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

Consolidated Financial Statements

December 31, 2009 and 2008

(With Independent Auditors' Report Thereon)

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# 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, 2009 and 2008, and the related consolidated statements of operations changes in stockholders' equity and cash flows 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 (FRS). 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.

During 2009, accounting changes were made as disclosed in Note 4 to the consolidated financial statements, which were recognized retrospectively.

As mentioned in notes 21 (a) and 21 (b), the Company has contingencies related to interconnection rates with mobile operators and with long distance terminating calls with Teléfonos de México (Telmex). On December 31, 2009, the differences between the amounts paid by the Company and the amounts billed by the mobile operators and Telmex amounted to approximately Ps. 950 million and Ps. 764 million, respectively, before value added tax. At the date of this report, the Administration of the Company and its legal advisors consider that they have sufficient elements to obtain favorable results in the trials related to such contingencies.

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, 2009 and 2008, and the results of their operations, and the changes in their stockholders' equity and cash flows for the years then ended, in conformity with Mexican Financial Reporting Standards.

KPMG Cárdenas Dosal, S.C.

Castillo

Leandro Castillo Parada

Monterrey, N.L., México
February 16, 2010

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

Consolidated Balance Sheets

December 31, 2009 and 2008

(Thousands of Mexican pesos)

| **Assets** | | **2009** | **2008** |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents | Ps. | 1,402,240 | 1,105,576 |
| Accounts receivable, net (note 6) | | 1,851,688 | 1,796,664 |
| Refundable taxes and other accounts receivable | | 197,946 | 250,284 |
| Prepaid expenses | | 33,833 | 33,104 |
| Inventories (note 9) | | 170,681 | 138,898 |
| Financial instruments (note 7a and 7b) | | 574,132 | 475,730 |
| Total current assets | | 4,230,520 | 3,800,256 |
| Long-term accounts receivable | | 18,491 | 20,098 |
| Property, systems and equipment, net (note 10) | | 15,210,619 | 15,306,448 |
| Intangible assets, net (note 13) | | 582,782 | 820,319 |
| Pre-operating expenses, net (note 11) | | 34,307 | 64,120 |
| Deferred income taxes (note 18) | | 1,150,507 | 1,192,323 |
| Deferred employees' statutory profit sharing (note 18) | | 9,707 | 7,815 |
| Investment in shares of associated company and other permanent investments (note 12) | | 16,295 | 18,008 |
| Other assets, net (note 14) | | 349,854 | 339,774 |
| Total assets | Ps. | 21,603,082 | 21,569,161 |
| **Liabilities and Stockholders' Equity** | | | |
| Current liabilities: | | | |
| Accounts payable and accrued liabilities | Ps. | 2,052,204 | 2,590,567 |
| Accrued interest | | 215,538 | 136,532 |
| Taxes payable | | 108,033 | 133,985 |
| Current maturities of long-term debt (note 15) | | 944,553 | 296,106 |
| Other accounts payable (note 16) | | 371,503 | 358,014 |
| Deferred revenue | | 559,542 | 547,628 |
| Derivative financial instruments (note 7a) | | 30,941 | - |
| Total current liabilities | | 4,282,314 | 4,062,832 |
| Long-term debt, excluding current maturities (note 15) | | 8,947,650 | 9,358,464 |
| Other long-term accounts payable | | 14,438 | 7,932 |
| Employee benefits (note 17) | | 70,630 | 63,345 |
| Deferred revenue | | 87,117 | 145,171 |
| Total liabilities | | 13,402,149 | 13,637,744 |
| Stockholders' equity (note 19): | | | |
| Common stock | | 7,562,075 | 7,562,075 |
| Additional paid-in capital | | 741,671 | 741,671 |
| Reserves for own shares | | 162,334 | 162,334 |
| Deficit | | (273,926) | (649,779) |
| Change in the fair value of derivative financial instruments (note 7a) | | 8,779 | 115,116 |
| Total stockholders' equity | | 8,200,933 | 7,931,417 |
| Commitments and contingencies (note 21) | | | |
| Subsequent events (notes 21(b) and 21(j)) | | | |
| Total liabilities and stockholders' equity | Ps. | 21,603,082 | 21,569,161 |

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

Years ended December 31, 2009 and 2008

(Thousands of Mexican pesos)

| | | 2009 | 2008 |
|---|---|---|---|
| Telephone services and related revenues (note 20) | Ps. | 10,968,877 | 11,572,401 |
| Operating costs and expenses: | | | |
| Cost of revenues and services | | (2,987,088) | (3,704,876) |
| Selling and administrative expenses | | (4,143,209) | (3,657,123) |
| Depreciation and amortization | | (3,065,798) | (2,855,839) |
| | | (10,196,095) | (10,217,838) |
| Operating income | | 772,782 | 1,354,563 |
| Comprehensive financing result: | | | |
| Interest expense (note 15) | | (925,261) | (801,687) |
| Interest income | | 24,513 | 58,938 |
| Foreign exchange gain (loss), net | | 279,814 | (1,602,127) |
| Change in the fair value of financial instruments (notes 7a and 7b) | | 212,262 | 54,051 |
| Comprehensive financing result, net | | (408,672) | (2,290,825) |
| Employees' statutory profit sharing (note 18) | | (11,152) | (7,974) |
| Deferred employees' statutory profit sharing (note 18) | | 1,892 | (6,365) |
| Other income (expenses), net (note 2) | | 10,404 | (54,055) |
| Other income (expenses), net | | 1,144 | (68,394) |
| Income (loss) before income taxes and equity in earnings of associated company | | 365,254 | (1,004,656) |
| Income taxes (note 18): | | | |
| Income tax expense | | (16,588) | (15,556) |
| Deferred income tax | | (119,431) | 286,045 |
| Flat tax | | (74,454) | (962) |
| Deferred flat tax | | 29,052 | 32,046 |
| Total income tax (expense) benefit | | (181,421) | 301,573 |
| Equity in earnings of associated company (note 12) | | (7,433) | 2,759 |
| Net income (loss) | Ps. | 176,400 | (700,324) |
| Weighted average of common shares outstanding | | 8,769,353,223 | 8,769,353,223 |
| Basic and diluted earnings (loss) per share (pesos) (note 19) | Ps. | 0.02 | (0.08) |

