

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

Consolidated Financial Statements

December 31, 2007 and 2006

(With Independent Auditors' Report Thereon)



KPMG Cárdenas Dosal
Oficinas en el Parque Torre II
Blvd. Díaz Ordaz 140 Pte.
Pisos 16 y 17 Col. Santa María
64650 Monterrey, N.L.

Teléfono: + 01 (81) 81 22 18 18
Fax: + 01 (81) 83 33 05 32
www.kpmg.com.mx

Independent Auditors' Report
(Translation from Spanish Original)

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

We have audited the accompanying consolidated balance sheets of Axtel, S.A.B. de C.V. and subsidiaries (the Company) as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in stockholders' equity, and changes in financial position for the years then ended. 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 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 and are prepared in accordance with Mexican Financial Reporting Standards. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the reporting standards 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.

As indicated in note 5 to the financial statements, on November 27, 2006 the Company acquired Avantel Infraestructura, S. de R.L. de C.V. and Avantel, S. de R.L. de C.V. in a transaction valued in approximately U.S. \$520 millions. This transaction was accounted for by the purchase method of accounting in accordance with Financial Reporting Standard B-7 "Business Combinations" and during the year 2007 some adjustments were made to the amounts initially recognized.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Axtel, S.A.B. de C.V. and its subsidiaries as of December 31, 2007 and 2006, and the consolidated results of their operations, the changes in their stockholders' equity and the changes in their financial position for the years then ended, in conformity with Mexican Financial Reporting Standards.

KPMG Cárdenas Dosal, S.C.



Leandro Castillo Parada

Monterrey, N.L., México
February 25, 2008

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

Consolidated Balance Sheets

(Thousands pesos of constant purchasing power as of December 31, 2007)

Assets	December 31	
	2007	2006
Current assets:		
Cash and cash equivalents	Ps. 1,573,877	1,222,145
Accounts receivable (note 7)	1,822,349	1,660,560
Refundable taxes and other accounts receivable (note 9)	113,148	252,662
Prepaid expenses	45,657	43,862
Inventories (note 10)	167,889	103,070
Total current assets	3,722,920	3,282,299
Long-term accounts receivable	18,254	20,686
Property, systems and equipment, net (notes 11 and 16)	13,679,871	14,036,601
Intangible assets (note 14)	1,058,204	1,422,814
Pre-operating expenses, net (note 12)	111,897	159,591
Deferred income taxes (note 19)	936,089	620,877
Deferred employee's profit sharing (note 19)	14,180	27,774
Investment in shares of associated company (note 13)	15,249	14,127
Other assets, net (note 15)	274,013	309,207
Total assets	Ps. 19,830,677	19,893,976
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities (note 9)	Ps. 1,848,934	1,919,175
Accrued interest	111,849	16,446
Taxes payable	136,556	62,624
Current maturities of long-term debt (note 16)	160,163	163,207
Other accounts payable (note 17)	394,006	511,205
Deferred revenue (note 9)	583,052	614,551
Derivative financial instruments (note 8)	93,861	68,541
Total current liabilities	3,328,421	3,355,749
Long-term debt, excluding current maturities (note 16)	7,484,955	8,294,282
Other long-term accounts payable	6,215	3,014
Severance, seniority premiums and other post retirements benefits (notes 18)	57,514	85,506
Deferred revenue (note 9)	203,226	271,103
Total liabilities	11,080,331	12,009,654
Stockholders' equity (note 20):		
Common stock	8,870,062	8,677,782
Additional paid-in capital	741,671	547,131
Deficit	(949,610)	(1,440,606)
Cumulative deferred income tax effect	132,168	132,168
Change in the fair value of derivative instruments (note 8)	(43,945)	(32,153)
Total stockholders' equity	8,750,346	7,884,322
Commitments and contingencies (note 22)		
Total liabilities and stockholders' equity	Ps. 19,830,677	19,893,976

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

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

Consolidated Statements of Operations

For the years ended December 31, 2007 and 2006

(Thousands pesos of constant purchasing power as of December 31, 2007)

	Years ended December 31,	
	<u>2007</u>	<u>2006</u>
Telephone services and related revenues (note 21)	Ps. 12,190,610	6,675,712
Operating costs and expenses:		
Cost of revenues and services	(4,504,713)	(2,104,361)
Selling and administrative expenses	(3,601,427)	(2,260,105)
Depreciation and amortization	(2,690,687)	(1,560,054)
	<u>(10,796,827)</u>	<u>(5,924,520)</u>
Operating income	<u>1,393,783</u>	<u>751,192</u>
Comprehensive financing result:		
Interest expense	(925,049)	(482,735)
Interest income	134,441	92,135
Foreign exchange gain, net	972	23,700
Change in the fair value of derivative instruments	19,942	(24,808)
Monetary position gain	268,797	11,467
Comprehensive financing result, net	<u>(500,897)</u>	<u>(380,241)</u>
Employee's profit sharing (note 19)	(6,088)	(1,570)
Deferred employee's profit sharing (note 19)	(13,594)	4,699
Other expenses, net	(438)	(35,770)
Other expenses, net	<u>(20,120)</u>	<u>(32,641)</u>
Income before income taxes and equity in results of associated company	<u>872,766</u>	<u>338,310</u>
Income tax expense (note 19)	(98,819)	(4,894)
Deferred income tax (note 19)	(284,381)	(112,656)
Total income taxes	<u>(383,200)</u>	<u>(117,550)</u>
Equity in earnings of associated company (note 13)	1,430	1,652
Net income	Ps. <u>490,996</u>	<u>222,412</u>
Weighted average common shares outstanding	8,754,493,119	8,522,810,598
Basic and diluted earnings per share (pesos)(note 20)	Ps. <u>0.06</u>	<u>0.03</u>

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

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

Consolidated Statements of Changes in Financial Position

For the years ended December 31, 2007 and 2006

(Thousands pesos of constant purchasing power as of December 31, 2007)

	Years ended December 31,	
	<u>2007</u>	<u>2006</u>
Operating activities:		
Net income	Ps. 490,996	222,412
Add charges (deduct credits) to operations not requiring (providing) resources:		
Depreciation	2,299,574	1,413,288
Amortization	391,113	146,766
Accrual for seniority premiums and severance payments	11,324	12,474
Deferred income tax and employee's profit sharing	297,975	107,957
Equity in earnings of associated company	(1,430)	(1,652)
Resources provided by operations	<u>3,489,552</u>	<u>1,901,245</u>
(Investment in) net financing from operations	<u>(262,804)</u>	<u>630,851</u>
Resources provided by operating activities	<u>3,226,748</u>	<u>2,532,096</u>
Financing activities:		
Increase in common stock	192,280	-
Additional paid-in capital	194,540	(9,804)
(Payments) proceeds from loans, net	(812,371)	5,409,926
Restricted cash	-	37,225
Accrued interest	95,403	2,680
Other accounts payable	11,523	8,986
Resources (used) provided by financing activities	<u>(318,625)</u>	<u>5,449,013</u>
Investing activities:		
Acquisition and construction of property, systems and equipment, net	(2,486,093)	(7,854,529)
Pre-operating expenses	-	(13,991)
Investment in shares of associated company	-	(12,474)
Intangible assets	-	(752,082)
Other assets	(70,298)	(167,551)
Resources used in investing activities	<u>(2,556,391)</u>	<u>(8,800,627)</u>
Increase (decrease) in cash and cash equivalents	351,732	(819,518)
Cash and cash equivalents at beginning of year	<u>1,222,145</u>	<u>2,041,663</u>
Cash and cash equivalents at end of year	Ps. <u><u>1,573,877</u></u>	<u><u>1,222,145</u></u>

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

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

Consolidated Statements of Changes in Stockholders' Equity

For the years ended December 31, 2007 and 2006

(Thousands pesos of constant purchasing power as of December 31, 2007)

		<u>Common stock</u>	<u>Additional paid-in capital</u>	<u>Deficit</u>	<u>Cumulative deferred income tax effect</u>	<u>Change in the fair value of derivative instruments</u>	<u>Total stockholders' equity</u>
Balances as of December 31, 2005	Ps.	8,677,782	556,935	(1,663,018)	132,168	(62,761)	7,641,106
Issuance costs		-	(9,804)	-	-	-	(9,804)
Comprehensive income (note 20c)		-	-	222,412	-	30,608	253,020
Balances as of December 31, 2006		8,677,782	547,131	(1,440,606)	132,168	(32,153)	7,884,322
Issuance of common stock (note 20a)		192,280	194,540	-	-	-	386,820
Comprehensive income (note 20c)		-	-	490,996	-	(11,792)	479,204
Balances as of December 31, 2007	Ps.	<u>8,870,062</u>	<u>741,671</u>	<u>(949,610)</u>	<u>132,168</u>	<u>(43,945)</u>	<u>8,750,346</u>

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

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

Notes to the Consolidated Financial Statements

For the years ended December 31, 2007 and 2006

(Thousand pesos of constant purchasing power as of December 31, 2007)

(1) Basis of presentation

These financial statements have been translated from Spanish language only for the convenience of the English-speaking readers.

