt are as follows:

Year		Amount
2006	$	34,796
2007		20,078
2008		-
2009 and thereafter		1,971,340
	$	2,026,214

The following are the most important changes in the Company long-term debt during 2004 and 2003:

a) On March 18, 2003, the Company obtained a loan for U.S.$ 75 million dollars from Banco Mercantil del Norte, S.A. (Banorte) at a variable Libor interest rate to 90 days plus certain basis points, payable quarterly. The loan payments were set in four equal consecutive quarterly installments of U.S.$ 4.5 million and one last installment of U.S.$ 57 million, beginning 24 months after the credit disposition date, which was March 20, 2003. On December 17, 2003 this loan was paid in full (see note 13d).

b) On March 20, 2003, the Company entered into a debt-restructuring agreement with Nortel Networks Limited and Nortel Networks de Mexico (Nortel), which resulted as follows: payment in cash of U.S.$ 125.2 million dollars, issuance by the Company of a promissory note for U.S.$ 24.2 million dollars and the capitalization of debt of U.S.$ 178.5 million dollars in exchange for 250,836,980 Series "N" shares of common stock (see note 17). As a result of this transaction, Axtel recognized a gain on extinguishment of debt of approximately $1,960,000 pesos (see note 20). The promissory note for U.S$ 24.2 million dollars was paid in December 2003 (see note 13d). After this transaction and in accordance with the debt restructuring agreement, all new purchases from Nortel should be either secured through the issuance of a letter of credit or prepaid (see note 7).

c) On May 2003 the Company entered in an agreement with Bell Canada International (BCI) to terminate all of the rights and obligations of both parties under the technical services agreement and a second agreement dated as of October 6, 1997, including Axtel's obligations to pay fees in the future based on the Company's financial performance and in full settlement of any and all claims that BCI may have against Axtel arising out of or related to the above mentioned agreements. The termination agreement was for U.S.$ 15.6 million, which was included in other income (expense) line item; originally payable as follows: U.S.$ 2.7 million at closing of the agreement, U.S.$ 1.1 million in June 2003, U.S.$ 1.1 million in September 2003, U.S.$ 1.1 million in December 2003 and U.S.$ 9.3 million, maturing thirty seven (37) months after closing payable without interest and in a single installment. On December 17, 2003 this debt was paid in full (see note 13d).

(Thousands pesos of constant purchasing power as of December 31, 2004)

d) On December 16, 2003, the Company completed an offering of senior unsecured notes, for a value of U.S. $175 million ($2,074 million pesos) maturing on December 15, 2013. Interest on the Notes are payable semiannually at a annual rate of 11%, beginning on June 15, 2004.

The indenture of the notes contain certain affirmative and negative covenants, as of December 31, 2004, the Company was in compliance with all covenants.

With the proceeds of the offering the Company prepaid in full the Banorte facility, the Nortel promissory note and the BCI Indebtedness.

Each of the Company's consolidated subsidiaries, Instalaciones y Contrataciones, S.A. de C.V. (Instalaciones), Impulsora e Inmobiliaria Regional, S.A. de C.V. (Impulsora) and Servicios Axtel, S.A. de C.V. (Servicios), are guaranteeing the notes with unconditional guaranties that are unsecured.

Some of the debt agreements that remain outstanding establish certain covenants, the most important of which refer to limitations on dividend payments and comprehensive insurance on pledged assets, among others. As of December 31, 2004, the Company was in compliance in all its covenants and obligations.

(14) Other Accounts Payable

As of December 31, 2004 and 2003 the other accounts payable consist of the following:

		2004	2003
Guarantee deposits (note 21a)	$	146,442	154,058
Interest payable (note 21a)		31,927	25,594
Other		22,290	25,293
	$	200,659	204,945

(15) Seniority premiums

The cost of the obligations and other elements of seniority premiums mentioned in note 2(i) have been determined based on independent actuarial calculations as of December 31, 2004 and 2003.

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The components of the net periodic cost for the years ended December 31, 2004, 2003 and 2002 are the following:

		2004	2003	2002
Net periodic cost				
Labor cost	$	611	608	185
Financial cost		78	65	43
Amortization of transition obligation		1	1	1
Variances in assumptions and experience adjustments		9	17	0
Inflationary effect		28	27	14
Net periodic cost	$	727	718	243

The actuarial present value of plan benefit obligations is as follows:

		2004	2003
Present benefit obligation	$	2,395	2,177
Present value of benefits attributable to future salary increases		183	134
Projected benefit obligation (PBO)		2,578	2,311
Items pending amortization:			
Variances in assumptions and experience adjustments		(372)	(430)
Transition liability		(7)	(8)
Minimum additional liability		195	236
Net projected liability recognized on the consolidated balance sheets	$	2,394	2,109

The most significant assumptions used in the determination of the net periodic cost of plan are the following:

	2004	2003
Discount rate	4.00%	4.00%
Rate of increase in future salary levels	1.00%	1.00%
Estimated inflation for the period	4.00%	4.00%
Amortization period of the transition liability	17 years	11 years

During 2004 the amortization period of the transition liability was increase for additional six years as the variable of probability for payments of pension (when personnel reach 65 years old) was incorporated in the new actuarial calculations. The effect of this change was not material.

(Thousands pesos of constant purchasing power as of December 31, 2004)

(16) Income tax (IT), tax on assets (TA), employee statutory profit sharing (ESPS) and tax loss carryforwards

The parent company and its subsidiaries file their tax returns on a stand-alone basis, and the consolidated financial statements show the aggregate of the amounts determined by each company.

In accordance with the current tax legislation, companies must pay either the IT or TA, whichever is greater. Both taxes recognize the effects of inflation, in a manner different from MexGAAP.

The TA law establishes a 1.8% tax on assets adjusted for inflation in the case of inventory, property, systems and equipment and deducted from certain liabilities. TA levied in excess of IT for the year can be recovered in the succeeding ten years, updated for inflation, provided that in any of such years IT exceeds TA.

In December 2004, the Mexican Congress approved changes to the Income Tax Law, previously on January 1, 2002 a new Income Tax Law had been enacted, this law provided for a 1% annual reduction in the income tax rate beginning in 2003, so that the income tax rate would have been 32% in 2005, nevertheless the main change included in December 2004 and its impact on the Company’s financial statements was related to a reduction in the income tax rates from previously approved tax rate of 32% in 2005 to a new tax rate of 30%. Also, for years 2006 and 2007 the tax rates will decrease to 29% and 28%, respectively. Consequently, the deferred income taxes, were calculated assuming a 30% tax rate for current assets and current liabilities; 29% and 28%, for assets and liabilities whose tax effects will be reversed after 2005. The effect of the reduction in the deferred income tax assets calculation for 2004 was $50,924.

The tax (expense) benefit attributable to the income (loss) before IT differed from the amount computed by applying the tax rate of 33% in 2004, 34% in 2003 and 35% in 2002 to pretax income (loss), as a result of the items mentioned below:

		2004	2003	2002
Computed “expected” income tax (expense) benefit	$	(24,203)	(498,761)	388,525
Increase (decrease) resulting from:				
Effects of inflation, net		(16,158)	3,994	(27,433)
Change in valuation allowance		(7,284)	(9,095)	(1,137)
Adjustments to deferred tax assets and liabilities for enacted changes in tax rates		(50,924)	(20,377)	16,456
Amendment to 2003 income tax return		(30,084)	-	-
Non-deductible expenses		(13,750)	(1,688)	(43,521)
Other		(8,072)	5,485	(77,951)
Deferred income tax (expense) benefit	$	(150,475)	(520,442)	254,939

(Thousands pesos of constant purchasing power as of December 31, 2004)

In June 2004 the Company filed before the Mexican tax authority its Statutory Tax Report and also filed an amended Income Tax Return for the year ended December 31, 2003. In that filing, the net tax operating loss carryforwards were decreased by approximately $90,000 as a result of certain expenses originally reported as deductible expenses and in the amended return reported as non-deductible expenses. As a consequence, the tax assets associated with these carryforwards were reduced resulting in an increase in the deferred tax expense for 2004 of approximately $30,000. This decrease and the enacted changes in tax rates are the main factors as to why the effective rate for the year ended December 31, 2004 is approximately 200% as compare to the 34.2% effective rate for the same period in 2003. Other factors contributing to the large effective tax rate mainly include non-deductible expenses and certain inflationary effects.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31, 2004 and 2003 are presented below:

		2004	2003
Deferred tax assets:			
Net operating loss carryforwards	$	515,009	526,821
Accounts receivable		28,061	182,915
Accrued liabilities		4,039	23,401
Tax on assets		17,303	9,067
Accrued vacations		2,022	2,590
Total gross deferred tax assets		566,434	744,794
Less valuation allowance		18,941	11,657
Net deferred tax assets		547,493	733,137
Deferred tax liabilities:			
Property, systems and equipment		178,025	227,703
Telephone concession rights		165,168	161,396
Pre-operating expenses		57,726	68,589
Other assets		5,016	1,951
Inventories		17,475	7,729
Total deferred tax liabilities		423,410	467,368
Deferred tax assets, net	$	124,083	265,769

(Thousands pesos of constant purchasing power as of December 31, 2004)

The Company assesses realizability of deferred tax assets based on the existence of taxable temporary differences expected to reverse in the same periods as the realization of deductible temporary differences or in later periods in which the tax loss carryforwards can be applied and when, in the opinion of management, there will be enough future taxable income for the realization of such deductible temporary differences. However, the amounts of realizable deferred tax assets could be reduced if the taxable income is lower. As of December 31, 2004 and 2003, a deferred tax asset valuation allowance was established for tax loss carryforwards from the subsidiaries and TA from the Company. No deferred tax asset valuation allowance was established for AXTEL tax loss carryforwards, since, in the opinion of Company management, there is a high probability that there will be enough future taxable income to realize the net deferred tax assets.

According to the IT law, the tax loss of a year, restated by inflation, may be carried to the succeeding ten years. The tax losses have no effect on ESPS. As of December 31, 2004, the tax loss carryforwards expire as follows:

Year	**Inflation-adjusted tax loss carryforwards**	**Recoverable TA**
2009	$ 593	-
2010	1,174,980	-
2011	223,375	-
2012	439,849	-
2013	521	8,595
2014	-	8,708
	$ 1,839,318	17,303

Effective January 1, 2002, Axtel transferred all of its personnel to a subsidiary Company, which eliminated any deferred ESPS liability.

(17) Stockholders' equity

The main characteristics of stockholders' equity are described below:

(a) Common stock structure

The main characteristics and issuances of common stock for 2004, 2003 and 2002 are described below:

Date	Amount (thousand dollars)		Amount (nominal pesos)	Amount (constant pesos)	Additional paid-in capital (constant pesos)
February 28, 2002	5,000	$	47,690	54,783	(2,155)
Total 2002	**5,000**	$	**47,690**	**54,783**	**(2,155)**
February 28, 2003	35,336	$	389,854	422,611	(8,358)
October 7, 2003	203,164		2,202,544	2,386,852	(7,267)
Total 2003	**238,500**	$	**2,592,398**	**2,809,463**	**(15,625)**

At the General Stockholders' Meeting, held on February 28, 2003 the stockholders approved the following:

1. Cancellation of the stockholders' outstanding contribution of U.S.$10 million dollars according to the resolutions of the General Stockholders' Meeting held on March 30, 2001, releasing the Company's stockholders from their obligation to make this contribution to capital. Consequently, a U.S.$10 million-dollar decrease was approved of the variable portion of common stock of the Company.

2. Additional contribution to the variable portion of common stock for an amount equivalent in Mexican pesos of U.S.$60 million dollars payable in cash. Consequently, it was approved to issue 2,156,184,303 shares, which was distributed as follows: 1,041,437,018 Series "A" shares Variable; 549,355,873 Series "B" shares Variable; 451,232,470 Series "C" shares Variable and 114,158,942 Series "N" shares, all of them with no par value. In addition the Shareholder's Meeting also resolved that all Series "B" shares were to be exchanged for either Series "A" shares, in the case of investors of Mexican nationality, or Series "C" shares, in the case of investors of non-Mexican nationality.

3. Additional contribution to the variable portion of common stock of the Company for up to the amount equivalent in Mexican pesos of U.S.$200 million dollars through the capitalization of liabilities payable to Nortel (See note 13). Consequently, it was approved to issue 250,836,980 registered shares, with no par value and no right to vote. All the shares were Series "N" shares of the Company's common stock in favor of Nortel, that when issued, will represent 9.9% of the total number of shares issued and paid of the Company's common stock.

In addition, on March 20, 2003 the Company entered in a subscription agreement with Nortel Networks Limited (Nortel), where Nortel agreed to subscribe for 250,836,980 nominative, non par value and non-voting Series "N" Shares for a total subscription price of $2,093,537 (U.S.$178.5 million dollars). Such subscription price shall be considered to be satisfied by means of the debt capitalization as contemplated in the Restructuring Agreement (see note 13). Upon subscription of the shares, such shares represent 9.9% of the total issued and outstanding shares of the common stock of the Corporation.

Also, during 2003 the Company entered in a subscription agreements with LAIF X Sprl, Tapazeca Sprl and New Hampshire Insurance Company whereby these entities agreed to subscribe and pay for 115,068,613 Series "B" shares, and 426,843,722 Series "C" shares all of which are nominative, non par value and voting shares, and 36,181,412 Series "N" shares which are nominative, non par value and non-voting for a total subscription price of US$16 million.

In the Extraordinary Shareholders Meeting held on September 8, 2004 the shareholders approved a proposal to increase the variable portion of the capital stock of the Company in the amount in Mexican pesos equal to $3,066 through the issuance of 124,957,212 non-voting Series "N" shares which will represent 4.7% of the total issued capital stock of the Company. These series "N" stocks have not been issued.

The Company common stock consists of 1,253,233,984 Series "A" shares, 888,152,627 Series "C" shares and 392,320,255 series "N" shares. Series "A" and "C" shares have the right to vote, and series "N" shares have no par value and no voting rights. Series "A" is restricted to Mexican individuals or corporations.

(b) Stockholders' equity restrictions

Stockholder contributions, restated as provided in the tax law, totaling of $7,170,569 may be refunded to stockholders tax-free.

No dividends may be paid while the Company has a deficit. Some of the debt agreements mentioned in note 13 establish limitations on dividend payment.

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(18) Rental, installation, service and other revenues

Revenues consist of the following:

		2004	2003	2002
Local calling services	$	2,722,077	2,300,041	1,932,563
Long distance services		381,854	312,255	305,617
Other services		757,382	466,914	348,377
	$	3,861,313	3,079,210	2,586,557

(19) Special item

In order to improve productivity and comply with the strategic plans, the Company restructured some of its operating areas during the years ended December 31, 2003 and 2002. The costs of restructuring, comprising compensation and benefits to personnel, were $10,987 and $34,194, respectively, and are presented as a special item in the statements of operations for the years ended December 31, 2003 and 2002.

(20) Other income (expenses), net

Other income (expenses) consist of the following:

		2004	2003	2002
Gain on extinguishment	$	-	1,960,118	-
Nortel prepayment		-	32,297	-
Nortel withholding cancellation		-	31,406	-
Banorte prepayment		-	(83,436)	-
BCI termination agreement		-	(126,790)	-
Other		21,004	(5,361)	(29,100)
Other income (expenses), net	$	21,004	1,808,234	(29,100)

(21) Commitments and contingencies

As of December 31, 2004, there are the following commitments and contingencies:

(a) On January 24, 2001 a contract was signed with Spectra Site Communications Mexico, S. de R.L. de C.V. (Spectra Site) expiring on January 24, 2004, to provide the Company with services to locate, construct, set up and sell sites within the Mexican territory. As part of the operation, the Company agreed to build 650 sites, subject to approval and acceptance by Spectra Site and, in turn, sell or lease them under an operating lease plan.