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

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

Consolidated Statement of Cash Flows

Years ended December 31, 2009 and 2008

(Thousands of Mexican pesos)

| | | 2009 | 2008 |
|---|---|---|---|
| Operating activities: | | | |
| Net income (loss) | Ps. | 176,400 | (700,324) |
| Income taxes | | 181,421 | (301,573) |
| Employees' statutory profit sharing | | 9,260 | 14,339 |
| Items related with investing activities: | | | |
| Depreciation | | 2,777,495 | 2,524,668 |
| Amortization | | 288,303 | 331,171 |
| Loss (gain) in sale of property, system and equipment | | 16,599 | (569) |
| Equity in earnings of associated company | | 7,433 | (2,759) |
| Items related with financing activities: | | | |
| Interest expense | | 925,261 | 801,687 |
| Amortization of premium on bond issuance | | (3,571) | (4,549) |
| Cancellation of intangible assets | | 16,367 | - |
| Change in the fair value of derivative financial instruments | | (212,262) | (54,051) |
| Subtotal | | 4,182,706 | 2,608,040 |
| Increase in accounts receivable | | (259,872) | (33,017) |
| Increase in allowance for doubtful accounts | | 204,847 | 58,702 |
| (Increase) decrease in inventories | | (31,783) | 28,992 |
| Decrease (increase) in other accounts receivable | | 6,618 | (121,483) |
| (Decrease) increase in accounts payable | | (554,780) | 651,408 |
| Taxes paid | | (62,716) | (150,504) |
| Decrease in deferred revenue | | (46,140) | (93,479) |
| Increase (decrease) in other accounts payable and other liabilities | | 10,640 | (107,721) |
| Net cash flow from operating activities | | 3,449,520 | 2,840,938 |
| Investing activities: | | | |
| Acquisition and construction of property, systems and equipment, net | | (2,674,436) | (4,000,615) |
| Increase in financial instruments and other investments | | (229,090) | - |
| Other assets | | (100,513) | (19,267) |
| Net cash flow from investing activities | | (3,004,039) | (4,019,882) |
| Cash surplus to be applied in (cash to be obtained from) financing activities | | 445,481 | (1,178,944) |
| Financing activities: | | | |
| Own shares sold | | 219,662 | - |
| Own shares acquired | | - | (277,666) |
| Interest paid | | (848,240) | (715,161) |
| Long terms loans, net | | 777,967 | 215,842 |
| Change in the fair value of derivative financial instruments | | (18,392) | (114,499) |
| Net cash flow from financing activities | | 130,997 | (891,484) |
| Net increase (decrease) in cash and cash equivalents | | 576,478 | (2,070,428) |
| Adjustment to cash flow from changes in foreign exchange | | (279,814) | 1,602,127 |
| Cash and cash equivalents at beginning of year | | 1,105,576 | 1,573,877 |
| Cash and cash equivalents at the end of year | Ps. | 1,402,240 | 1,105,576 |

The accompanying notes are an integral part of the condensed 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, 2009 and 2008

(Thousands of Mexican pesos)

| | | Common stock | Additional paid-in capital | Reserves for own shares | (Deficit) | Cumulative deferred income tax effect | Change in the fair value of derivative instruments | Total stockholders' equity |
|---|---|---|---|---|---|---|---|---|
| Balances as of December 31, 2007 | Ps. | 8,870,062 | 741,671 | - | (949,610) | 132,168 | (43,945) | 8,750,346 |
| Effects of the application of FRS D-4 (note 3q) | | - | - | - | 132,168 | (132,168) | - | - |
| Absorption of accumulated deficit from prior years (note 19a) | | (1,307,987) | - | - | 1,307,987 | - | - | - |
| Reserves for own shares (note 19a) | | - | - | 440,000 | (440,000) | - | - | - |
| Own shares acquired (note 19a) | | - | - | (277,666) | - | - | - | (277,666) |
| Comprehensive loss (note 19c) | | - | - | - | (700,324) | - | 159,061 | (541,263) |
| Balances as of December 31, 2008 | | 7,562,075 | 741,671 | 162,334 | (649,779) | - | 115,116 | 7,931,417 |
| Effects of the application of FRS C-8 (notes 4d and 11) | | - | - | - | (20,209) | - | - | (20,209) |
| Own shares sold (note 19a) | | - | - | - | 219,662 | - | - | 219,662 |
| Comprehensive income (note 19c) | | - | - | - | 176,400 | - | (106,337) | 70,063 |
| Balances as of December 31, 2009 | Ps. | 7,562,075 | 741,671 | 162,334 | (273,926) | - | 8,779 | 8,200,933 |

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

December 31, 2009 and 2008

(Thousands of Mexican pesos)

## (1) Authorization and basis of presentation

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

On February 16, 2010, the Administration of the Company authorized the issuance of the accompanying consolidated financial statements and related notes thereto.