On February 25, 2008, the Administration of the Company authorized the issuance of the accompanying consolidated financial statements and related footnotes.

According to Mexican General Corporation Law and the Company statutes, the stockholders' have the right to change the financial statements after their issuance. The accompanying financial statements will have to be approved at the next Stockholders' Meeting.

The accompanying consolidated financial statements have been prepared in accordance with Mexican Financial Reporting Standards.

(2) Organization, description of business and salient events

Axtel, S.A.B. 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 22e). 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.

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

On August 31, 2007, the stockholders' approved a three-for-one stock split (the split). The split became effective on October 8, 2007. The proportional equity interest participation of existing stockholders did not change as a result of the split. For comparison purposes, the number of shares is presented in note 20 adjusted for the effects of the split.

On February 2, 2007, the Company issued U.S. \$275 million of 10-year unsecured senior notes. This issuance matures on February 1, 2017. The interest will be payable semiannually and the senior notes bear interest at $7\frac{5}{8}$ % beginning on August 1, 2007. The proceeds of this issuance were used to prepay the bridge financing related to the December 2006 acquisition of Avantel (see note 16).

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(Thousand pesos of constant purchasing power as of December 31, 2007)

As described in note 20, on January 4, 2007 Telecomunicaciones Holding Mx, S. de R.L. de C.V. (“Tel Holding”) subscribed and paid 246,453,963 Series B shares (represented by 35,207,709 CPOs) through the Instituto Nacional de Valores (“INDEVAL”), in relation to the subscription agreement.

As described in note 5, on November 27, 2006 the Company signed an agreement with Banco Nacional de Mexico, S.A. (“Banamex”) and Tel Holding to acquire all the assets and shares of Avantel Infraestructura, S. de R.L. de C.V. and Avantel, S. de R.L. de C.V. therefore the results of operations have been included in the Company’s consolidated statement of operations since December 1, 2006. The acquisition transaction was financed through various loans amounting to approximately U.S. \$515 million, as described in note 16.

On February 22, 2006 the Company redeemed U.S. \$87,500,000 aggregate principal amount of its 11% senior notes due 2013, or 35% of the U.S. \$250,000,000 original aggregate principal amount of the notes. The redemption was made at a price of 111% of the principal amount of the notes, plus accrued and unpaid interest through the redemption date. The premium paid on this transaction amounted to approximately U.S. \$9.6 million, and is included in the statement of operations as part of the comprehensive financing result.

(3) 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) Use of estimates

The preparation of consolidated 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 consolidated 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 derivative instruments; and assets and obligations related to employee benefits. Actual results could differ from those estimates and assumptions.

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

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

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(Thousand pesos of constant purchasing power as of December 31, 2007)

(b) Recognition of the effects of inflation

The accompanying consolidated financial statements have been prepared in accordance with Financial Reporting Standards in Mexico (FRS), which include the recognition of the effects of inflation on the financial information, and are expressed in thousands of Mexican pesos at the constant purchasing power of December 31, 2007 based upon the National Consumer Price Index (NCPI) published by Banco de Mexico. The indexes used in recognizing the effects of inflation were as follows:

	<u>NCPI</u>	<u>Inflation %</u>
December 31, 2007	459.101	3.76
December 31, 2006	442.468	4.05
December 31, 2005	425.232	3.30

(c) Principles of consolidation

The consolidated financial statements include the financial statements of Axtel and the subsidiaries mentioned below. All accounts and intercompany transactions have been eliminated in the preparation of the consolidated financial statements. The consolidation was made based on audited financial statements of each of the subsidiaries, which were prepared in accordance with the FRS

The Company owns 100% directly or indirectly of the following subsidiaries:

	<u>Main activity</u>
Instalaciones y Contrataciones, S. A. de C. V. ("Icosa")	Administrative services
Impulsora e Inmobiliaria Regional, S. A. de C. V. ("Inmobiliaria")	Property management
Servicios Axtel, S. A. de C. V. ("Servicios Axtel")	Administrative services
Avantel, S. de R.L. de C.V. ("Avantel")*	Telecommunication services
Avantel Infraestructura S. de R.L. de C.V. ("Avantel Infraestructura")*	Telecommunications services
Adequip, S.A.	Fiber optic rings leasing
Avantel Recursos, S.A. de C.V. ("Recursos")	Administrative services
Avantel Servicios, S.A. de C.V. ("Servicios")	Administrative services
Telecom. Network, Inc. ("Telecom")	Telecommunications services

* On June 30, 2005, Avantel Infraestructura and certain subsidiaries as partners, together with Avantel as a representative partner of the Joint Venture, entered into a Joint Venture agreement to permit Avantel provide services and operate Avantel Infraestructura's public telecommunications network. Under this agreement, Avantel Infraestructura contributed the concessioned network, and the other associates contributed the customer agreements, as well as support and human resources services.

As a result of the above, Avantel Infraestructura entered into an agreement with Avantel to transfer the concession rights granted by the Secretaria de Comunicaciones y Transportes ("SCT").

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

Notes to the Consolidated Financial Statements

(Thousand pesos of constant purchasing power as of December 31, 2007)

(d) Cash equivalents

Cash equivalents of Ps. 1,390,858 and Ps. 948,961 at December 31, 2007 and 2006, respectively, consist of overnight repurchase agreements and certificates of deposit with an initial term of less than three months. Cash equivalents are carried 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.

(e) Trade accounts receivable

Trade accounts receivable includes the amount billed to customers and a provision for services rendered at the balance sheet date but not billed. Amounts billed are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company reviews its allowance for doubtful accounts monthly. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential recovery is considered remote.

(f) Investment in shares of associated company

The investment in shares of associated company is accounted for by the equity method.

(g) Inventories and cost of sales

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

(h) Property, systems and equipment

Property, systems and equipment are recorded at acquisition cost and restated by NCPI factors. Property under capital leases are stated at the present value of minimum lease payments.

Starting January 1, 2007, the acquisitions of assets in period of construction or installation include the corresponding comprehensive financing result as part of the assets value.

Comprehensive financing results incurred up to June 1999 during construction or installation periods were capitalized as part of the cost of the assets that were acquired during the pre-operating stage. Since that date, comprehensive financing results have been recognized as part of the results of the 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 11.

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

Maintenance and repairs, including the cost of replacing minor items not constituting substantial betterments are expensed as incurred and charged principally to selling and administrative expenses.

(i) Telephone concession rights

Telephone concession rights that are included within intangible assets are restated by NCPI factors and amortized under the straight-line method over a period of 20 to 30 years (the initial term of the concession rights). Avantel's telephone concession rights are amortized over the remaining term of life.

(j) 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, 2004, 2005 and 2006 in opening offices in other cities throughout the country. 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 12).

(k) Other and intangible assets

Other assets mainly include costs related to Telmex / Telnor infrastructure costs and notes issuance costs. These assets are restated by NCPI factors and amortized on a straight line method. Also includes guarantee deposits and, beginning 2005, the intangible asset related to the labor obligations (see note 15).

As a consequence of the acquisition of Avantel and based upon calculations prepared by an independent expert appraiser, the Company recognized different intangible assets as follows: trade name, customers' relationships and concession right (see note 14).

(l) Seniority premiums, severance payments and post employment benefits

Seniority premium benefits, and, beginning 2005, severance compensation for reasons other than restructuring, to which employees are entitled in accordance with the Federal Labor Law are charged to expense based on actuarial computations of the present value of this obligation. Amortization of prior service costs is based on the estimated average service lives of existing personnel. As of December 31, 2007, the average service life of employees entitled to plan benefits approximates 16 years.

(m) Derivative financial instruments

The Company accounts for derivatives and hedging activities in accordance with Bulletin C-10 for Mexican GAAP and FASB Statement No. 133, for US GAAP, *Accounting for Derivative Instruments and Certain Hedging Activities*, as amended, which require that all derivative instruments be recorded on the balance sheet date at their respective fair values, including those derivatives embedded in financial or non financial contractual agreements.

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Notes to the Consolidated Financial Statements

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The Company uses financial derivative instruments in order to manage financial exposures, especially foreign exchange related, and rates related. According to NIF C-10 and FASB-133, allows to account such operations as a hedging operation if it accomplishes certain requirements as effectiveness proves, and to avoid the recording of volatility in derivative instruments fair values in the income statement. The Company accounts the operations with financial derivative instruments with hedging activities into two main classifications: (i) Fair value hedging and (ii) Cash flows hedging.

In spite of last paragraph, the Company has accounted operations with financial derivative instruments under the classification of trade, which fair value have been accounted directly in the income statement. This is due to the reason that some operations did not accomplish some of the requirements in actual norms to be registered under accounting hedge model, even though these operations are hedging activities highly effective.

The Company has financial derivative instruments that are registered as fair value hedge and the accounting register is realized by taking the changes in the fair value and the changes in the fair value of the risk primary position to the results of the year, for their compensation. For the financial derivative instruments registered as cash flow hedging the Company registers in the comprehensive income the change in the fair value of them and at the moment when a profit or loss is realized, is registered at the results of the Company, recycling the comprehensive income.

The ineffectiveness portion of the change in the fair value of a derivative instrument that qualifies as a hedging activity is reported in the income statement.