On January 24, 2001, the Company received 13 million dollars from Spectra Site to secure the acquisition of the 650 sites at 20,000 dollars per site. These funds are not subject to restriction per the contract for use and destination. However, the contract provides for the payment of interest at a Prime rate in favor of Spectra Site on the amount corresponding to the number of sites that as of June 24, 2004 had not been sold or leased in accordance with the terms of the contract. The Company has recognized a liability to cover such interest for $31,927, presenting it as other accounts payable in the balance sheet as of December 31, 2004.

During 2002, Spectra Site Communications filed an Ordinary Mercantile Trial against the Company before the Thirtieth Civil Court of Mexico City, demanding the refund of the guarantee deposit mentioned above, plus interest and trial-related expenses. The Company countersued Spectra Site for unilateral rescission of the contract. As of December 31, 2004, the trial is at a stage where evidence is being shown, and thus it not possible to determine whether there is a contingency for the Company.

(b) On October 2002, Metronet, S.A. de C.V. ("Metronet") filed an action against the Company in the Fourth Civil Court in Monterrey (Mexico). Metronet claims that the Company wrongfully terminated a letter of intent and is seeking payment for services and direct damages of approximately U.S.$3.8 million, plus other expenses and attorneys' fees. The trial court ruled against the Company in first instance. The Company appealed such judgment before the Appeal Court and the Appeal Court on October 22, 2004 ruled in favor of the Company, discharging Axtel of any liability, damages or payment in favor of Metronet. Metronet has a last resource before the Mexican Federal Courts to change the Appeal Court judgment.

(c) The Company is involved in a number of lawsuits and claims arising in the normal course of business. It is expected that the final outcome of these matters will not have significant adverse effects on the Company’s financial position and results of operations.

(d) In compliance with commitments made in the acquisition of concession rights, the Company has granted surety bonds to the Federal Treasury and to the Ministry of Communication and Transportation of $31,736 and to other service providers for $48,402.

(e) The concessions granted by the Ministry of Communications and Transportation (SCT), mentioned in note 1, establish certain obligations of the Company, including, but not limited to: (i) filing annual reports with the SCT, including identifying main shareholders of the Company, (ii) reporting any increase in common stock, (iii) providing continuous services with certain technical specifications, (iv) filing monthly reports about disruptions, (v) filing the services' tariff, and (vi) providing a bond.

(f) The Company leases some equipment and facilities under operating leases. Some of these leases have renewal clauses. Lease expense for 2004, 2003 and 2002 was $287,561, $205,706 and $222,177, respectively.

The annual payments under these leases as of December 31, 2004 are as follows:

	Contracts in:		
	Pesos	**Dollars (thousands)**	**UDIS (Investment units)**
2005	$ 59,286	6,716	54,833
2006	45,131	5,551	54,833
2007	39,179	4,588	54,833
2008	33,475	2,819	54,833
2009	27,834	2,727	45,694
Thereafter	106,903	11,461	-
	$ 311,808	33,862	265,026

(g) As of December 31, 2004, the Company has placed purchase orders which are pending delivery from suppliers for approximately $765,748.

(h) On April 20, 2004 Axtel and Airspan entered into Amendment Agreement No. 2 to the Purchase and License Agreement of Fixed Wireless Access Equipment and the Technical Assistance Support Services Agreement, both dated March 20, 2004, by virtue of which the parties agreed to: (i) reduce the prices of (a) the Fixed Wireless Access Equipment (RSS customer premise equipment and the radio base station equipment) and (b) the Technical and Support Services for years 2004 and 2005; (ii) eliminate Axtel's obligation to provide a payment guarantee and modify its payments terms under such Agreements, (iii) improve the delivery times of the equipments; (iv) create a single unit of RSS (customer premise equipment) which will be sold at a lower price in comparison of the current RSS customer premise equipment; and (v) cancel Axtel's purchase commitments of years 2005, 2006 and 2007 established under sold Agreements and to replace such commitments with two new commitments, one for U.S.$ 55.0 million to purchase Fixed Wireless Access Equipment commencing April 20, 2004 and ending on December 31st, 2005 and the second commitment for the amount of U.S.$ 10.0 million to purchase any Airspan product, commencing January 1st, 2006 and ending on May 1st, 2006.

(i) On December 2004, the Company entered into a Purchase and License Agreement for FWA Equipment, by virtue of which the Company acquires the commitment of purchasing equipment manufactured by Airspan for the amount of U.S. $38.7 millions, from December 2004 through December 2006.

As of December 31, 2004 the Company has placed purchase orders for the amount of U.S. $28.7 millions.

(j) On July 20, 2004 Axtel, Nortel Networks Limited and Nortel Networks de México, S.A. de C.V., entered into a Purchase and License Agreement for the supply of next generation soft switch equipment and related services (the "NGN PLA"). This NGN PLA contains standard commercial and legal terms. In this NGN PLA, Axtel has a purchase commitment to acquire from Nortel Networks the equipment and the software licenses required to have 100,000 lines in services by the end of the five (5) year term of such agreement.

(k) Those arising from labor obligations mentioned in note 2(i).

(22) Subsequent events

During January 2005, the Company re-opened its bond issuance program, issuing U.S. $75,000,000 under the current indenture. This issuance matures on December 2013. The bonds were issued at a price of 106.75% over face value having a yield to maturity of 9.84%.

(23) New accounting pronouncements

a) Business combinations

In March, 2004, the Mexican Institute of Public Accountants issued the new Bulletin B-7 Business Combinations, which is mandatory beginning on January 1, 2005, although it allows his early application. The Bulletin B-7 provides for certain rules to the accounting treatment of business acquisitions and investments in associate entities. The most relevant aspects included in the Bulletin B-7 among others are: the adoption of the purchase method as a unique rule of valuation. In consequence, the use of the International Accounting Standard IAS-22, Business Combinations was eliminated; modification of the accounting treatment of the goodwill, eliminating his amortization and establishing certain rules of impairment; it provides for specific rules in the acquisition of the minority interest, transferences of assets or exchange of stocks among entities under common control, and the accounting treatment of the intangible assets recognized in a business combinations.

The Company estimates that the adoption of this Bulletin will not have any important impact in its financial position or operation results.

b) Labor obligations.

The new Bulletin D-3, issued in January 2004, substitutes and supersedes former Bulletin D-3, published in January 1993 and revised in 1998. The provisions of this Bulletin are effective immediately, except for those relating to payments upon termination of labor relationships, which are effective January 1, 2005.

This Bulletin adds the issue of post-retirement benefit payments, to supersede Circular 50, "Interest Rates to be Used for Valuing Labor Obligations and Supplementary Application of Accounting Principles, Relating to Labor Obligations." Also, this Bulletin eliminates the issue of unforseen payments, and replaces it with the one relating to "Payments Upon Termination of the Labor Relationship," defining them as those payable to workers upon termination of the labor relationship before retirement age. These payments are of two types: (i) for restructuring reasons, for which the provisions of Bulletin C-9, "Liabilities, Accruals, Contingent Assets and Liabilities, and Commitments," should be applied, and (ii) for reasons other than restructuring, which valuation and disclosure requirements are the same as those for pension and seniority premium payments, permitting that, upon adoption of the Bulletin, the transition asset or liability be immediately recognized in the results of operations, or else, that it be amortized over the average remaining service life of employees.

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(24) Differences between Mexican and United States accounting principles

The consolidated financial statements of the Company are prepared according to accounting principles generally accepted in Mexico (Mexican GAAP), which differ in certain significant respects from those applicable in the United States of America (U.S. GAAP).

The consolidated financial statements under Mexican GAAP include the effects of inflation provided for by Bulletin B-10, whereas the financial statements prepared under US GAAP are presented on a historical cost basis. The following reconciliation does not eliminate the inflation adjustments for Mexican GAAP, since they represent an integral measurement of the effects of the changes in the price levels in the Mexican economy and, as such, are considered a more meaningful presentation than the financial reports based on historic costs for book purposes for Mexico and the United States of America.