According to Mexican General Corporation Law and bylaws of the Company, the stockholders are empowered to modify the financial statements after their issuance. The accompanying financial statements will be submitted to the next Stockholders' Meeting for approval.

The accompanying consolidated financial statements have been prepared in accordance with Mexican Financial Reporting Standards (FRS) in effect as of the balance sheet date.

## (2) Description of business and significant transactions

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 notes 21 (f) and (g)). 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 September 22, 2009, the Company completed an issuance of senior unsecured notes, for an amount of U.S. $300 million with due date September 22, 2019 and with an annual interest rate of 9.0% which will be paid semiannually starting March 22, 2010. The proceeds of this issuance were used to reduce outstanding debt as described in note 15.

In order to implement its strategic plans, the Company restructured some of its operations during the year ended December 31, 2008 in some of its operational areas. The cost of this restructuring, consisting of compensation and employee severance payments amounted to Ps. 39,354, and is included in the statement of operations for the year ended December 31, 2008 as part of the other expenses.

As described in note 19, during July 2008, the Company began a shares buyback program which was approved at an ordinary shareholders' meeting held on April 23, 2008 for up to Ps. 440 million. During 2009 the totality of shares repurchased were sold again in the market.

(Thousands of Mexican pesos)

In an ordinary shareholders' meeting held on July 15, 2008, the stockholders approved the merger of Impulsora e Inmobiliaria Regional, S.A. de C.V., Adequip, S.A. de C.V., Avantel Equipos, S.A. de C.V., Avantel Recursos, S.A. de C.V., Avantel Servicios, S.A. de C.V. and Avantel Telecomunicaciones, S.A. de C.V. (as the mergers companies) with Servicios Axtel, S. A. de C. V. (as the merging company). The merger was effective among the parties and in relation with third parties since August 1, 2008 and doesn't have any impact on the operation or the consolidated figures of the Company.

## (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 in conformity with financial reporting standards requires management of the Company to make a number of estimates and assumptions that affect 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, systems and equipment, valuation allowances for receivables, inventories and deferred income tax assets; valuation of derivative instruments; and assets and obligations related to employee benefits. Due to current economic environment, actual results could differ from those estimates and assumptions. Those estimates are based on the better judgment of the management of the Company. Company's management evaluates its estimated and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment which management believes to be reasonable under the circumstances. Management adjusts the assumptions when facts and circumstances dictate.

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. $, or USD are to dollars of the United States of America.

### *(b) Recognition of the effects of inflation*

The accompanying consolidated financial statements have been prepared in accordance with financial reporting standards (FRS) in effect as of the balance sheet date and include the recognition of the effects of inflation on the financial information through December 31, 2007, based upon the Mexican National Consumer Price Index (NCPI) published by Banco de México. Cumulative inflation percentage of the three preceding years and the indexes used to recognized inflation through such year were as follows:

| December 31, | NCPI | Inflation | |
|---|---|---|---|
| | | Yearly | Cumulative |
| 2009 | 138.541 | 3.57% | 14.48% |
| 2008 | 133.761 | 6.53% | 15.01% |
| 2007 | 125.564 | 3.76% | 11.56% |

(Thousands of Mexican pesos)

### *(c) Principles of consolidation*

The consolidated financial statements include the financial statements of Axtel and its subsidiaries. All significant balances 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 as of December 31, 2009 and 2008, which were prepared in accordance with the FRS.

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

| | Main activity |
|---|---|
| Instalaciones y Contrataciones, S. A. de C. V. ("Icosa") | Administrative services |
| 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 |
| 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").

### *(d) Cash equivalents*

Cash equivalents of Ps. 1,335,670 and Ps. 989,494 at December 31, 2009 and 2008, 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 and other permanent investments*

The investment in shares of associated company is accounted for by the equity method. The other permanent investments are recorded at the acquisition cost.

***(g) Inventories and cost of sales***

Inventories are carried at the lower of cost or net realizable value. Cost of revenues include expenses related to the termination of customers' cellular and long-distance calls in other carriers' networks, as well as expenses related to billing, payment processing, operator services and our leasing of private circuit links.

***(h) Property, systems and equipment***

Property, system and equipment, including capital leases, are initially recorded at acquisition cost and until December 31, 2007, adjusted for inflation by using factors derived from the NCPI.

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.

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 10.

Leasehold improvements are amortized over the useful life of the improvement or the related contract term, whichever is shorter.

Maintenance and repairs, including the cost of replacing minor items not constituting substantial improvements 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 were restated by NCPI factors until December 31, 2007 and are amortized under the straight-line method over a period of 20 to 30 years (the initial term of the concession rights).

***(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 cities throughout the country. These expenses were capitalized, and until December 31, 2007 were adjusted for inflation based on factors derived from the NCPI and are amortized under the straight-line method over a period of 10 years (see note 11).