The Company will discontinue hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative expires or is sold, terminated, or exercised. In any of these cases the fair value of the financial instrument is recognized directly in the income statement (see note 8).

(n) 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.

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(Thousand pesos of constant purchasing power as of December 31, 2007)

(o) *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.

(p) *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.

(q) *Cumulative deferred income tax effect*

Represents the cumulative effects of deferred taxes as of the date of adoption of the FRS D-4.

(r) *Comprehensive financing result (CFR)*

The CFR includes interest income and expense, foreign exchange gain and loss, the monetary position gain and valuation effects of financial instruments, 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.

(s) *Revenue recognition*

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

- *Telephony Services* –The Company generates revenue by enabling our customers to originate and receive an unlimited number of calls. Customers are charged a flat monthly fee for basic service, a per call fee for local calls (“measured service”), a per minute usage fee for calls completed on a cellular line (“calling party pays” or “CPP calls”) and national and international long distance calls, and a monthly fee for value-added services and internet services when requested by the customer. The costs related to the termination of our customers' cellular and long distance calls on other carriers' networks are charged to cost in the same month that the revenue is earned.

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- *Activation* - At the moment of installing the service when the customer has a contract with indefinite term; otherwise is recognized according to the term of the contract between the customer and the Company.
- *Equipment*. At the moment of selling the equipment and when the customer acquires the property of the equipment and assumed all risks.
- *Integrated services*. At the moment when the client receives the service.

(t) *Business and risk concentration*

The Company rendered services to one client that represents approximately 11% and 16% of total net rental, installation, service and other revenues during 2007 and 2006 respectively. The Company provides an allowance for doubtful accounts based on management's analyses and estimations. The allowance expense is included as part of the selling and administrative expenses in the consolidated statement of operations.

(u) *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.

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

The Company evaluates, at least once a year, the adjusted values of its property, systems and equipment and other non-current assets subject to amortization to determine whether there is an indication of potential impairment or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed off are separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

(w) *Segment information*

The Company believes that it operates in one business segment. Management does view the business as consisting of two revenues 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.

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(x) Business combinations

To account for the acquisition of Avantel, the Company followed guidelines established on FRS B-7 “*Business Combinations*”, which was mandatory since January 1st 2005. The following procedures were followed by Axtel: a) The acquisition was accounted for by the purchase method of accounting; b) Allocated the cost of Avantel to the assets acquired and liabilities assumed based on their estimated fair value at the date of acquisition; c) Identified and account for identifiable intangible assets acquired; and d) The negative goodwill was reduced proportionately from the fixed assets and intangibles acquired, net of taxes.

(4) Accounting changes

- The FRS B-3, *Statement of Income*, issued by the Mexican Board for Research and Development of Financial Reporting Standards (Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera or CINIF) became effective beginning January 1, 2007. Accordingly, the accompanying statement of income for 2006, has been modified for reporting as provided under this FRS, which together with the Interpretation of Financial Reporting Standards (INIF) 4, modified the general rules for the presentation and structure of the statement of income, eliminating the special and extraordinary items classifications, and requiring that the employee statutory profit sharing be reported under other expenses and income, rather than being presented in a line following tax on earnings, and additionally requiring that income, costs and expenses be classified as follows:
 - i) Ordinary – Those related to the entity’s line of business, i.e., those arising from or inherent to its primary activities, representing the principal sources of revenue, whether frequent or not.
 - ii) Non-ordinary – Those arising from activities which do not represent the entity’s principal sources of revenue, which are generally infrequent.

In addition, this FRS requires that ordinary costs and expenses be classified based on their nature, function, or a combination of both. Since the Company is a service entity, ordinary costs and expenses are classified in order to present a clearer understanding of the financial information.

- FRS D-6, Capitalization of the Comprehensive Financial Results (CFR) issued by the CINIF, became effective beginning January 1, 2007. This FRS establishes the requirement to capitalize CFR attributable to certain assets having an extended acquisition period prior to being put into use. The effects of adopting this FRS are disclosed in note 11.

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(5) Acquisition of Avantel

On November 27, 2006, the Company signed an agreement with Banamex, and Tel Holding, former controlling stockholders of Avantel, to purchase substantially all of the assets of Avantel Infraestructura, S. de R.L. de C.V. ("Avantel Infraestructura") for U.S. \$485 millions. We also agreed to purchase the equity interests of Avantel Infraestructura and Avantel, S. de R.L. de C.V. ("Avantel Concesionaria," both companies together being referred to as "Avantel") and each of Avantel's subsidiaries for U.S. \$31 millions. After obtaining all required approvals from Axtel's stockholders and government regulators, we completed the acquisition on December 4, 2006. The operating results of Avantel are included in the consolidated financial statements of the Company since December 1, 2006.

(a) Description of Avantel

Avantel Concesionaria and Avantel Infraestructura are affiliated companies and participate in a Joint Venture. Through this vehicle, the companies offer services of local telephony, domestic and international long distance and data services in Mexico.

Avantel provides telecommunication services to business, government and residential customers in Mexico. Avantel is Mexico's second largest provider of domestic and international long distance telephone services based on revenues and, recently, has increased its participation in the internet and data transmission markets. Avantel operates a fiber optic network of approximately 7,700 kilometers that reaches over 200 cities in Mexico.

Avantel is one of the leading providers of Internet-Protocol (IP) solutions in Mexico. Avantel's IP solutions are especially tailored to meet the diverse needs of companies of all sizes and sectors, and their scope ranges from intelligent voice and data transmission to virtual private networks, or VPN's, integrated telecommunications packages and managed services.

(b) Transaction objective

The main objective of the transaction is to create an added value for the stockholders of the Company through the projected benefits of synergies, more strength by increasing the size of the Company, more presence on nationwide coverage and more efficiency for the expansion in new cities, among others, which will traduce in an increase of our competitive advantages that Axtel keeps against its actual and future competitors.

(c) Purchase price allocation

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date. The acquisition cost of Avantel was approximately U.S. \$520 million. This amount includes certain costs and expenses associated with the transaction, such as financial advisory costs, lawyers, independent experts of valuation, among others.

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After the recognition of the effects of FRS B-7, an excess in the value of the net assets acquired over the cost of the transaction was recognized of approximately Ps. 1,157,926, and following the rules of the FRS B-7 we diminished it proportionally from the property, systems and equipment and intangible assets.

As of November 30, 2007, the effect of the assets acquired and liabilities assumed after the adjustments made during 2007 are as follows:

<u>Balance Sheet:</u>		<u>Preliminary Value</u>	<u>Adjustments</u>	<u>Definitive Value</u>
Current assets	Ps.	1,242,121	-	1,242,121
Property, systems and equipments, net		6,568,961	(597,333)	5,971,628
Intangible assets		831,100	(122,870)	708,230
Deferred income tax		748,093	595,007	1,343,100
Others		84,604	-	84,604
Total of assets acquired		<u>9,474,879</u>	<u>(125,196)</u>	<u>9,349,683</u>
Current liabilities		2,455,832	(107,687)	2,348,145
Long term liabilities		867,201	(17,509)	849,692
Total of liabilities assumed		<u>3,323,033</u>	<u>(125,196)</u>	<u>3,179,837</u>
Net assets acquired	Ps.	<u>6,151,846</u>	<u>-</u>	<u>6,151,846</u>

As of December 31, 2006 the revenues and costs of Avantel that were included in the consolidated financial statements amounted to Ps. 689,835 and Ps. 567,793, respectively.

The main adjustments are detailed as follows:

- Property, systems and equipment: The additional adjustments during the period were related with the final appraisal realized by independent experts, cancellation of systems that will not be used anymore and will be replaced by systems of Axtel and the effects of the of negative goodwill.
- Intangible assets: The additional adjustments during the period were related with the final appraisal realized by independent experts and the effects of the negative goodwill.
- Deferred income taxes: The adjustments were related mainly to the cancellation of reserves of tax loss carryforwards from Avantel subsidiaries for better results than they were expected in the last year, and the effect derived from the other adjustments mentioned above.
- Current liabilities: These adjustments correspond to the elimination of the accrual created in connection to the early termination of links leased by Avantel. The terminated contracts did not have any cost associated.
- Long-term liabilities: This adjustment corresponds to the cancellation of the pension plan as mentioned in note 18.

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(d) Pro forma financial information

We derived the summary unaudited pro forma financial information from our consolidated financial statements of Axtel, S.A.B. de C.V. and Subsidiaries and the combined financial statements of Avantel Infraestructura, S. de R.L. de C.V. and Subsidiaries and Avantel, S. de R.L. de C.V. adjusted to give effects to the purchase method of accounting for the acquisition described above and the results of operations as through the combination had been completed at the beginning of 2006.

The Company provides the unaudited pro forma financial information for informational purposes only. They do not purport to indicate the operating results or financial position that would have been achieved if the acquisition had occurred on the assumed dates, nor do they purport to indicate our future operating results or financial position.