The main differences between Mexican GAAP and U.S. GAAP and their effect on consolidated net (loss) income and stockholders' equity as of December 31, 2004, 2003 and 2002 is presented below, with an explanation of the adjustments.

		Year ended December 31,		
		2004	**2003**	**2002**
Net (loss) income reported under Mexican GAAP	$	(77,132)	946,503	(855,132)
Approximated US GAAP adjustments				
1. Deferred income taxes (see 25a)		141,686	511,375	(254,939)
2. Amortization of start-up cost (see 25c)		37,328	37,322	37,728
3. Start-up costs of the year (see 25c)		(28,876)	-	-
4. Allowance for post retirement benefits (see 25d)		7,712	198	11,648
5. Revenue recognition (see 25b)		(6,087)	30,493	64,365
6. Deferred financing cost amortization (see 25f)		-	14,013	(2,325)
7. Accrued vacations (see 25d)		-	-	1,287
8. Capitalized interest (see 25e)		(1,354)	(1,042)	-
9. Gain on the forgiveness of debt (see 25g)		-	1,350,728	-
Total approximate US GAAP adjustments		150,409	1,943,087	(142,236)
Approximate net income (loss) under US GAAP	$	73,277	2,889,590	(997,368)

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		Year ended December 31,	
		2004	**2003**
Total stockholders' equity reported under Mexican GAAP	$	5,599,075	5,676,506
Approximate US GAAP adjustments			
1. Deferred income taxes (see 25a)		(124,083)	(265,769)
2. Start up costs (see 25c)		(202,623)	(211,075)
3. Revenue recognition (see 25b)		(83,469)	(77,382)
4. Allowance for post retirement benefits (see 25d)		(20,959)	(28,671)
5. Capitalized interest (see 25e)		24,753	26,107
Total approximate US GAAP adjustments		(406,381)	(556,790)
Total approximate stockholders' equity under US GAAP	$	5,192,694	5,119,716

The term "SFAS" as used in this document refers to Statement of Financial Accounting Standards.

(a) Deferred income taxes (IT) and employee's statutory profit sharing ("ESPS")

For Mexican GAAP Deferred IT are accounted for under the asset and liability method. All of the Company's pretax income (loss) and reported income tax (expense) benefit is derived from domestic operations.

For Mexican GAAP Deferred ESPS is recognized only for timing differences arising from the reconciliation of book income (loss) to income (loss) for ESPS purposes, which can be reasonably presumed to result in a future liability or benefit, with indication that the liabilities or benefits will materialize.

For U.S. GAAP purposes, the Company accounts for IT and ESPS under SFAS 109 *"Accounting for Income Taxes,"* which uses the asset and liability method to account for deferred tax assets and liabilities. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences of "temporary differences," by applying the enacted statutory tax rates applicable to future years to the differences between the book amounts of the financial statements and the tax bases of existing assets and liabilities and the tax loss carryforwards. The amount of deferred income taxes charged or credited to the operations in each period, for U.S. GAAP purposes, is based on the difference between the beginning and ending balances of the deferred tax assets and liabilities for each period, expressed in nominal pesos. The deferred tax effect of a change in the tax rate is recognized in the results of operations of the period in which the change is enacted.

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The tax (expense) benefit attributable to the income (loss) before IT differed from the amount computed by applying the tax rate of 33% in 2004, 34% in 2003 and 35% in 2002 to pretax loss, as a result of the items mentioned below:

		2004	2003	2002
Computed "expected" income tax (expense) benefit	$	(24,181)	(985,544)	349,079
Increase (decrease) resulting from:				
Effects of inflation, net		(16,158)	3,994	(27,433)
Change in valuation allowance		138,880	528,415	(199,239)
Gain on the forgiveness of debt		-	459,248	-
Adjustments to deferred tax assets and liabilities for enacted changes in tax rates		(50,924)	(20,377)	16,456
Amendment to 2003 Income Tax Return			-	
(see note 16)		(30,084)	-	-
Non-deductible expenses		(13,750)	(1,688)	(43,521)
Other		(3,783)	15,952	(95,342)
Deferred income tax (expense) benefit	$	-	-	-

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities as of December 31, 2004 and 2003 for U.S. GAAP are presented below:

		2004	2003
Deferred tax assets:			
Net operating loss carryforwards	$	515,009	526,821
Accounts receivable		28,061	182,915
Deferred revenues		23,372	26,309
Seniority premium and allowance for post retirement benefits		6,538	9,174
Accrued vacations		2,022	2,590
Accrued liabilities		4,039	23,401
Tax on assets		17,303	9,067
Total gross deferred tax assets		596,344	780,277
Less valuation allowance		(227,508)	(375,096)
Net deferred tax assets		368,836	405,181

(Thousands pesos of constant purchasing power as of December 31, 2004)

Deferred tax liabilities:			
Property, systems and equipment		186,193	236,056
Telephone concession rights		165,168	161,396
Inventories		17,475	7,729
Total deferred tax liabilities		368,836	405,181
Net deferred tax liabilities under US GAAP		-	-
Less net deferred tax assets recognized under Mexican GAAP		124,083	265,769
US GAAP adjustment to stockholders' equity	$	124,083	265,769

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Since the Company had not generated taxable income prior 2002 a deferred tax asset valuation allowance of $227,508, $ 375,096 and $903,513 as of December 31, 2004, 2003 and 2002, respectively, was recorded for U.S. GAAP. This represents a (decrease) and increase in the valuation allowance of $(147,588), $(528,415) and $206,006 for the years ended December 31, 2004, 2003 and 2002, respectively.

(b) Revenue recognition

On December 3, 1999, the SEC issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" (SAB 101). This bulletin summarizes the point of view of the SEC in the recognition of revenues in the financial statements according to U.S. GAAP. The SEC concluded that only when all the following conditions are met is revenue recognition appropriate:

a) there is persuasive evidence of an agreement;
b) the delivery was made or the services rendered;
c) the sales price to the purchaser is fixed or determinable; and
d) collection is reasonable assured.

SAB 101, specifically in Topic 13A, Question 5, discusses the situation of recognizing as revenue certain non-refundable cash items. SAB 101 provides that the seller should not recognize non-refundable charges generated in certain transactions when there is continuous involvement by the vendor.

One of the examples provided by SAB 101 is activation revenues from telecommunication services. The SAB concludes that unless the charge for the activation service is an exchange for products delivered or services rendered that represent the culmination of a separate revenue-generating process, the deferral method of revenue is appropriate.

Based on the provisions and interpretations of SAB 101, for purposes of the U.S. GAAP reconciliation, the Company has deferred the activation revenues over a three-year period starting in the month such charge is originated. This period was determined based on Company experience. The net effect of the deferral and amortization is presented in the above U.S. GAAP reconciliation.

(c) Start-up costs

In April 1998, the AICPA issued Statement of Position 98-5, "Report of Start-up Costs" (SOP 98-5), which requires start-up costs, including organization costs, to be expensed as incurred. SOP 98-5 is effective, except for certain investment companies, for fiscal years beginning after December 15, 1998. Under Mexican GAAP, this costs were recognized when incurred as a deferred asset and amortized over a period of 10 years. The Company has reversed the amortization of $37,328, $37,322 and $37,728 in 2004, 2003 and 2002, as shown in the U.S. GAAP reconciliation, and has reduced stockholders' equity by $202,623 and $211,075 to write off the unamortized balance at each year end. For US GAAP purposes during 2004 the Company reversed $28,876 of capitalized amortization costs.

(d) Other employee benefits

Vacation

For the years ended December 31, 2002 and before, under Mexican GAAP the vacation expense was recognized when taken rather than during the period the employees earn it. In order to comply with SFAS 43, the Company recorded an increase in net income of $1,287 for the year ended December 31, 2002. Starting on January 2003, Mexican GAAP requires the recognition of vacation expense when earned.