***(k) Other and intangible assets***

Other assets mainly include costs related to Telmex / Telnor infrastructure costs, guarantee deposits and notes issuance costs (see note 14).

As a consequence of the acquisition of Avantel and based upon calculations prepared by an independent expert appraiser, the Company recognized certain intangible assets as follows: trade name, customer relationships and concession rights (see note 13).

***(l) Employee benefits***

Termination benefits for reasons other than restructuring and retirement to which employees are entitled are charged to operations for each year, based on actuarial computations using the projected unit credit method. As of December 31, 2009 and for purposes of recognizing benefits upon retirement, the remaining average service life of employees entitled to plan benefits approximates 20.5 years.

The actuarial gain or loss is recognized directly in the results of the period as is accrued, in the case of termination benefits, and its amortized based in the remaining service life of the employees, for the retirements benefits.

***(m) Derivative financial instruments***

The Company accounts for derivatives and hedging activities in accordance with FRS C-10, which requires that all derivative instruments be recorded on the balance sheet date at their respective fair values.

The Company uses derivative financial instruments in order to manage financial exposures, especially risks associated with foreign currency and interest rates. In accordance with FRS C-10, the Company may apply hedge accounting to such instruments if it meets certain requirements and assesses whether the derivatives that are used in hedging transactions are highly effective in offsetting cash flows of hedged items. The Company accounts for the derivative financial instruments designated as hedging activities into two main classifications: (i) Fair value hedging and (ii) Cash flows hedging.

In addition, the Company has accounted for certain derivative financial instruments under the classification of trade, that did not meet the requirements for hedge accounting at fair value in the balance sheet with changes in fair value recognized directly in the income statement, even though these instruments are highly effective. These derivative instruments expired on December 15, 2008.

The Company uses financial derivative instruments that are designated as a Fair Value Hedge where the gain or loss on a derivative instrument designated and qualifying as a fair value hedging instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk shall be recognized currently in earnings in the same accounting period. For financial derivative instruments designated as a Cash Flow Hedge the effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedging instrument shall be reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged forecasted transaction affects earnings. The ineffectiveness of a gain or loss on the derivative instrument, if any, shall be recognized currently in earnings.

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 all situations in which hedge accounting is discontinued, the Company continues to carry the derivative at its fair value on the balance sheet and recognizes any subsequent changes in the fair value of the financial instrument directly in the income statement. (See note 7a).

***(n) Income taxes (IT), Assets Tax (AT), Flat Rate Business Tax (IETU) and employee statutory profit sharing (ESPS)***

Current IT, IETU and ESPS payable for the year are determined in conformity with the tax provisions in effect.

Deferred IT and from January 1, 2008 deferred IETU and ESPS' are accounted under the asset and liability method. Deferred tax and ESPS 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 in the case of income taxes, for operating loss and asset tax (AT) carryforwards. Deferred tax and ESPS 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 and ESPS assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

***(o) Inflation adjustment of capital stock, other stockholders contributions and deficit***

Until December 31, 2007, the inflation adjustment of capital stock and deficit, was determined by multiplying stockholder contributions and deficit by factors derived from the NCPI, which measure accumulated inflation from the dates such contributions were made or such deficit arose through year end 2007, date on which change was effected to a non-inflationary economy in accordance with FRS B-10 "Effects of Inflation". The resulting amounts thus obtained represented 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***

Through December 31, 2007, cumulative deferred income taxes, represented the cumulative effect of the adoption of the deferred taxes accounting standard. In 2008, such amount, for a total of 132,168, was reclassified to deficit.

***(r) Comprehensive financing result (CFR)***

The CFR includes interest income and expense, foreign exchange gain and loss and valuation effects of financial instruments, less the amounts capitalized, as part of fixed assets.

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.

***(s) Revenue recognition***

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

- *Telephony Services* -The Company generates revenue by enabling 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.
- *Activation* - At the moment of installing the service when the customer has a contract with indefinite life; otherwise is recognized according to the length 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 risk concentration***

The Company rendered services to three clients that represented approximately 22% and 23% of total net rental, installation, service and other revenues during 2009 and 2008. The Company provides an allowance for doubtful accounts based on management's analyses and estimations. The allowance expense is included as selling and administrative expenses in the consolidated statement of operations.

***(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.

***(x) Accruals***

The company recognizes, based on the administration estimates, accrual liabilities for those present obligations in which the assets transfer or rendering of services is virtually unavoidable and comes as a consequence of events in the past, mainly interests, salaries and other payments to employees.

***(y) Advertising expenses***

Advertising costs are expensed as incurred.

## (4) Accounting changes

The Mexican Board of Research and Development of Financial Reporting Standards (Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera or CINIF) has issued the following FRS, effective for years beginning on and after January 1, 2009, with the respective prospective or retrospective application being specified in each case.

***(a) FRS B-7 "Business combinations"***– FRS supersedes Bulletin B-7 and establishes, among other things, general rules for the initial valuation and recognition at the acquisition date of net assets, regarding that all business combinations should be accounted for using the purchase method. The provisions of this FRS became effective for acquisitions effected on or after January 1, 2009. Any accounting change resulting from this FRS is to be applied on a prospective basis.

The application of this FRS did not result in accounting changes to the consolidated financial statements of the Company.