The unaudited consolidated pro forma financial information is as follows:

		Year ended December 31, 2006 <u>(Unaudited)</u>
Revenues	Ps.	12,202,687
Costs of revenues and services		(4,917,435)
Selling and administrative expenses		(3,782,407)
Depreciation and amortization		(2,676,745)
Operating income		826,100
Net income (loss)		10,527
Earning (loss) per share		0.00

The pro forma financial information is not an indicative of the consolidated operating results that the Company would have reported if the acquisition of Avantel would have taken place in the assumed date, and it should not be taken as representative of the operating results in the future.

(6) Foreign currency exposure

Monetary assets and liabilities denominated in dollars as of December 31, 2007 and 2006 are as follows:

	<u>(Thousands of dollars)</u>	
	<u>2007</u>	<u>2006</u>
Current assets	125,138	120,606
Current liabilities	(82,750)	(85,125)
Long-term liabilities	<u>(552,826)</u>	<u>(587,343)</u>
Foreign currency liability position, net	<u>(510,438)</u>	<u>(551,862)</u>

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The U.S. dollar exchange rates as of December 31, 2007 and 2006 were Ps. 10.86 and Ps. 10.88, respectively. As of February 25, 2007, the exchange rate was Ps. 10.80.

As of December 31, 2007, the Company had foreign exchange derivative instruments (see note 8).

As of December 31, 2007 and 2006, 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)	
	<u>2007</u>	<u>2006</u>
Inventories	11,602	4,154
Systems and equipment, gross	1,172,351	1,164,437
	<u>1,183,953</u>	<u>1,168,591</u>

Following is a summary for the years ended December 31, 2007 and 2006, of transactions carried out with foreign entities, excluding imports and exports of systems and equipment:

	(Thousands of dollars)	
	<u>2007</u>	<u>2006</u>
Income services	79,996	7,505
Interest expense	61,493	34,569
Commissions	6	21
Administrative and technical advisory services	4,107	1,336
Cost of services	1,115	591
	<u>146,717</u>	<u>44,022</u>

(7) Accounts receivable

Accounts receivable consist of the following:

	<u>2007</u>	<u>2006</u>
Trade	Ps. 3,188,094	2,880,468
Less allowance for doubtful accounts	<u>1,365,745</u>	<u>1,219,908</u>
Accounts receivable, net	Ps. <u>1,822,349</u>	<u>1,660,560</u>

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The activity in the allowance for doubtful accounts for the years ended December 31, 2007 and 2006 was as follows:

	<u>2007</u>	<u>2006</u>
Balances at beginning of year	Ps. 1,175,711	179,043
Bad debt expense	190,034	119,563
Write-offs	-	(13)
Avantel	-	877,118
	<hr/>	<hr/>
Balances at end of year not adjusted for inflation	1,365,745	1,175,711
Effects of inflation	-	44,197
	<hr/>	<hr/>
Balances at year end at constant pesos	Ps. <u>1,365,745</u>	<u>1,219,908</u>

(8) Derivative instruments and hedging activities

The Company and its subsidiaries are exposed, by their normal business relations, to some financial risks denominated as rate risks and currency exchange rate risks, principally. To mitigate the exposure to those risks the Company and its subsidiaries use financial derivative instruments.

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 counterparty 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.

In the operations with financial derivative instruments that are registered as hedging activities it establish a relation of hedging, in which the Company and its subsidiaries formally establish the objective of the hedging, the strategy of administration of risks, the instrument of hedging, or the transaction covered, the nature of the risk that its being hedged, how the effectiveness of the financial instrument will be proved to compensate the risk covered and the methodology to measure the effectiveness of hedging.

The Company and its subsidiaries realize proves of effectiveness, prospective and retrospective, to watch in every moment that the relations of hedging keep a high effectiveness according to accounting standards. At the moment that ineffectiveness is detected the Company will register that amount in the results as part of the CFR.

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Financial derivative instruments registered with hedging purposes

According to the accounting models for hedging activities that are permitted by financial standards, the dimension, risks and estimated impact in balance sheet or income statement of the following financial derivative instruments are presented below. Contrarily to financial instruments with trading purposes, the derivatives with hedging purpose will not generate volatility in the income statement, as long as they accomplish in all the term, with the requirements of the financial standards to keep the classification of hedging activities:

Fair value hedge

- a) On March 22, 2007, the Company contracted a CCS (Currency Swap) to cover the risk of exchange rate generated by the syndicated term loan for U.S. \$110.2 million in which the Company will receive payments of 3 month Libor plus 150 basis points over U.S. \$110.2 million notional and will pay a monthly rate of TIE 28 days plus 135 basis points over Ps. 1,215,508 notional which includes the amortizations of principal. This transaction is under the fair value hedge accounting model.

(Amounts in charts are expressed in millions)

Maturity date	Currencies		Interest Rates		
	Notional amount (USD)	Notional amount (MXP)	Axtel receives	Axtel pays	Estimated fair value
February 29, 2012	<u>U.S. \$ 110.23</u>	<u>Ps. 1,216</u>	Libor + 1.5	TIE +1.35	<u>U.S. \$(2.4)</u>

For the year ended December 31, 2007 the change in the fair value of the hedging activity of the syndicated term loan resulted in an unrealized loss amount of U.S.\$3.1 million recognized in the comprehensive financial result, compensates by the change in the fair value of the debt valued at December 31, 2007 in U.S.\$2.9 million.

Cash flow hedge

- a) On March 29, 2004, the Company entered into a derivative a Ps-USD CCS to hedge a portion of its U.S. dollar foreign exchange exposure resulting from the issuance of the U.S. \$175 million 11% senior notes, which matures in 2013. Under this 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 Ps.1,270,019 (nominal value) at annual rate of 12.30%.

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- b) Derived from the reopening of the issuance on March 2005 for U.S. \$75 million and as a complement of the hedge strategy mentioned above, on June 6, 2005, the Company entered into a new derivative a Ps-USD CCS. The purpose of this agreement was to hedge the remaining portion of its U.S. dollar foreign exchange exposure resulting from the first issuance, and the totality of its U.S. \$75 million issuance. Under this agreement, Axtel will receive semiannual payments calculated based on the aggregate notional amount of U.S. \$136.25 million at an annual rate of 11%, and the Company will make semiannual payments calculated based on the aggregate of Ps.1,480,356 (nominal value) at annual rate of 12.26%.
- c) On February 3, 2007, the Company entered into a new derivative IOS (“Interest Only Swap”). The purpose of this agreement was to hedge the debt service from its new U.S. dollar bond issuance. Under this agreement, Axtel will receive semiannual payments calculated based on the aggregate notional amount of U.S. \$275 million at a fixed annual rate of 7.625%, and the Company will make semiannual payments calculated based on the aggregate of Ps.3,038,750 (nominal value) at a fixed annual rate of 8.54%.

As of December 31, 2007, the CCS information is as follows:

(Amounts in charts are expressed in millions)

Maturity date	Currencies		Interest Rates		
	Notional amount (USD)	Notional amount (nominal value) (MXP)	Axtel receives (USD)	Axtel pays (MXP)	Estimated fair value
December 15, 2008	U.S. \$ 113.75	Ps. 1,270	11.00%	12.30%	U.S.\$ (1.6)
December 15, 2008	U.S. \$ 136.25	Ps. 1,480	11.00%	12.26%	U.S.\$ (1.5)
February 1, 2012	<u>U.S. \$ 275.00</u>	<u>Ps. 3,039</u>	7.86%	8.54%	<u>U.S.\$ (4.2)</u>

For the year ended December 31, 2007, the change in the fair value of these CCS is an unrealized loss amount of U.S. \$1.7 million. This gain was recognized within the other comprehensive income section of equity, net of deferred taxes.

Derivatives registered as trading

The Company does not enter into any financial derivative instrument with any other purpose but hedging. The Company does not speculate using financial instruments.

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However, the Company redeemed 35% of the issuance of U.S. \$250 million derived from the issuances of debt of December, 2003 and March, 2005. In the face of this situation and originated by the closing of Swaps described in sections a) and b) from the paragraph "Cash flow hedges", the Company stayed with an "over-hedge" in these derivatives therefore it decided to cover this excess of hedge with an inverse operation, having the volatility of this portion being registered in the CFR. This operation is a CCSS (Currency Swap), in this transaction the Company receives 12.26% over a notional amount of Ps. 950.7 million and pays 11% over the notional amount of U.S. \$87.5 million. According to the financial reporting standards this Swap does not comply with the requirements to be registered as a risk hedge; however it is considered as an economic hedge by the Company. The CCS information is as follows:

(Amounts in charts are expressed in millions)

Maturity date	Currencies		Interest Rates		
	Notional amount (USD)	Notional amount (MXP)	Axtel receives (USD)	Axtel pays (MXP)	Estimated fair value
December 15, 2008	U.S. \$ 87.50	Ps. 950.7	12.26%	11.0%	U.S. \$0.9

For the year ended December 31, 2007 the added value of U.S. \$1.0 million of this operation was registered in the comprehensive financial result.

Embedded derivatives

The Company has conducted an initiative to identify, analyze and segregate if applicable, those contractual terms and clauses that implicitly or explicitly embed derivatives characteristics within financial or non financial agreements. These instruments are commonly known as embedded derivatives and do follow the same accounting treatment as of those free-standing contractual derivatives. Based on the above, the Company identified and recognized an amount of Ps. 1,261 from embedded derivatives effects during 2007 in the accounting records.