Severance

Under Mexican GAAP (Bulletin D-3), severance payments should be recognized in earnings in the period in which they are paid, unless such payments are used by an entity as a substitution of pension benefits, in which case, they should be considered as a pension plan. Under U.S. GAAP, post-employment benefits for former or inactive employees, excluding retirement benefits, are accounted for under the provisions of SFAS 112, which requires recognition of certain benefits, including severance, over an employee's service life. For the years ended December 31, 2004, 2003 and 2002 the Company recorded an increase in net income of $7,712, $198 and $11,648, respectively, and recognized an accrual amounting to $20,959 and $28,671 as of December 31, 2004 and 2003, respectively.

(e) Capitalized interest

Under Mexican GAAP, the Company capitalizes interest on property, systems and equipment under construction. The amount of financing cost to be capitalized is comprehensively measured in order to include properly the effects of inflation. Therefore, the amount capitalized includes: (i) the interest cost of the debt incurred, plus (ii) any foreign currency fluctuations that result from the related debt, and less (iii) the monetary position result recognized on the related debt. Under U.S. GAAP, only interest is considered an additional cost of constructed assets to be capitalized and depreciated over the lives of the related assets.

The U.S. GAAP reconciliation removes the foreign currency gain or loss and the monetary position result capitalized for Mexican GAAP derived from borrowings denominated in foreign currency.

(f) Deferred financing cost amortization

Under Mexican GAAP, the Company amortizes deferred financing cost under the straight-line method over the life of the related debt. For U.S. GAAP, this cost is amortized on the interest method over the life of the related debt.

(g) Gain on extinguishment

As disclosed in note 14 to the financial statements, on March 20, 2003, the Company entered into a debt-restructuring agreement with Nortel Networks Limited and Nortel Networks de Mexico (Nortel). The Company paid Nortel $125.2 million dollars in cash, issued a new note for $24.2 million dollar and capitalized 178.5 million dollars in exchange for 250,836,980 Series “N” shares of common stock to settled all the debt outstanding with Nortel as of the date of the transaction.

For US GAAP, and as required by SFAS 15 “Accounting for Debtors and Creditors for Troubled Debt Restructurings”, the equity provided by the Company to Nortel was recorded at the fair market value resulting in a net gain on extinguishment of the debt of approximately $3,310,846.

(h) Supplemental cash flow information under U.S. GAAP

Under Mexican GAAP, statements of changes in financial position identify the sources and uses of resources based on the differences between beginning and ending consolidated financial statement balances in constant pesos. Monetary position results and unrealized foreign exchange results are treated as cash items in the determination of resources provided by operations. Under U.S. GAAP (SFAS 95), statements of cash flows present only cash items and exclude non-cash items. SFAS 95 does not provide guidance with respect to inflation-adjusted financial statements. The differences between Mexican GAAP and U.S. GAAP in the amounts reported are mainly due to: (i) elimination of inflationary effects of monetary assets and liabilities from financing and investing activities against the corresponding monetary position result in operating activities, (ii) elimination of foreign exchange results from financing and investing activities against the corresponding unrealized foreign exchange result included in operating activities, and (iii) the recognition in operating, financing and investing activities of the U.S. GAAP adjustments.

The following table summarizes the cash flow items as required under SFAS 95 provided by operating, financing and investing activities, giving effect to the U.S. GAAP adjustments, excluding the effects of inflation required by Bulletin B-10. The following information is presented in thousands of pesos on a historical peso basis and is not presented in pesos of constant purchasing power:

	Years Ended December 31,		
	2004	**2003**	**2002**
Net cash provided by (used in) operating activities	1,118,390	(11,160)	668,419
Net cash provided by (used in) financing activities	(193,983)	1,038,913	(210,035)
Net cash used in investing activities	(1,382,981)	(329,221)	(265,855)

Net cash flows from operating activities reflect cash payments for interest and income taxes as follows:

	Years Ended December31,		
	2004	**2003**	**2002**
Interest paid	278,528	463,711	103,958
Income taxes paid	8,789	8,597	-

(Thousands pesos of constant purchasing power as of December 31, 2004)

During the years ended December 31, 2004, 2003 and 2002, the Company acquired property, systems and equipment through notes payable financing amounting to approximately $203,810, $119,655 and $243,523, respectively.

(i) Condensed financial information under U.S. GAAP

The following table presents consolidated condensed statements of operations for the years ended December 31, 2004, 2003 and 2002, prepared under US GAAP, and includes all differences described in this note as well as certain other reclassifications required for purposes of US GAAP:

	Years Ended December 31,		
Statements of operations	**2004**	**2003**	**2002**
Revenues	3,851,213	3,105,565	2,650,922
Operating income (loss)	255,566	180,283	(130,494)
Comprehensive financing result	(194,504)	(429,601)	(803,580)
Other income (expenses), net	21,004	3,147,975	(63,294)
Tax on assets	(8,789)	(9,067)	-
Consolidated net income (loss)	73,277	2,889,590	(997,368)

The following table presents consolidated condensed balance sheets at December 31, 2004 and 2003, prepared under US GAAP, including all differences and reclassifications as compared to Mexican GAAP described in this note 24:

	At December 31,	
Balance sheets	**2004**	**2003**
Current assets	1,334,604	1,729,981
Property, systems and equipment	6,137,026	5,502,485
Deferred charges	864,351	890,885
Total assets	8,335,981	8,123,351
Current liabilities	1,006,708	758,485
Long-term debt	2,026,214	2,134,697
Other non-current liabilities	110,365	110,453
Total liabilities	3,143,287	3,003,635
Stockholders' equity	5,192,694	5,119,716
Total liabilities and stockholders' equity	8,335,981	8,123,351

(j) Fair value of financial instruments

The carrying amount of cash, trade accounts receivable, other accounts receivable, trade accounts payable, other accounts payable and accrued expenses and short-term debt, approximates fair value because of the short-term maturity of these financial assets and liabilities.

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The carrying value of the Company's long-term debt and the related fair value based on quoted market prices for the same or similar instruments or on current rates offered to the Company for debt of the same remaining maturities (or determined by discounting future cash flows using borrowing rates currently available to the Company) at December 31, 2003 is summarized as follows:

	Carrying amount	Estimated fair value
Long-term debt	175,000	66,757

(k) Segment information

The Company believes that it operates in one business segment. Management does review the business as consisting of two revenues information streams (Mass market and Business Market), however it is not possible to attribute direct or indirect costs to the individual streams other than selling expenses. Additionally management believes that the two revenue streams are so similar that they can be expected to have essentially the same economic characteristics.

(l) Recently Issued Accounting Standards

In December 2004, the FASB issued FASB Statement No. 123 (revised 2004), Share-Based Payment, which addresses the accounting for transactions in which an entity exchanges its equity instruments for goods or services, with a primary focus on transactions in which an entity obtains employee services in share-based payment transactions. This Statement is a revision to Statement 123 and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. For nonpublic companies, this Statement will require measurement of the cost of employee services received in exchange for stock compensation based on the grant-date fair value of the employee stock options. Incremental compensation costs arising from subsequent modifications of awards after the grant date must be recognized. This Statement will be effective for the Company as of January 1, 2006.

In December 2004, the FASB issued FASB Statement No. 153, Exchanges of Nonmonetary Assets, which eliminates an exception in APB 29 for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. This Statement will be effective for the Company for nonmonetary asset exchanges occurring on or after January 1, 2006.

The Company estimates that the adoption of the above bulletins will not have a material effect on its financial position or results of operations.

(m) Guaranteed debt

On December 16, 2003, the Company completed an offering of senior unsecured notes, for a value of U.S.$175 million ($2,074 million pesos) maturing on December 15, 2013. Interest on the notes are payable semiannually at annual rate of 11%, beginning on June 15, 2004.

Each of the Company's consolidated subsidiaries, Instalaciones y Contrataciones, S.A. de C.V. (Instalaciones), Impulsora e Inmobiliaria Regional, S.A. de C.V. (Impulsora) and Servicios Axtel, S.A. de C.V. (Servicios), are guaranteeing the notes with unconditional guaranties that are unsecured. Each of the subsidiary guarantors is 99.99% owned by Axtel, S.A. de C.V. All guarantees are full and unconditional and are joint and several.