*(b)* ***FRS B-8 "Consolidated or combined financial statements"–*** FRS B-8 supersedes Bulletin B-8 "Consolidated and combined financial statements and valuation of investments in shares" and establishes general rules for the preparation and presentation of consolidated and combined financial statements, and related disclosures. Amendments include:

(i) Required of consolidation of special purpose entities (SPEs) when controlled.

(ii) The possibility, under certain conditions, of presenting unconsolidated financial statements.

(iii) Consideration is given to the existence of potential voting rights that might be exercised or converted in favor of the entity in its capacity as holding Company and that may change its interference in decisionmaking at the time of assessing the existence of control.

The application of this FRS did not result in accounting changes to the consolidated financial statements of the Company.

*(c)* ***FRS C-7 "Investments in associates and other investments"–*** FRS C-7 sets forth the rules to account for investments in associates as well as other investments where control, joint control or significant influence is not exercised. The principal changes with respect to the former standard include the following:

(i) The equity method of accounting is required for SPEs where significant influence is exercised.

(ii) Consideration is given to the existence of potential voting rights that might be exercised or converted in favor of the entity in its capacity as the holding Company and that may change its interference in decision-making at the time of assessing the existence of significant influence.

(iii) A specific procedure and a limit for recognition of an associated entity's losses are provided.

The application of this FRS did not result in accounting changes to the consolidated financial statements of the Company.

*(d)* ***FRS C-8 "Intangible assets"–*** FRS C-8 supersedes Bulletin C-8 ***"Intangible Assets"*** and establishes, among other things, primarily the following revisions:

(i) Redefinition of intangible assets, establishing that separability is not the only condition for the intangible asset to be identifiable.

(ii) The acquisition cost must be considered for the initial valuation, identifying whether it is an individual acquisition, business combination or it is internally generated. Additionally, future financial benefits should be generated.

(iii) Subsequent outlays for research and developments in progress should be recorded as expenses if they are part of the research phase or recorded as an intangible asset if they meet the criteria to be recognized as such.

(iv) The presumption that the useful life of an intangible asset may not exceed twenty years was eliminated.

As a consequence of the adoption of this FRS, in 2009, the Company canceled the unamortized balance at December 31, 2008 of the pre-operating capitalized costs until December 31, 2002 for an amount of Ps. 19,436, net of deferred income taxes for an amount of Ps. 7,558, against deficit without restating the financial statements of previous years. In addition the Company Conectividad Inalambrica 7 GHz, S.de R.L., recognized using the equity method, cancelled Ps. 1,546, net of deferred income taxes for an amount of Ps. 312.

## (5) Foreign currency exposure

Monetary assets and liabilities denominated in dollars as of December 31, 2009 and 2008 are as follows:

| | (Thousands of dollars) | |
|---|---|---|
| | **2009** | **2008** |
| Current assets | 94,360 | 76,762 |
| Current liabilities | (138,535) | (126,564) |
| Long-term liabilities | (617,908) | (571,209) |
| Foreign currency liability position, net | (662,083) | (621,011) |

The U.S. dollar exchange rates as of December 31, 2009 and 2008 were Ps. 13.05 and Ps. 13.53, respectively. As of February 16, 2010, the exchange rate was Ps. 12.98.

As of December 31, 2009, the Company had foreign exchange derivative instruments (see note 7).

Following is a summary for the years ended December 31, 2009 and 2008, of transactions carried out with foreign entities, excluding imports and exports of systems and equipment:

| | (Thousands of dollars) | |
|---|---|---|
| | **2009** | **2008** |
| Interest expense | 58,863 | 57,636 |
| Commissions | 412 | 50 |
| Administrative and technical advisory services | 4,094 | 6,240 |
| Cost of services | 7,526 | 12,435 |
| | 70,895 | 76,361 |

(Thousands of Mexican pesos)

## (6) Accounts receivable

Accounts receivable consist of the following:

| | | 2009 | 2008 |
|---|---|---|---|
| Trade | Ps. | 3,509,743 | 3,249,872 |
| Less allowance for doubtful accounts | | 1,658,055 | 1,453,208 |
| Accounts receivable, net | Ps. | 1,851,688 | 1,796,664 |

The activity in the allowance for doubtful accounts for the years ended December 31, 2009 and 2008 was as follows:

| | | 2009 | 2008 |
|---|---|---|---|
| Balances at beginning of year | Ps. | 1,453,208 | 1,394,506 |
| Bad debt expense | | 204,847 | 193,800 |
| Adjustment to bad debt expense from previous years | | - | (135,098) |
| Balances at year end | Ps. | 1,658,055 | 1,453,208 |

## (7) Financial instruments

### (a) Derivative Financial instruments

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

For derivative financial instruments that are designated as hedging activities, the Company and its subsidiaries formally document the hedging relationship and its risk management objective and strategy for undertaking the hedge, the hedging instrument, the hedged item, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed and the methodology to measure the ineffectiveness.

The Company and its subsidiaries undertake prospective and retrospective tests of effectiveness to ascertain in every moment whether the hedging employed remains effective according to applicable accounting standards. At the moment that ineffectiveness is detected the Company registers that amount in the results as part of the CFR. Due to the fact that the fair value of derivative financial instruments may suffer significant fluctuations, it is very probable that the Company will be exposed to the volatility related to unrealized profits and losses due to the changes in the fair value of derivative financial instruments in the future.