(9) Related parties transactions

The main transactions with related parties, during the years ended December 31, 2007 and 2006 are as follows:

		2007	2006
Telecommunication services revenue	Ps.	595,055	94,309
Commissions and administrative services Banamex		19,490	5,801
Interest expense		146,894	12,757
Commissions for debt restructure		-	41,016
Lease expense		24,198	24,452
Banamex deferred revenue		437,918	724,767
Installations services expense		7,429	6,425
Others		2,594	-

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During December 2006, Avantel received from Banamex approximately U.S. \$40 million in relation to diverse contracts of services between them. One of the contracts is to provide services of technical support on site during 60 months and the second contract consists in the prepayment of 13 months of recurring telephony services for three years. During 2007, Avantel received from Banamex approximately U.S. \$39 millions in relation to the contract of the prepayment of 13 months of recurring telephony services.

The accounts receivable and accounts payable with related parties as of December 31, 2007 and 2006, included in the accounts receivable, accounts payable and accrued liabilities, respectively are as follows:

	<u>2007</u>	<u>2006</u>
Due from:		
Operadora de Parques y Servicios, S.A. de C.V.	Ps. <u>1,996</u>	<u>4,942</u>
	<u>2007</u>	<u>2006</u>
Due to:		
GEN Industrial, S.A. de C.V.	Ps. 45	-
Instalaciones y Desconexiones Especializadas, S.A. de C.V.	329	-
Neoris de Mexico, S.A. de C.V.	<u>8,423</u>	<u>-</u>
Total	Ps. <u>8,797</u>	<u>-</u>

At December 31, 2007 the Company has debt as described in note 16.

(10) Inventories

Inventories consist of the following:

	<u>2007</u>	<u>2006</u>
Telephones and caller identification devices	Ps. 17,308	32,643
Installation material	18,653	10,220
Tools	11,240	9,164
Network spare parts	54,313	35,613
Directories and others	<u>66,375</u>	<u>15,430</u>
Total inventories	Ps. <u>167,889</u>	<u>103,070</u>

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(11) Property, systems and equipment

Property, systems and equipment are as follows:

		<u>2007</u>	<u>2006</u>	<u>Useful Lives</u>
Land	Ps.	162,100	168,202	
Building		344,377	355,908	25 years
Computer and electronic equipment		1,849,492	1,542,930	3 years
Transportation equipment		88,791	107,764	4 years
Furniture and fixtures		138,060	120,733	10 years
Network equipment		18,070,984	16,376,096	6 to 28 years
Leasehold improvements		244,930	198,324	5 to 14 years
Construction in progress		1,475,384	1,130,535	
Advances to suppliers		19,646	28,501	
		<u>22,393,764</u>	<u>20,028,993</u>	
Less accumulated depreciation		<u>8,713,893</u>	<u>5,992,392</u>	
Property, systems and equipment, net	Ps.	<u>13,679,871</u>	<u>14,036,601</u>	

The Company has capitalized Comprehensive Financial Result ("CFR") in construction in progress as a complement of the acquisition cost, for an accumulated amount of Ps. 13,006, as of December 31, 2007. The CFR capitalized during 2007 amounted to Ps. 10,545. During 2006 the Company did not capitalized CFR.

(12) Pre-operating expenses, net

The capitalized pre-operating expenses incurred up to June 1999 and expenses incurred during 2000, 2004, 2005 and 2006 in opening new operations are as follows:

		<u>2007</u>	<u>2006</u>
Salaries	Ps.	231,963	231,963
Legal and financial advisory		118,238	118,238
Operating expenses		96,649	96,649
Depreciation		10,275	10,275
Comprehensive financing result		(25,929)	(25,929)
Service and other revenues		(14,657)	(14,657)
Other		40,880	40,880
		<u>457,419</u>	<u>457,419</u>
Less accumulated amortization		<u>345,522</u>	<u>297,828</u>
Pre-operating expenses, net	Ps.	<u>111,897</u>	<u>159,591</u>

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(13) Investment in shares of associated company

As of December 31, 2007, the investment in shares of associated company through Avantel is represented by a non-controlling 50% interest in the equity shares of Conectividad Inalámbrica 7GHZ, S. de R.L. The operation of this company consists in providing radio communication services in Mexico under the concession granted by the SCT. Such concession places certain performance conditions and commitments to this company, such as (i) filing annual reports with the SCT, including identifying main stockholders of the Company, (ii) reporting any increase in common stock, (iii) providing continuous services with certain technical specifications, (iv) to present a code of marketing strategies, (v) to register rates of service, (vi) to provide a bond and (vii) fulfilling the program of investments presented when the company solicited the concession.

Since the Company does not have effective control, this investment is accounted for by the equity method.

Condensed financial information of the associated company as of December 31, 2007 and 2006 is as follows:

<u>Balance Sheet:</u>	<u>2007</u>	<u>2006</u>
Current assets	Ps. 12,972	7,955
Intangible assets	17,586	20,909
Total assets	30,558	28,864
Total liabilities	60	611
Stockholders' equity	Ps. 30,498	28,253
50% equity interest	Ps. 15,249	14,127
 <u>Statement of operations:</u>		
Revenues from rent of frequency bands	Ps. 5,602	503
Costs of services and operating expenses	(2,088)	(151)
Operating income	3,514	352
Comprehensive financial results	(368)	2,953
Deferred income tax	(287)	-
Net income	Ps. 2,859	3,305
Equity in income of associated company	Ps. 1,430	1,652

As of December 31, 2007 and 2006, the liabilities of the Company with Conectividad Inalámbrica were Ps. 5,194 and Ps. 853, respectively.

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(14) Intangible assets

Intangible assets consist of the following:

	<u>2007</u>	<u>2006</u>
Telephone concession rights from Axtel	Ps. 1,073,135	1,073,135
Telephone concession rights from Avantel	114,336	150,417
Customers relationships	324,183	401,111
Trade name "Avantel"	<u>186,074</u>	<u>200,555</u>
	1,697,728	1,825,218
Less accumulated amortization	<u>639,524</u>	<u>402,404</u>
Intangible assets, net	Ps. <u>1,058,204</u>	<u>1,422,814</u>

Concessions rights of the Company

The Company has either obtained concessions as described below to offer telecommunications services or auctioned the following licenses over the spectrum of frequencies necessary to provide the services:

On June, 1996 Axtel obtained a concession to offer local and long distance telephony services, for a period of thirty years. To maintain this concession the Company needs to comply with certain conditions. It can be renewed for another period of thirty years;

- On September 15, 1995 Avantel obtained a concession to offer local and long distance telephony services, for a period of thirty years. To maintain this concession the Company needs to comply with certain conditions. It can be renewed for another period of thirty years;
- Two concessions in 929 MHz to offer mobile paging services;
- 50MHz in the 3.4GHz band. The licenses obtained allow nationwide coverage. The investment was Ps. 831,043 for a period of twenty years with an extension option;
- 56 MHz in the 7 GHz band, countrywide coverage, for a point-to-point transport (through the property of 50% of Conectividad Inalambrica 7GHz, S. de R.L.);
- 60MHz for Point-to-Multi-Point in the 10.5GHz band nationwide. The acquisition of these twenty-year concessions, with an extension option, represented an investment of Ps. 160,931 for the Company;
- 120 MHz in three regions in 10.5 GHz band, for point-to-multi-point access (Concession originally granted to Avantel);

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- 112MHz for Point-to-Point in the 15GHz band and a 100MHz in the 23GHz band, both with nationwide coverage. The acquisition of these twenty-year concessions, with an extension option, represented an investment of Ps. 81,161 for the Company;
- 56 MHz in the 15 GHz band, nationwide coverage, for point-to-point access and transport (Concession originally granted to Avantel);
- 268 MHz in the 23 GHz band, nationwide coverage, for point-to-point access and transport (Concession originally granted to Avantel);
- 112 MHz in the 37 to 38.6 GHz band, in 5 regions, for point-to-point transport (Concession originally granted to Avantel).

Each license of spectrum has a period of life of 20 years and it can be renovated for additional periods of 20 years as long as Axtel complies with all of its obligations, with all conditions imposed by the law and with any other condition that SCT imposes.

The concessions allow the Company to offer the following services:

- Local telephony service;
- National long distance telephony service;
- Selling or leasing of network capacity for the generation, transmission or reception of data, signs, images, voice, sounds and other type of information of any kind;
- Selling or leasing network capacity from other countries, including the leasing of digital circuits;
- Value added services
- Operator services
- Mobile paging services
- Data services, video, audio conferences and videoconferences, except to restricted TV, continuous services of music or digital audio services; y
- Prepaid phone cards or credit phone cards

In November 2006, SCT granted us, as part of the concession of Axtel, a new permission to provide SMS (short messaging system) to our customers.

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Intangible assets arising from the acquisition of Avantel

Derived from the acquisition of Avantel, the Company recorded certain intangible assets such as: trade name "Avantel", customers' relationships and telephone concession rights, whose value was determined by using an independent external expert appraiser at the acquisition date and accounted for in accordance to FRS B-7. The trade name and customers relationships are amortized in over a three-year period; meanwhile the concession is amortized over the remaining term of the concession on a straight-line basis.