Axtel is eligible, under Adopting Release (nos. 33-7878 and 34-43124) and a no-action request letter, for presenting the condensed consolidating financial information of Impulsora, Instalaciones and Servicios in this note in accordance with Rule 3-10 (f) of Regulation S-X. Each of Impulsora, Instalaciones and Servicios have total capital stock outstanding of 50,000 common shares. Axtel directly owns all but one share of each of Impulsora, Instalaciones and Servicios. The ownership of the remaining share by someone other than Axtel is a requirement of Mexican law.

For the purpose of the accompanying condensed consolidating balance sheets, income statements and changes in financial position under Mexican GAAP, the first column "Axtel" corresponds to the parent company issuer. The second column, "Combined Guarantors", represents the combined amounts of Instalaciones, Impulsora and Servicios, after adjustments and eliminations relating to their combination. The third column, "Adjustments and Eliminations", includes all amounts resulting from the consolidation of Axtel, and the guarantors. The fourth column, "Axtel Consolidated", represents the Company's consolidated amounts as reported in the audited consolidated financial statements. Additionally, all amounts presented under the line item "Investments in subsidiaries" for both the balance sheet and the income statement are accounted for by the equity method.

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The condensed consolidating financial information is as follows:

Condensed consolidating balance sheets:

As of December 31, 2004		Axtel	Combined Guarantors	Adjustments and Eliminations	Axtel Consolidated
Current assets	$	1,349,862	110,732	(125,990)	1,334,604
Property, systems and equipment, net		6,104,165	9,417	(1,309)	6,112,273
Deferred charges		1,024,432	5,837	-	1,030,269
Investment in subsidiaries		24,206	-	(24,206)	-
Other-non current assets		156,818	3,970	-	160,788
Total assets	$	8,659,483	129,956	(151,505)	8,637,934
Current liabilities	$	1,030,651	102,047	(125,990)	1,006,708
Long-term debt		2,026,214	-	-	2,026,214
Other non-current liabilities		3,543	2,394	-	5,937
Total liabilities		3,060,408	104,441	(125,990)	3,038,859
Total stockholders equity		5,599,075	25,515	(25,515)	5,599,075
Total liabilities and stockholders equity	$	8,659,483	129,956	(151,505)	8,637,934

As of December 31, 2003		Axtel	Combined Guarantors	Adjustments and Eliminations	Axtel Consolidated
Current assets	$	1,727,339	98,437	(95,795)	1,729,981
Property, systems and equipment, net		5,467,837	10,376	(1,835)	5,476,378
Deferred charges		1,224,844	6,580	-	1,231,424
Investment in subsidiaries		22,002	-	(22,002)	-
Other non-current assets		136,131	174	-	136,305
Total assets	$	8,578,153	115,567	(119,632)	8,574,088
Current liabilities	$	764,659	89,621	(95,795)	758,485
Long-term debt		2,134,697	-	-	2,134,697
Other non-current liabilities		2,291	2,109	-	4,400
Total liabilities		2,901,647	91,730	(95,795)	2,897,582
Total stockholders equity		5,676,506	23,837	(23,837)	5,676,506
Total liabilities and stockholders equity	$	8,578,153	115,567	(119,632)	8,574,088

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Condensed consolidating income statements:

For the year ended December 31, 2004		Axtel	Combined Guarantors	Adjustments and Eliminations	Axtel Consolidated
Rental, installation, service and other revenues	$	3,861,313	920,902	(920,902)	3,861,313
Cost of sales and services		(1,229,500)	-	-	(1,229,500)
Selling and administrative expenses		(1,369,936)	(929,271)	920,902	(1,378,305)
Depreciation and amortization		(1,000,260)	(905)	-	(1,001,165)
Operating income		261,617	(9,274)	-	252,343
Comprehensive financing result, net		(199,131)	(2,123)	1,250	(200,004)
Other income (expenses), net		20,530	1,724	(1,250)	21,004
Income tax		(149,652)	(823)	-	(150,475)
Investment in subsidiaries		(10,496)	-	10,496	-
Net (loss) income	$	(77,132)	(10,496)	10,496	(77,132)

For the year ended December 31, 2003		Axtel	Combined Guarantors	Adjustments and Eliminations	Axtel Consolidated
Rental, installation, service and other revenues	$	3,079,143	809,140	(809,073)	3,079,210
Cost of sales and services		(852,647)	-	-	(852,647)
Selling and administrative expenses		(1,208,924)	(800,508)	809,073	(1,200,359)
Depreciation and amortization		(907,226)	(421)	-	(907,647)
Operating (loss) income		110,346	8,211	-	118,557
Comprehensive financing result, net		(448,204)	(1,926)	1,271	(448,859)
Other expenses, net		1,806,964	(8,446)	(1,271)	1,797,247
Income tax		(518,983)	(1,459)	-	(520,442)
Investment in subsidiaries		(3,620)	-	3,620	-
Net income (loss)	$	946,503	(3,620)	3,620	946,503

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For the year ended December 31, 2002		**Axtel**	**Combined Guarantors**	**Adjustments and Eliminations**	**Axtel Consolidated**
Rental, installation, service and other revenues	$	2,586,557	855,752	(855,752)	2,586,557
Cost of sales and services		(645.699)	-	-	(645,699)
Selling and administrative expenses		(1,339,143)	(848,109)	855,752	(1,331,500)
Depreciation and amortization		(853,925)	(955)	-	(854,880)
Operating (loss) income		(252,210)	6,688		(245,522)
Comprehensive financing result, net		(801,245)	(1,549)	1,539	(801,255)
Other expenses, net		(26,805)	(34,950)	(1,539)	(63,294)
Income tax		246,789	8,150	-	254,939
Investment in subsidiaries		(21,661)	-	21,661	-
Net (loss) income	$	(855,132)	(21,661)	21,661	(855,132)

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Condensed consolidating statements of changes in financial position:

For the year ended December 31, 2004		Axtel	Combined Guarantors	Adjustments and Eliminations	Axtel Consolidated
Operating activities:					
Net (loss) income	$	(77,132)	(10,496)	10,496	(77,132)
Non-cash items		1,160,408	2,455	(10,496)	1,152,367
Resources provided by (used in) operations		1,083,276	(8,041)	-	1,075,235
Net (investment in) financing from operations		106,588	1,369	(229)	107,728
Resources provided by (used in) operations, net		1,189,864	(6,672)	(229)	1,182,963
Financing activities:					
Increase in common stock		-	12,700	(12,700)	-
Additional paid-in capital		-	-	-	-
Loans payments, net		(93,530)	(229)	229	(93,530)
Others		(31)	-	-	(31)
Resources provided by financing activities		(93,561)	12,471	(12,471)	(93,561)
Investing activities:					
Acquisition and construction of property, systems and equipment, net		(1,532,165)	(473)	-	(1,532,638)
Investment in subsidiaries		(12,700)	-	12,700	-
Other assets		(66,950)	(3,796)	-	(70,746)
Resources used in investing activities		(1,611,815)	(4,269)	12,700	(1,603,384)
Increase (decrease) in cash and equivalents		(515,512)	1,530	-	(513,982)
Cash and equivalents at the beginning of the year		1,067,902	481	-	1,068,383
Cash and equivalents at the end of the year	$	552,390	2,011	-	554,401

AXTEL, S. A. DE C. V. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Thousands pesos of constant purchasing power as of December 31, 2004)

For the year ended December 31, 2003		Axtel	Combined Guarantors	Adjustments and Eliminations	Axtel Consolidated
Operating activities:					
Net (loss) income	$	946,503	(3,620)	3,620	946,503
Non-cash items		(530,289)	2,598	(3,620)	(531,311)
Resources used in operations		416,214	(1,022)	-	415,192
Net financing from (investment in) operations		(244,548)	15	(2,262)	(246,795)
Resources provided by (used in) operations, net		171,666	(1,007)	(2,262)	168,397
Financing activities:					
Increase in common stock		2,809,462	2,389	(2,388)	2,809,463
Additional paid-in capital		(15,625)	-	-	(15,625)
Proceeds from (loans payments), net		(1,591,004)	(2,262)	2,262	(1,591,004)
Others		(60,571)	-	-	(60,571)
Resources provided by financing activities		1,142,262	127	(126)	1,142,263
Investing activities:					
Acquisition and construction of property, systems and equipment, net		(485,292)	-	-	(485,292)
Investment in subsidiaries		(2,388)	-	2,388	-
Other assets		(101,686)	(174)	-	(101,860)
Resources used in investing activities		(589,366)	(174)	2,388	(587,152)
Increase in cash and equivalents		724,562	(1,054)	-	723,508
Cash and equivalents at the beginning of the year		343,340	1,535	-	344,875
Cash and equivalents at the end of the year	$	1,067,902	481	-	1,068,383