**Derivative financial instruments with hedging purposes**

According to the accounting models for hedging activities that are permitted by financial accounting standards, the dimension, risks and estimated impact in the balance sheet or income statement of the following derivative financial instruments are presented below. In contrast to financial instruments with trading purposes, the derivatives designated as hedges do not generate volatility in the income statement, as long as the instruments are highly effective and continue to meet the financial accounting standards to keep the classification as hedging activities:

**Fair value hedge**

i) On March 22, 2007, the Company contracted a CCS (Currency Swap) to cover the risk of interest rate and exchange rate generated by the syndicated term loan for U.S. $110.2 million, which matures in February 2012, in which the Company will receive payments of 3 months Libor plus 150 basis points over U.S. $110.2 million notional and will pay a monthly rate of TIIE 28 days plus 135 basis points over Ps. 1,215.5 notional which includes the amortizations of principal. This transaction for its characteristics, is registered under the fair value hedge accounting model. During the month of September 2009 the Company prepaid U.S. $85 million of the portion in U.S. dollars of the syndicated loan, the respective hedge was canceled, and the fair value of such positions was used in a new financial instrument that it is mentioned in the following paragraphs. The CCS information is as follows:

**(Amounts in charts are expressed in millions)**

| | | | Estimated fair value (USD) | |
|---|---|---|---|---|
| **Counterpart** | **Notional** | **Conditions** | **2009** | **2008** |
| Credit Suisse | Ps. 278 MXP<br>$25.2 USD | The Company pays TIIE + 135 basis points and receives Libor + 150 basis points | $ 3.9 | $ 23.3 |

For the year ended December 31, 2009 the change in the fair value of the hedging activity of the syndicated term loan resulted in an unrealized loss amount of U.S. $7.0 million recognized in the comprehensive financial result, offset it by the change in the fair value of the debt valuated at December 31, 2009 in U.S. $16.1 million.

**Cash flow hedge**

i) 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. This swap was made to cover 65% of the debt. 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.1,270.0 (nominal value) at annual rate of 12.30%. This derivative instrument expired on December 15, 2008.

ii) 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. 1,480.4 (nominal value) at annual rate of 12.26%. This derivative instrument expired on December 15, 2008.

iii) In August 2007, the Company issued senior unsecured notes for U.S. $ 275 million on a fixed rate. The Company decided to enter into a new derivative to cover the risk of exchange rate derived from this issuance denominated ("Currency Swap"). 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. 3,038.75 (nominal value) at a fixed annual rate of 8.54%.

As of December 31, 2009, the *CCS* information is as follows:

**(Amounts in charts are expressed in millions)**

| | | | Estimated fair value (USD) | |
|---|---|---|---|---|
| **Counterpart** | **Notional** | **Basic conditions** | **2009** | **2008** |
| Credit Suisse | Ps. 3,039 MXP<br>$275 USD | The Company pays fixed annual rate of 8.54% and receives fixed annual rate of 7.625% | $. 4.3 | $ 12.4 |

iv) In September 2009, the Company issued senior unsecured notes for U.S. $ 300 million on a fixed rate. The Company decided to cover the risk of exchange rate derived from this issuance with some derivative financial instruments denominated "Currency Swap". Under these agreements, Axtel will receive and will make payments detailed in the following table:

**(Amounts in charts are expressed in millions)**

| Counterpart | Notional | Conditions | Estimated Fair Value (USD) 2009 |
|---|---|---|---|
| Credit Suisse | Ps. 1,623 MXP<br>$125 USD | The Company pays fixed rate in pesos of 7.696% and receives fixed rate in usd of 9.00% | $11.9 |
| Deutsche Bank | Ps. 1,320 MXP<br>$100 USD | The Company pays fixed rate in pesos of 10.107% and receives fixed rate in usd of 9.00% | ($1.4) |
| Merrill Lynch | Ps. 658 MXP<br>$50 USD | The Company pays fixed rate in pesos of 10.0825% and receives fixed rate in usd of 9.00% | ($0.5) |
| Morgan Stanley | Ps. 327 MXP<br>$25 USD | The Company pays fixed rate in pesos of 10.080% and receives fixed rate in usd of 9.00% | ($0.2) |

For the year ended December 31, 2009, the change in the fair value of these CCS is an unrealized gain amount of U.S. $9.52 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 contracts for derivative financial instruments for any purpose other than hedging. The Company does not speculate using financial instruments. 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. 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 CCS (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. This derivative instrument expired on December 15, 2008.

**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 U.S. $0.1 million from embedded derivatives effects during 2009 in the accounting records.

**(b) Other financial instruments.**

During the months of July, August and September of 2009, the Company acquired call options denominated "Zero Strike Call" that have a notional of 26,096,700 CPOs of Axtel. The underlying of these instruments is the market value of the CPOs before indicated. The premium paid was equivalent to the market value of the notional plus fees. The strike price established was 0.000001 pesos per option. This instrument is redeemable in cash and not in kind. These are American options. At the Company's decision, they can be exercised at any time, for a six months period and are extendable. The position is detailed in the following table:

| Counterparty | Notional | Conditions | Fair value (Millions of pesos) 2009 |
|---|---|---|---|
| Bank of America Merrill Lynch | 26,096,700 CPOs | The Company receives in cash the market value of the notional | Ps. 309.5 |

At the year ended December 31, 2009 the change in the fair value of the Zero Strike Call resulted in an unrealized gain of Ps. 86,911 recognized in the CFR.