(15) Other assets

Other assets consist of the following:

	<u>2007</u>	<u>2006</u>
Notes issuance costs	Ps. 143,730	99,533
Deferred financing costs	41,016	89,826
Telmex / Telnor infrastructure costs	68,279	68,279
WTC concession rights	22,474	22,474
Guarantee deposits	35,572	44,737
Others	<u>97,196</u>	<u>49,585</u>
	408,267	374,434
Less accumulated amortization	<u>134,254</u>	<u>65,227</u>
Other assets, net	Ps. <u>274,013</u>	<u>309,207</u>

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 on a straight line basis 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 Telmex and Telnor for their investment in infrastructure that Telmex / Telnor made in order to provide interconnection for the new telephone companies in Mexico.

Deferred financing costs related with the acquisition of Avantel

The deferred financing costs incurred in the acquisition of Avantel will be amortized based upon the terms of the loans that they are related.

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(16) Long-term debt

Long-term debt as of December 31, 2007 and 2006 consist of the following:

	<u>2007</u>	<u>2006</u>
U.S. \$275,000,000 in aggregate principal amount of 7 ⁵ / ₈ % Senior Unsecured Notes due 2017. Interest is payable semiannually in February 1 and August 1 of each year.	Ps. 2,988,205	-
U.S. \$162,500,000 in aggregate principal amount of 11% Senior Unsecured Notes due 2013. Interest is payable semiannually in arrears on June 15, and December 15 of each year.	1,765,758	1,834,631
Premium on Senior Notes issuance	27,291	32,319
Unsecured Bridge Loan with Credit Suisse, Cayman Island Branch, as the administrative agent, for an aggregate amount of U.S. \$310.9 million, with an interest rate of LIBOR + 125 basis points, maturing in May 2008.	-	3,510,636
Unsecured Syndicated Loan with Citibank, N.A., as the administrative agent, and Banamex as the peso agent, with a peso tranche in the aggregate amount of Ps. 1,042.4 and a U.S. dollar tranche in the aggregate amount of U.S. \$110.2. The final maturity date is February 2012, with quarterly principal repayments starting February 2010, with an interest rate for the tranche in pesos of TIIE + 150 basis points, and the tranche in U.S. dollar of LIBOR + 150 basis points.	2,240,091	2,325,992
Change in the fair value of syndicated loan	(31,023)	-
Capacity lease agreement with Teléfonos de Mexico, S.A.B. de C.V. of approximately Ps. 800,000 payable monthly and expiring in 2011.	534,271	593,702
Other long-term financing with several credit institutions with interest rates fluctuating between 6.0% and 7.5% for those denominated in dollars and TIIE (Mexican average interbank rate) plus three percentage points for those denominated in pesos.	<u>120,525</u>	<u>160,209</u>
Total long-term debt	7,645,118	8,457,489
Less current maturities	<u>160,163</u>	<u>163,207</u>
Long-term debt, excluding current maturities	Ps. <u>7,484,955</u>	<u>8,294,282</u>

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Annual installments of long-term debt are as follows:

<u>Year</u>		<u>Amount</u>
2009	Ps.	40,561
2010		1,060,740
2011		1,057,763
2012 and thereafter		<u>5,325,891</u>
	Ps.	<u>7,484,955</u>

As of December 31, 2007 and 2006 long-term debt principal characteristics are as follows:

On February 2, 2007, the Company issued U.S. \$275 million of 10-year unsecured senior notes. This issuance matures on February 1, 2017. Interest will be payable semiannually and the senior notes bear interest at $7\frac{5}{8}$ % beginning on August 1, 2007. The proceeds of this issuance were used to prepay the bridge financing related to the December 2006 acquisition of Avantel.

On December 4, 2006, the Company entered into an Unsecured Bridge Loan Facility with Credit Suisse, Cayman Island Branch, as the Administrative Agent, for an aggregate amount of U.S. \$310,950,000. The bridge loan facility matures eighteen months after the initial drawdown date. With an interest rate of LIBOR +125 basis points. This loan was prepaid on February 2, 2007. Certain subsidiaries of the Company guaranteed this facility.

On December 4, 2006, The Company entered into an Unsecured Credit Agreement with Citibank, N.A. as the Administrative Agent and Banamex as the Peso Agent, and it was modified later on February 23, 2007, with a peso tranche in the aggregate amount of Ps. 1,042,362,416 and a U.S. dollar tranche in the aggregate amount of U.S. \$110,225,133. The credit agreements bear interest rate at LIBOR + 150 basis points for the tranche in U.S. dollar and THIE + 150 basis points for the peso tranche. Avantel, S de R.L. de C.V., Avantel Infraestructura, S. de R.L. de C.V. and Adequip, S.A. guarantee this credit agreement.

On February 22, 2006 the Company redeemed U.S. \$87,500,000 aggregate principal amount of its 11% senior notes due 2013, or 35% of the U.S. \$250,000,000 original aggregate principal amount of the notes. The redemption was made at a price of 111% of the principal amount of the notes, plus accrued and unpaid interest to the redemption date. The premium paid on this transaction was U.S. \$9.6 million, which was recorded in the statement of operations as part of the comprehensive financing result.

On October 1, 2006, Avantel Infraestructura, S. de R.L. a subsidiary of Axtel S.A.B. de C.V. from December 4, 2006 entered into a capacity lease agreement with Teléfonos de México, S.A.B. de C.V. for purposes of connecting the installations of Avantel and those of Telmex in certain cities by using dedicated links of data for an amount of approximately Ps. 800,000. The monthly lease payment for this contract is approximately Ps. 15 million.

Avantel evaluated this lease agreement and determined that the present value of the minimum future payments is substantially equal to the market value of the infrastructure and dedicated equipment. Such market value was determined by an independent expert telecommunications appraiser registered within the COFETEL. Avantel recorded the lease as a capital lease according to FRS D-5.

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Some of the debt agreements that remain outstanding establish certain covenants, the most significant of which refer to limitations on dividend payments and comprehensive insurance on pledged assets. For the year ended December 31, 2007, the Company was in compliance with all of its covenants.

(17) Other accounts payable

As of December 31, 2007 and 2006 other accounts payable consist of the following:

	<u>2007</u>	<u>2006</u>
Guarantee deposits (note 22(a))	Ps. 141,261	146,770
Interest payable (note 22(a))	72,430	58,598
Labor reserves	3,701	122,955
Guarantee deposit (SR Telecom)	69,631	-
Other	<u>106,983</u>	<u>182,882</u>
	Ps. <u>394,006</u>	<u>511,205</u>

(18) Labor obligations

The cost of the obligations and other elements of seniority premiums, severance payments and pensions mentioned in note 3(l) have been determined based on independent actuarial calculations as of December 31, 2007 and 2006.

The components of the net periodic cost for the years ended December 31, 2007 and 2006 are as follows:

	<u>2007</u>		<u>2006</u>		
	<u>Seniority Premium</u>	<u>Severance payments</u>	<u>Seniority Premium</u>	<u>Severance payments</u>	<u>Pensions</u>
Net periodic cost:					
Labor cost	Ps. 1,677	6,019	975	4,156	-
Financial cost	281	1,296	151	772	-
Amortization of transition obligation	1	3,453	1	3,446	-
Variances in assumptions and experience adjustments	(53)	(1,782)	47	72	-
Inflationary effect	<u>71</u>	<u>359</u>	<u>48</u>	<u>338</u>	<u>-</u>
Net periodic cost before Avantel's acquisition	Ps. 1,977	9,345	1,222	8,784	-
Labor cost of Avantel	-	-	46	338	2,085
Net periodic cost	<u>Ps. 1,977</u>	<u>9,345</u>	<u>1,268</u>	<u>9,122</u>	<u>2,085</u>

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

		2007		2006		
		Seniority premium	Severance payments	Seniority premium	Severance payments	Pensions
Present benefit obligation	Ps.	10,931	41,429	4,567	24,004	-
Present value of benefits attributable to future salary increases		662	1,843	331	1,075	-
Projected benefit obligation (PBO)		11,593	43,272	4,898	25,079	-
Items pending amortization:						
Variances in assumptions and experience adjustments		(548)	14,631	(1,179)	(3,087)	-
Transition liability		(3)	(11,502)	(5)	(15,059)	-
Minimum additional liability		71	-	852	17,070	-
Net projected liability recognized on the consolidated balance sheet before Avantel's acquisition		11,113	46,401	4,566	24,003	-
Obligations from Avantel's acquisition		-	-	7,757	32,766	35,145
Labor periodic cost		-	-	46	338	2,085
Reclassification to reserve for personal restructuring		-	-	(2,190)	(9,813)	(9,197)
Net projected liability	Ps.	11,113	46,401	10,179	47,294	28,033

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

Discount rate used to reflect the present value of obligations	<u>4.00%</u>	<u>4.00%</u>	<u>4.00% -5.00%</u>	<u>4.00% -5.00%</u>	<u>5.00%</u>
Rate of increase in future salary levels	<u>1.00%</u>	<u>1.00%</u>	<u>0.75% -1.00%</u>	<u>0.75% -1.00%</u>	<u>0.75%</u>
Amortization period of the transition liability	<u>16 years</u>	<u>6 years</u>	<u>17 years</u>	<u>6 years</u>	<u>20.37 years</u>

On May 1, 2007, all the personnel of Avantel Recursos, S.A. de C.V. and Avantel Servicios, S.A. de C.V. passed to be part of Servicios Axtel, S.A. de C.V. and Instalaciones y Contrataciones, S.A. de C.V., respectively, transferring with it, all the obligations and rights in labor matter that the personnel had until such date on each of the companies substituted. As part of the homologation of benefits, the pension plan belonging to personnel transferred was concluded, because it does not exist such benefit in the enterprises where the personnel were transferred.