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Notes to the Consolidated Financial Statements

(Thousands pesos of constant purchasing power as of December 31, 2004)

For the year ended December 31, 2002		Axtel	Combined Guarantors	Adjustments and Eliminations	Axtel Consolidated
Operating activities:					
Net (loss) income	$	(855,132)	(21,661)	21,661	(855,132)
Non-cash items		628,797	(6,952)	(21,661)	600,184
Resources used in operations		(226,335)	(28,613)	-	(254,948)
Net investment in operations		258,711	(14,565)	(1,375)	242,771
Resources used in operations, net		32,376	(43,178)	(1,375)	(12,177)
Financing activities:					
Increase in common stock		54,783	45,715	(45,715)	54,783
Additional paid-in capital		(2,155)	-	-	(2,155)
Proceeds from (loans payments), net		665,049	(1,375)	1,375	665,049
Others		95,827	-	-	95,827
Resources provided by financing activities		813,504	44,340	(44,340)	813,504
Investing activities:					
Acquisition and construction of property, systems and equipment, net		(596,293)	-	-	(596,293)
Investment in subsidiaries		(45,715)	-	45,715	-
Other assets		(1,533)	38	-	(1,495)
Resources used in investing activities		(643,541)	38	45,715	(597,788)
Decrease in cash and equivalents		202,339	1,200	-	203,539
Cash and equivalents at the beginning of the year		141,001	335	-	141,336
Cash and equivalents at the end of the year	$	343,340	1,535	-	344,875

AXTEL, S. A. DE C. V. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Thousands pesos of constant purchasing power as of December 31, 2004)

The tables below present combined balance sheets as of December 31, 2003 and 2002, and income statements and statements of changes in financial position for each of the three-year periods ended December 31, 2003 for the Guarantors. Such information presents in separate columns each individual Guarantor, consolidation adjustments and eliminations, and the combined guarantors. All significant related parties balances and transactions between the Guarantors have been eliminated in the "Combined Guarantors" column.

The amounts presented in the column "Combined Guarantors" are readily comparable with the information of the Guarantors included in the condensed consolidated financial information.

Guarantors' Combined Balance Sheets:

As of December 31, 2004

Assets		Icosa	Inmobiliaria	Servicios Axtel	Adjustments and Eliminations	Combined Guarantors
Cash and cash equivalents	$	589	12	1,410	-	2,011
Related parties receivables		7,343	-	88,102	(4)	95,441
Refundable taxes and other accounts receivable		1,326	1,193	10,761	-	13,280
Total current assets		9,258	1,205	100,273	(4)	110,732
Property, systems and equipment, net		-	9,417	-	-	9,417
Deferred income taxes		9	-	6,060	(232)	5,837
Other		803	-	3,167	-	3,970
Total non current assets		812	9,417	9,227	(232)	19,224
Total assets	$	10,070	10,622	109,500	(236)	129,956
Liabilities and Stockholders Equity						
Account payable and accrued liabilities	$	162	-	18,180	-	18,342
Taxes payable		4,724	-	50,727	-	55,451
Related parties payables		4	8,592	-	(4)	8,592
Other accounts payable		1,067	-	18,595	-	19,662
Total current liabilities		5,957	8,592	87,502	(4)	102,047
Deferred income taxes		-	232	-	(232)	-
Others		402	-	1,992	-	2,394
Total liabilities		6,359	8,824	89,494	(236)	104,441
Stockholders' equity		4,895	1,390	29,726	-	36,011
Net (loss) income		(1,184)	408	(9,720)	-	(10,496)
Total stockholders equity		3,711	1,798	20,006	-	25,515
Total liabilities and stockholders equity	$	10,070	10,622	109,500	(236)	129,956

AXTEL, S. A. DE C. V. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Thousands pesos of constant purchasing power as of December 31, 2004)

As of December 31, 2003

Assets		Icosa	Inmobiliaria	Servicios Axtel	Adjustments and Eliminations	Combined Guarantors
Cash and cash equivalents	$	168	15	298	-	481
Accounts receivable		35	-	101	-	136
Related parties receivables		5,603	-	80,571	(606)	85,568
Refundable taxes and other accounts receivable		1,036	1,405	9,811	-	12,252
Total current assets		6,842	1,420	90,781	(606)	98,437
Property, systems and equipment, net		-	10,376	-	-	10,376
Deferred income taxes		3	-	7,029	(452)	6,580
Other		174	-	-	-	174
Total non current assets		177	10,376	7,029	(452)	17,130
Total assets	$	7,019	11,796	97,810	(1,058)	115,567
Liabilities and stockholders' equity						
Account payable and accrued liabilities	$	171	-	8,911	-	9,082
Taxes payable		2,895	-	50,287	-	53,182
Related parties payables		-	9,427	-	(606)	8,821
Other accounts payable		465	-	18,071	-	18,536
Total current liabilities		3,531	9,427	77,269	(606)	89,621
Deferred income taxes		-	452	-	(452)	-
Others		292	-	1,817	-	2,109
Total liabilities		3,823	9,879	79,086	(1,058)	91,730
Stockholders' equity		3,970	1,570	21,917	-	27,457
Net (loss) income		(774)	347	(3,193)	-	(3,620)
Total stockholders equity		3,196	1,917	18,724	-	23,837
Total liabilities and stockholders equity	$	7,019	11,796	97,810	(1,058)	115,567

AXTEL, S. A. DE C. V. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Thousands pesos of constant purchasing power as of December 31, 2004)

Guarantors' Combined Income Statements:

For the year ended December 31, 2004	Icosa	Inmobiliaria	Servicios Axtel	Adjustments and Eliminations	Combined Guarantors
Rental and service revenues	$ 79,312	1,975	839,615	-	920,902
Administrative expenses	(80,154)	(500)	(849,117)	500	(929,271)
Depreciation and amortization	-	(432)	(473)	-	(905)
Operating (loss) income	(842)	1,043	(9,975)	500	(9,274)
Comprehensive financing result, net	(272)	(856)	(995)	-	(2,123)
Other income (expenses), net	6	-	2,218	(500)	1,724
(Loss) income before income taxes and employee statutory profit sharing	(1,108)	187	(8,752)	-	(9,673)
Total income (tax) and employee statutory profit sharing benefit	(76)	221	(968)	-	(823)
Net (loss) income	$ (1,184)	408	(9,720)	-	(10,496)
For the year ended December 31, 2003					
Rental and service revenues	$ 47,063	2,067	760,010	-	809,140
Administrative expenses	(47,453)	(527)	(753,055)	527	(800,508)
Depreciation and amortization	-	(421)	-	-	(421)
Operating income (loss)	(390)	1,119	6,955	527	8,211
Comprehensive financing result, net	(146)	(898)	(882)	-	(1,926)
Other expenses, net	26	6	(7,951)	(527)	(8,446)
(Loss) income before income taxes and employee statutory profit sharing	(510)	227	(1,878)	-	(2,161)
Total income tax and employee statutory profit sharing	(264)	120	(1,315)	-	(1,459)
Net (loss) income	$ (774)	347	(3,193)	-	(3,620)

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Notes to the Consolidated Financial Statements

(Thousands pesos of constant purchasing power as of December 31, 2004)