## (8) Related parties transactions and balances

The transactions with related parties during the years ended December 31, 2009 and 2008, are mainly with Banamex, and are as follows:

| | | 2009 | 2008 |
|---|---|---|---|
| Telecommunication services revenue | Ps. | 561,145 | 606,965 |
| Commissions and administrative services | | 11,406 | 11,960 |
| Interest expense | | 29,176 | 39,983 |
| Rent expense | | 15,145 | 25,757 |
| Deferred revenue | | 423,843 | 439,077 |
| Installations services expense | | 26,122 | 9,984 |
| Others | | 40,280 | 36,784 |

The balances with related parties as of December 31, 2009 and 2008, included in accounts payable are as follows:

| | | 2009 | 2008 |
|---|---|---|---|
| Due to: | | | |
| GEN Industrial, S.A. de C.V. | Ps. | 132 | 84 |
| Instalaciones y Desconexiones Especializadas, S.A. de C.V. | | - | 3,191 |
| Neoris de Mexico, S.A. de C.V. | | - | 14,191 |
| Total | Ps. | 132 | 17,466 |

(Thousands of Mexican pesos)

Compensation paid to key directors for the years ended December 31, 2009 and 2008 amounted to approximately Ps. 64 million and Ps. 51 million, respectively. At December 31, 2009 the Company has debt as described in note 15.

## (9) Inventories

Inventories consist of the following:

| | | 2009 | 2008 |
|---|---|---|---|
| Telephones and call identification devices | Ps. | 19,849 | 12,383 |
| Installation material | | 32,731 | 32,069 |
| Tools | | 19,745 | 13,854 |
| Network spare parts | | 27,156 | 30,476 |
| Others | | 71,200 | 50,116 |
| Total inventories | Ps. | 170,681 | 138,898 |

## (10) Property, systems and equipment

Property, systems and equipment are as follows:

| | | 2009 | 2008 | Useful lives |
|---|---|---|---|---|
| Land | Ps. | 167,331 | 167,331 | |
| Building | | 263,659 | 263,659 | 25 years |
| Computer and electronic equipment | | 2,482,616 | 2,192,657 | 3 years |
| Transportation equipment | | 200,373 | 143,013 | 4 years |
| Furniture and fixtures | | 183,577 | 169,238 | 10 years |
| Network equipment | | 23,408,327 | 20,692,528 | 6 to 28 years |
| Leasehold improvements | | 372,363 | 343,270 | 5 to 14 years |
| Construction in progress | | 1,981,971 | 2,418,684 | |
| Advances to suppliers | | 14,128 | 61,803 | |
| | | 29,074,345 | 26,452,183 | |
| Less accumulated depreciation | | 13,863,726 | 11,145,735 | |
| Property, systems and equipment, net | Ps. | 15,210,619 | 15,306,448 | |

The Company has capitalized CFR as a complement of the acquisition cost, of Ps. 23,830 and Ps. 150,061 for the years ended December 31, 2009 and 2008, respectively.

As of December 31, 2009, certain financial leases amounting to approximately Ps. 12 million were guaranteed with the equipment acquired with those leases.

(Thousands of Mexican pesos)

## (11) Pre-operating expenses

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:

| | | 2009 | 2008 |
|---|---|---|---|
| Operating expenses | Ps. | 32,330 | 96,649 |
| Salaries | | 24,933 | 231,963 |
| Legal and financial advisory | | - | 118,238 |
| Depreciation | | - | 10,275 |
| Comprehensive financing result | | - | (25,929) |
| Service and other revenues | | - | (14,657) |
| Other | | 3,341 | 40,880 |
| | | 60,604 | 457,419 |
| Less accumulated amortization | | 26,297 | 393,299 |
| Pre-operating expenses, net | Ps. | 34,307 | 64,120 |

As a consequence of the adoption of FRS C-8 in 2009 the Company canceled the unamortized balance at December 31, 2008 of the pre-operating expenses capitalized costs until December 31, 2002 for an amount of Ps. 19,436, net of deferred income tax for an amount of Ps. 7,558, against deficit, without a restatement of the financial statements of previous years.

## (12) Investment in shares of associated company and other permanent investments

As of December 31, 2009, 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 requested the concession.

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

(Thousands of Mexican pesos)

Condensed financial information of the associated company as of December 31, 2009 and 2008 is as follows:

| Balance Sheet: | | **2009** | **2008** |
|---|---|---|---|
| Current assets | Ps. | 7,952 | 20,436 |
| Intangible assets | | 12,901 | 15,868 |
| Total assets | | 20,853 | 36,304 |
| Total liabilities | | 1,250 | 287 |
| Stockholders' equity | Ps. | 19,603 | 36,017 |
| 50% equity interest | Ps. | 9,802 | 18,008 |
| Statement of operations: | | | |
| Revenues from rent of frequency bands | Ps. | - | 7,510 |
| Costs of services and operating expenses | | (1,108) | (2,010) |
| Operating (loss) income | | (1,108) | 5,500 |
| Other expenses | | (14,940) | (7) |
| Comprehensive financial results | | 14 | 26 |
| Deferred income tax | | 1,168 | - |
| Net (loss) income | Ps. | (14,866) | 5,519 |
| Equity in income of associated company | Ps. | (7,433) | 2,759 |

As of December 31, 2008, the liabilities of the Company with Conectividad Inalámbrica were Ps. 13,053.