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(19) 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 financial reporting standards.

On October 1, 2007 new laws were published, a number of tax laws were revised, and additionally a presidential decree was issued on November 5, 2007, which will come into effect on January 1, 2008. The most important changes are: (i) elimination of the Asset Tax Law and (ii) the introduction of a new tax (Flat Rate Business Tax or IETU) which is based on cash flows and limits certain deductions; additionally, certain tax credits are granted mainly with respect to inventories, salaries taxed for IT purposes and social security contributions, tax losses arising from accelerated deductions, recoverable asset tax, and deductions related to investments in fixed assets, deferred charges and expenses. The IETU rate is 16.5% for 2008, 17% for 2009 and 17.5% for 2010 and thereafter.

Accordingly, beginning in 2008, companies will be required to pay the greater of IETU or IT. If, IETU results, the payment will be considered final i.e. not subject to recovery in subsequent years (with certain exceptions).

At December 31, 2007 the Company has evaluated according to Financial Reporting Standards Interpretation (INIF-8 "Efectos del Impuesto Empresarial a Tasa Unica"), after the evaluation the Company estimates that the tax payable in future years will be IT, deferred tax effects as of December 31, 2007 have been recorded on the IT basis.

The TA law establishes a 1.8% tax on assets adjusted for inflation in the case of inventory, property, systems and equipment and net of certain liabilities in accordance with law. 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.

Effective January 1, 2002 a new Income Tax Law had been enacted, which 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. In December 2004 the Mexican Congress approved changes to the Income Tax Law where the tax rate for 2005 was further reduced to 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 28% tax rate for assets and liabilities. The effects of the reduction in the deferred income tax asset calculation for 2006 were Ps. 12,055.

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The tax expense attributable to the income before IT differed from the amount computed by applying the tax rate of 28% in 2007 and 29% in 2006 to pretax income, as a result of the items mentioned below:

	<u>2007</u>	<u>2006</u>
Computed "expected" tax expense	Ps. (244,374)	(97,203)
Increase (decrease) resulting from:		
Effects of inflation, net	(1,432)	(9,179)
Change in valuation allowance	(101,463)	2,649
Deferred employees' profit sharing	13,594	12,055
Immediate deduction effect	(43,550)	(32,161)
Non-deductible expenses	(5,757)	-
Other	(218)	6,289
IT expense	Ps. <u>(383,200)</u>	<u>(117,550)</u>

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, 2007 and 2006 are presented below:

	<u>2007</u>	<u>2006</u>
Deferred tax assets:		
Net operating loss carryforwards	Ps. 968,090	1,426,521
Allowance for doubtful accounts	361,402	319,781
Accrued liabilities	479,781	337,747
Recoverable AT	418,851	332,540
Premium on bond issuance	10,179	12,719
Fair value of derivative instruments	17,090	12,504
Total gross deferred tax assets	2,255,393	2,441,812
Less valuation allowance	877,001	775,538
Net deferred tax assets	<u>1,378,392</u>	<u>1,666,274</u>
Deferred tax liabilities:		
Property, systems and equipment	63,486	507,118
Telephone concession rights	171,848	232,207
Intangible and other assets	206,969	306,072
Total deferred tax liabilities	<u>442,303</u>	<u>1,045,397</u>
Deferred tax assets, net	Ps. <u>936,089</u>	<u>620,877</u>

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The rollforward for the net deferred income tax asset for the years ended December 31, 2007 and 2006 is presented below:

		<u>2007</u>	<u>2006</u>
Balances at beginning of year	Ps.	620,877	18,562
Deferred IT expense		(284,381)	(112,656)
Deferred IT of derivative financial instruments		4,586	(11,903)
Additional paid-in capital		-	-
Deferred IT from Avantel's acquisition		<u>595,007</u>	<u>726,874</u>
Balances at end of year	Ps.	<u><u>936,089</u></u>	<u><u>620,877</u></u>

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon of future taxable income during 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. In order to fully realize the deferred tax asset, the Company will need to generate future taxable income of approximately Ps. 3,343,175 prior to the expiration of the net operating loss carryforwards in various dates as disclosed below. Taxable income for the years ended December 31, 2007 and 2006 were Ps. 1,502,050 and Ps. 1,040,353, respectively. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of the existing valuation allowances at December 31, 2007. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced. As of December 31, 2007 and 2006, a deferred tax asset valuation allowance was established for a portion of the tax loss carryforwards from the subsidiaries and TA from the Company.

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, 2007, the tax loss carryforwards expire as follows:

<u>Year</u>		<u>Inflation-adjusted tax loss carryforwards</u>	<u>Recoverable TA</u>
2008	Ps.	1,177,505	-
2009		463,804	-
2010		367,233	-
2011		146,863	70,004
2012		663,555	50,451
2013		454,992	76,966
2014		92,634	72,514
2015		11,489	31,307
2016		75,263	31,298
2017		<u>4,128</u>	<u>86,311</u>
	Ps.	<u><u>3,457,466</u></u>	<u><u>418,851</u></u>

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The tax effects of temporary differences that give rise to deferred employee's profit sharing as of December 31, 2007 and 2006 are presented below:

	<u>2007</u>	<u>2006</u>
Deferred ESPS assets:		
Accrued liabilities	Ps. 2,013	13,793
Accrued for labor obligations	6,554	13,871
Other payroll accruals	<u>7,489</u>	<u>5,526</u>
Net deferred ESPS asset	<u>16,056</u>	<u>33,190</u>
Deferred ESPS liabilities:		
Deferred income	1,876	3,942
Other	<u>-</u>	<u>1,474</u>
Total deferred ESPS liability	<u>1,876</u>	<u>5,416</u>
Deferred ESPS asset, net	Ps. <u>14,180</u>	<u>27,774</u>

The rollforward for the net deferred employee's profit sharing asset for the years ended December 31, 2007 is presented below:

	<u>2007</u>	<u>2006</u>
Balances at beginning of year	Ps. 27,774	-
Deferred ESPS (expense) benefit	(13,594)	4,699
Deferred ESPS for acquisition of Avantel	<u>-</u>	<u>23,075</u>
Balances at end of year	Ps. <u>14,180</u>	<u>27,774</u>

Total ESPS expense was calculated from the individual net income of each subsidiary that has employees. The tax profit for ESPS effects of these companies for the year ended December 31, 2007 and 2006 were Ps. 60,880 and Ps. 15,700, respectively.

(20) Stockholders' equity

The principal characteristics of stockholders' equity are described below:

(a) Common stock structure

At December 31, 2007, the Company has 8,769,353,223 shares issued and outstanding. Company's shares are divided in two Series: Series A and B; both Series have two type of classes, Class "I" and Class "II", with no par value. From the total shares, 96,636,627 shares are Series A and 8,672,716,596 shares are Series B. At December 31, 2007 the Company has only issued Class "I" shares. Also, at December 31, 2007 all shares issued are part of the fixed portion.

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On August 31, 2007, the stockholders' approved a three-for-one stock split (the split). The split became effective on October 8, 2007. The proportional equity interest participation of existing stockholders did not change as a result of the split. For comparison purposes, the number of shares is presented adjusted for the effects of the split. Following table shows the effects of the Split:

	Number of Shares before the <u>Split</u>	Number of Shares after the <u>Split</u>
Series A Shares	32,212,209	96,636,627
Series B Shares	<u>2,890,905,532</u>	<u>8,672,716,596</u>
Total of Shares	2,923,117,741	8,769,353,223

The percentages of shares holding did not change derived from the Split. For effects of comparability the present note shows the number of shares after the Split.

The following represents a rollforward of Company's shares for the years ended December 31, 2007 and 2006:

	Issued and subscribed <u>shares</u>		Common <u>stock</u>	Additional paid-in <u>capital</u>
Balances as of December 31, 2005	8,522,810,598	Ps.	8,677,782	556,935
Issuance costs	<u>-</u>		<u>-</u>	<u>(9,804)</u>
Balances as of December 31, 2006	8,522,810,598		8,677,782	547,131
Shares issued and subscribed	<u>246,542,625</u>		<u>192,280</u>	<u>194,540</u>
Balances as of December 31, 2007	<u>8,769,353,223</u>	Ps.	<u>8,870,062</u>	<u>741,671</u>

As of December 31, 2007 and 2006, the common stock of the Company is Ps. 6,625,536 (nominal value), represented by 96,636,627 common shares, with no nominal value, Class "I", "A" Series, subscribed and paid, and 8,672,716,596 common shares, with no nominal value, Class "I", "B" Series, subscribed and paid.