For the year ended December 31, 2002		Icosa	Inmobiliaria	Servicios Axtel	Adjustments and Eliminations	Combined Guarantors
Rental and service revenues	$	38,041	2,164	815,547	-	855,752
Administrative expenses		(37,459)	(548)	(810,650)	548	(848,109)
Depreciation and amortization		(481)	(474)	-	-	(955)
Operating income		101	1,142	4,897	548	6,688
Comprehensive financing result, net		(201)	(903)	(445)	-	(1,549)
Other expenses, net		(1,758)	-	(32,644)	(548)	(34,950)
Loss before income taxes and employee statutory profit sharing		(1,858)	239	(28,192)	-	(29,811)
Total income tax and employee statutory profit sharing		355	186	7,609	-	8,150
Net (loss) income	$	(1,503)	425	(20,583)	-	(21,661)

AXTEL, S. A. DE C. V. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Thousands pesos of constant purchasing power as of December 31, 2004)

Guarantors' Combined Statements of Changes in Financial Position:

For the year ended December 31, 2004	Icosa	Inmobiliaria	Servicios Axtel	Adjustments and Eliminations	Combined Guarantors
Operating activities:					
Net (loss) income	$ (1,184)	408	(9,720)	-	(10,496)
Non-cash items	214	211	2,030	-	2,455
Resources (used in) provided by operations	(970)	619	(7,690)	-	(8,041)
Net (investment in) financing from operations	320	(393)	1,442	-	1,369
Resources (used in) provided by operations, net	(650)	226	(6,248)	-	(6,672)
Financing activities:					
Increase in common stock	1,700	-	11,000	-	12,700
Loans payment, net	-	(229)	-	-	(229)
Resources provided by (used in) financing activities	1,700	(229)	11,000	-	12,471
Investing activities:					
Property. System and Equipment, net	-	-	(473)	-	(473)
Other assets	(629)	-	(3,167)	-	(3,796)
Resources used in investing activities	(629)	-	(3,640)	-	(4,269)
Increase (decrease) in cash and equivalents	421	(3)	1,112	-	1,530
Cash and equivalents at the beginning of the year	168	15	298	-	481
Cash and equivalents at the end of the year	$ 589	12	1,410	-	2,011

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(Thousands pesos of constant purchasing power as of December 31, 2004)

For the year ended December 31, 2003	Icosa	Inmobiliaria	Servicios Axtel	Adjustments and Eliminations	Combined Guarantors
Operating activities:					
Net income (loss)	$ (774)	347	(3,193)	-	(3,620)
Non-cash items	369	301	1,928	-	2,598
Resources (used in) provided by operations	(405)	648	(1,265)	-	(1,022)
(Investment in) financing from operations, net	(194)	46	163	-	15
Resources (used in) provided by operations, net	(599)	694	(1,102)	-	(1,007)
Financing activities:					
Increase in common stock	860	1,529	-	-	2,389
Loans payments, net	-	(2,262)	-	-	(2,262)
Resources provided by (used in) financing activities	860	(733)	-	-	127
Investing activities:					
Other assets	(174)	-	-	-	(174)
Resources used in investing activities	(174)	-	-	-	(174)
(Decrease) increase in cash and equivalents	87	(39)	(1,102)	-	(1,054)
Cash and equivalents at the beginning of the year	81	54	1,400	-	1,535
Cash and equivalents at the end of the year	$ 168	15	298	-	481

AXTEL, S. A. DE C. V. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Thousands pesos of constant purchasing power as of December 31, 2004)

For the year ended December 31, 2002	Icosa	Inmobiliaria	Servicios Axtel	Adjustments and Eliminations	Combined Guarantors
Operating activities:					
Net (loss) income	$ (1,503)	425	(20,583)	-	(21,661)
Non-cash items	178	288	(7,418)	-	(6,952)
Resources (used in) provided by operations	(1,325)	713	(28,001)	-	(28,613)
Investment in operations, net	(695)	658	(14,528)	-	(14,565)
Resources (used in) provided by operations, net	(2,020)	1,371	(42,529)	-	(43,178)
Financing activities:					
Increase in common stock	1,844	-	43,871	-	45,715
Loans payment	-	(1,375)	-	-	(1,375)
Resources provided by (used in) financing activities	1,844	(1,375)	43,871	-	44,340
Investing activities:					
Other assets	38	-	-	-	38
Resources used in investing activities	38	-	-	-	38
(Decrease) increase in cash and equivalents	(138)	(4)	1,342	-	1,200
Cash and equivalents at the beginning of the year	219	58	58	-	335
Cash and equivalents at the end of the year	$ 81	54	1,400	-	1,535

AXTEL, S. A. DE C. V. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(Thousand pesos of constant purchasing power as of December 31, 2004)

Guarantors – U.S. GAAP reconciliation of net income and stockholders' equity:

As discussed at the beginning of this note 25, the following reconciliation to U.S. GAAP does not eliminate the inflation adjustments for Mexican GAAP, since they represent an integral measurement of the effects of the changes in the price levels in the Mexican economy and, as such, are considered a more meaningful presentation than the financial reports based on historic costs for book purposes for Mexico and the United States.

The main differences between Mexican GAAP and US GAAP and their effect on consolidated net loss and stockholders' equity as of December 31, 2004, 2003 and 2002 is presented below, with an explanation of the adjustments.

		Year ended December 31,		
		2004	**2003**	**2002**
Net loss reported under Mexican GAAP	$	(10,496)	(3,620)	(21,661)
Approximated US GAAP adjustments				
1. Deferred income taxes (A)		741	1,382	(8,150)
2. Amortization of start-up cost (B)		-	-	480
3. Allowance for post retirement benefits (C)		7,712	198	(26,904)
4. Accrued vacations (C)		-	-	(2,162)
Total approximate US GAAP adjustments		8,453	1,580	(36,736)
Approximate net loss under US GAAP	$	(2,043)	(2,040)	(58,397)

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Notes to the Consolidated Financial Statements

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		Year ended December 31,	
		2004	**2003**
Total stockholders' equity reported under Mexican GAAP	$	25,515	23,837
Approximate US GAAP adjustments			
1. Deferred income taxes (A)		(5,837)	(6,580)
2. Preoperating result		-	-
3. Allowance for post retirement benefits (C)		(20,959)	(28,671)
Total approximate US GAAP adjustments		(26,796)	(35,251)
Total approximate stockholders' equity under US GAAP	$	(1,281)	(11,414)

Guarantors-Notes to the U.S. GAAP reconciliation

A. Deferred income taxes

Deferred income taxes adjustment in the stockholders' equity reconciliation to U.S. GAAP, at December 31, 2004 and 2003, represented decreases of $ 5,837 and $ 6,580, respectively.

B. Start-up costs

In April 1998, the AICPA issued Statement of Position 98-5, "Reporting on the Costs of Start-up Costs" (SOP 98-5), which requires start-up costs, including organization costs, to be expensed as incurred. SOP 98-5 is effective, except for certain investment companies, for fiscal years beginning after December 15, 1998. Under Mexican GAAP, this type of costs were recognized when incurred as a deferred asset and amortized over a period of 10 years. The Company has reversed the amortization of $ 480 in 2002, as shown in the US GAAP reconciliation.

C. Other employee benefits

Vacation-For years ended December 31, 2002 and before, under Mexican GAAP the vacation expense was recognized when taken rather than during the period the employees earn it. In order to comply with SFAS 43, for the year ended December 31, 2002, the Company recorded a decrease in net income of $ 2,162. Starting on January 2003, Mexican GAAP requires the recognition of vacation expense when earn.

Severance-Under Mexican GAAP (Bulletin D-3), severance payments should be recognized in earnings in the period in which they are paid, unless such payments are used by an entity as a substitution of pension benefits, in which case, they should be considered as a pension plan. Under U.S. GAAP, post-employment benefits for former or inactive employees, excluding retirement benefits, are accounted for under the provisions of SFAS 112, which requires recognition of certain benefits, including severance, over an employee's service life. For the years ended December 31, 2004, 2003 and 2002 the Company recorded an increase or (decrease) in net income of $7,712, $198 and $ (26,904), respectively, and recognized an accrual amounting to $20,959 and $28,671 as of December 31, 2004 and 2003, respectively.