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In relation to our acquisition of Avantel also included a Series B Shares Subscription Agreement (“Subscription Agreement”) with Tel Holding, an indirect subsidiary of Citigroup, Inc., for an amount equivalent to up to 10% of Axtel’s common stock. To give effect to the above, we obtained stockholder approval (i) to increase our capital by issuing Series B Shares in a number that was sufficient for Tel Holding to subscribe and pay for Series B Shares (in the form of CPOs) representing up to a 10% equity participation in Axtel; and (ii) for the subscription and payment of the Series B Shares that represented the shares subscribed for by Tel Holding and any shares subscribed for by stockholders that elected to subscribe and pay for additional Series B Shares in exercise of their preferential right granted by the Mexican General Corporation Law.

On December 22, 2006 pursuant to the Subscription Agreement, we received a notice from Tel Holding confirming that it acquired 533,976,744 Series B Shares (represented by 76,282,392 CPOs) from the Mexican Stock Exchange (*Bolsa Mexicana de Valores*, or “BMV”) and confirming its intention to subscribe and pay for 246,453,963 new Series B Shares (represented by 35,207,709 CPOs). The new Series B Shares were subscribed and paid for, which we refer to herein as the “Equity Subscription,” by Tel Holding through the CPOs Trust on January 4, 2007. Tel Holding may not, subject to certain exceptions, transfer CPOs purchased in the Equity Subscription until January 3, 2008.

(b) Stockholders’ equity restrictions

Stockholders’ contributions, restated for inflation as provided in the tax law, totaling of Ps. 6,981,059 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 16 establish limitations on dividend payment.

(c) Comprehensive income

The comprehensive income reported on the statements of stockholders’ equity represents the results of the total performance of the Company during the year, and includes the items mentioned below which, in accordance with Mexican GAAP, are reported directly in stockholders’ equity, except for net income.

	<u>2007</u>	<u>2006</u>
Net income	Ps. 490,996	222,412
Fair value of derivative instruments	(16,378)	42,511
Deferred IT of derivative financial instruments	<u>4,586</u>	<u>(11,903)</u>
Comprehensive income	Ps. <u>479,204</u>	<u>253,020</u>

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(21) Telephone services and related revenues

Revenues consist of the following:

	<u>2007</u>	<u>2006</u>
Local calling services	Ps. 5,336,628	4,330,038
Long distance services	1,532,176	583,605
Data services	2,513,751	459,063
International traffic	1,210,233	552,791
Other services	<u>1,597,822</u>	<u>750,215</u>
	Ps. <u>12,190,610</u>	<u>6,675,712</u>

(22) Commitments and contingencies

As of December 31, 2007, the Company has the following commitments and contingencies:

- (a) On January 24, 2001 a contract was signed with Global Towers Communications Mexico, S. de R.L. de C.V. (Formerly Spectrasite Communications Mexico, S. de R.L. de C.V.) 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 Global Towers Communications Mexico, S. de R.L. de C.V. (Global Towers) and, in turn, sell or lease them under an operating lease plan.

On January 24, 2001, the Company received 13 million dollars from Global Towers to secure the acquisition of the 650 sites at 20,000 dollars per site. These funds are not subject to restriction as per the contract for use and destination. However, the contract provides for the payment of interest at a Prime Rate in favor of Global Towers 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 Ps. 72,430 and the principal amount, included within other accounts payable in the balance sheet as of December 31, 2007.

During 2002, Global Towers 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 Global Towers for unilateral rescission of the contract. As of December 31, 2007, the trial is at a stage where evidence is being shown.

- (b) On December 14, 2007, the Company subscribed an agreement with Metronet, S.A. de C.V., in which the trial that Metronet filed against the Company was terminated. From this date on there is neither contingency nor liability about this concept.

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- (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 amounting to Ps. 1,214 and to other service providers amounting to Ps. 819,648.
- (e) The concessions granted by the Ministry of Communications and Transportation (SCT), mentioned in note 2, establish certain obligations to the Company, including, but not limited to: (i) filing annual reports with the SCT, including identifying main stockholders 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) In September and November 2005, Avantel Infraestructura filed before the Federal Court of Tax and Administrative Justice a lawsuit claiming the lack of answer to a petition previously filed by Avantel Infraestructura requesting confirmation of a criterion. This petition was based on the fact that Avantel is not obligated to pay for some governmental services established under article 232, fraction I, of the Federal Rights Law, with respect to the use of exclusive economic geographic zone in Mexico related to certain landing points in "Playa Niño", region 86, Benito Juarez Itancah Tulum, Carrillo Puerto, Quintana Roo. The file was turned for study and resolution to the 5th Metropolitan Regional Court of the Federal Court of Tax and Administrative Justice, which is still pending to be admitted.
- (g) The Company leases some equipment and facilities under operating leases. Some of these leases have renewal clauses. Lease expense for 2007 and 2006 was Ps. 457,457 and Ps. 397,591, respectively.

The annual payments under these leases as of December 31, 2007 are as follows:

	Contracts in:	
	Pesos	Dollars
	(thousands)	(thousands)
2008	Ps. 150,868	\$ 9,352
2009	136,816	7,658
2010	106,682	6,214
2011	84,823	5,637
2012	65,974	5,039
Thereafter	338,001	14,761
	Ps. <u>883,164</u>	\$ <u>48,661</u>

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- (h) As of December 31, 2007, the Company has placed purchase orders which are pending delivery from suppliers for approximately Ps. 1,334,617.
- (i) In connection to one of the contracts that Avantel signed with Telmex on October 2006, Avantel should issue a letter of credit in case of change of control in Avantel, situation that occurred during the month of November, at the moment that Axtel acquired the shares from Tel Holding and Banamex. The amount of this instrument is U.S. \$60 million. Axtel is a guarantor of this instrument with Banamex, which issued the letter of credit.

(23) Recently issued accounting standards

The CINIF has issued the following FRS, effective for years beginning after December 31, 2007, and which do not provide for earlier application.

- (a) **FRS B-10 “Effects of inflation”**- FRS B-10 supersedes Bulletin B-10 and its five amendments, as well as the related circulars and INIF (Interpretation of Financial Reporting Standards) 2. The principal considerations established by this FRS are: (i) the change in the value of the Investment Unit (UDI) may be used for determining the inflation for a given period; (ii) the election to use inventory replacement costs as well as specific indexation for fixed assets, is eliminated; (iii) an entity is only required to recognize the effects of inflation when operating in an inflationary economic environment (accumulated inflation equal to or higher than 26% in the most recent three-year period); and (iv) the accounts of Gain or Loss from Holding Non-monetary Assets (RETANM - Spanish abbreviation), Monetary Position Gains or Losses (REPOMO - Spanish abbreviation), and Deficit/Excess in Equity Restatement, will be reclassified to retained earnings, when the unrealized portion is not identified.

Management is still evaluating the impact of this FRS.

- (b) **FRS D-3 “Employee benefits”**- FRS supersedes Bulletin D-3, the portion applicable to Employee Statutory Profit Sharing (ESPS) of Bulletin D-4 and INIF (Interpretation of Financial Reporting Standards) 4. The principal considerations established by this FRS are: (i) a maximum of five years is established for amortizing unrecognized/unamortized items, and the option is provided for immediate recognition of actuarial gains or losses in results of operations; (ii) the recognition of an additional liability and related intangible asset and any related item as a separate element of stockholders' equity, is eliminated; (iii) severance benefits are to be recognized directly in results of operations; and (iv) ESPS, including deferred ESPS, is to be presented in the statement of income as ordinary operations. Furthermore, FRS D-3 establishes that the asset and liability method required by FRS D-4 should be used for determining deferred ESPS, stating that any effects arising from the change are to be recognized in retained earnings, with no restatement of prior years' financial statements.

Management estimates that the initial effects of this new FRS will not be material.

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- (c) **FRS D-4 “Tax on earnings”**- FRS supersedes Bulletin D-4 and Circulars 53 and 54. The principal considerations established by this FRS are: (i) the balance of the cumulative IT effects resulting from the initial adoption of Bulletin D-4 in 2000 is reclassified to retained earnings; (ii) AT is recognized as a tax credit (benefit), rather than as a tax prepayment; and (iii) the accounting treatment of ESPS incurred and deferred is transferred to FRS D-3, as mentioned in paragraph (b) above.

Management estimates that the initial effects of this new FRS will not be material.

- (d) **FRS B-2 “Statement of cash flows”**- FRS supersedes Bulletin B-12 and paragraph 33 of Bulletin B-16. The principal considerations established by this FRS are: (i) the statement of cash flows replaces the statement of changes in financial position; (ii) cash inflows and cash outflows are reported in nominal currency units i.e. the effects of inflation are not included; (iii) two alternative preparation methods (direct and indirect) are established, without stating preference for either method. Furthermore, cash flows from operating activities are to be reported first, followed by cash flows from investing activities and lastly cash flows from financing activities; (iv) captions of principal items are to be reported gross; and (v) disclosure of the composition of those items considered cash equivalents is required.