**Other permanent investments**

The other permanent investments are as follows:

| **December 31, 2009** | | **Acquisition cost** |
|---|---|---|
| Eden Rock Communications | Ps. | 6,493 |

(Thousands of Mexican pesos)

## (13) Intangible assets

Intangible assets with defined useful lives consist of the following:

| | | **2009** | **2008** |
|---|---|---|---|
| Telephone concession rights Axtel | Ps. | 1,073,135 | 1,073,135 |
| Telephone concession rights Avantel | | 114,336 | 114,336 |
| Customers relationships | | 324,183 | 324,183 |
| Trade name "Avantel" | | 186,074 | 186,074 |
| | | 1,697,728 | 1,697,728 |
| Less accumulated amortization | | 1,114,946 | 877,409 |
| Intangible assets, net | Ps. | 582,782 | 820,319 |

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);
- 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; and
- Prepaid phone cards or credit phone cards

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

On September 15, 2009, SCT granted the Company a concession to install, operate and exploit a public telecommunications network to provide satellite television and audio services.

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”, customer relationships and telephone concession rights, whose value were 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 customer relationships are amortized over a three-year period; meanwhile the concession is amortized over the remaining term of the concession on a straight-line basis. As of December 31, 2009 the values of the trade name “Avantel” and of customer relationships were totally amortized.

(Thousands of Mexican pesos)

## (14) Other assets

Other assets consist of the following:

| | | 2009 | 2008 |
|---|---|---|---|
| Notes issuance costs | Ps. | 131,348 | 143,730 |
| Long-term prepaid expenses | | 85,054 | 92,003 |
| Telmex / Telnor infrastructure costs | | 68,279 | 68,279 |
| Guarantee deposits | | 43,730 | 38,003 |
| Deferred financing costs | | 41,016 | 41,016 |
| World Trade Center concession rights | | 22,474 | 22,474 |
| Others | | 107,520 | 110,087 |
| | | 499,421 | 515,592 |
| Less accumulated amortization | | 149,567 | 175,818 |
| Other assets, net | Ps. | 349,854 | 339,774 |

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. During 2009, derived from the prepayment of debt mentioned in note 15, the Company cancelled approximately Ps. 99,536 of note issuance costs related to those obligations less their accumulated amortization of Ps. 71,408.

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 investments in infrastructure that Telmex / Telnor made in order to provide interconnection for the new telephone companies in Mexico. These costs are amortized over a period of fifteen years.

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.

(Thousands of Mexican pesos)

## (15) Long-term debt

Long-term debt as of December 31, 2009 and 2008 consist of the following:

| | | 2009 | 2008 |
|---|---|---|---|
| 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. | 3,591,143 | 3,723,033 |
| U.S. $300,000,000 in aggregate principal amount of 9% Senior Unsecured Notes due 2019. Interest is payable semiannually in arrears starting on March 22, 2010. | | 3,917,610 | - |
| 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. Prepaid during the months of September and December 2009. | | - | 2,199,973 |
| Premium on Senior Notes issuance originated on the Senior Unsecured Notes with an aggregate principal of 162,500,000 with an interest rate of 11%, due 2013, was prepaid during the months of September and December 2009. | | - | 22,743 |
| 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. | | 1,371,770 | 2,534,623 |
| Change in the fair value of syndicated loan (See note 7(a)) | | 39,740 | 250,083 |
| Capacity lease agreement with Teléfonos de Mexico, S.A.B. de C.V. of approximately Ps. 800,000 payable monthly and expiring in 2011. | | 280,336 | 415,184 |
| Other long-term financing with several credit institutions with interest rates fluctuating between 3.60% and 7.20% for those denominated in dollars and TIIE (Mexican average interbank rate) plus 1.5 and 3 percentage points for those denominated in pesos. | | 691,604 | 508,931 |
| Total long-term debt | | 9,892,203 | 9,654,570 |
| Less current maturities | | 944,553 | 296,106 |
| Long-term debt, excluding current maturities | Ps. | 8,947,650 | 9,358,464 |

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

Notes to the Consolidated Financial Statements

(Thousands of Mexican pesos)

Annual installments of long-term debt are as follows:

| **Year** | | **Amount** |
|---|---|---|
| 2011 | Ps. | 896,309 |
| 2012 | | 433,909 |
| 2013 | | 68,940 |
| 2017 and thereafter | | 7,548,492 |
| | Ps. | 8,947,650 |

Most significant changes in the long-term debt during 2009 and 2008 are as follows:

On September 22, 2009, the Company issued U.S. $300 million of 10-year 9% unsecured senior notes. The notes mature on September 22, 2019. Interest will be payable semiannually and the senior notes bear interest at 9.0% commencing on March 22, 2010. The proceeds of this issuance were used to prepay the debt described as follows:

(1) During the months of September, October and December of 2009, the Company redeemed U.S. $162.5 million aggregate principal amount of its 11% Senior Unsecured Notes due 2013 equal to 100% of the remaining balance. The redemption was realized as follows:

Amounts in millions of USD:

| Date | | Amount | Price |
|---|---|---|---|
| September 22, 2009 | $ | 128.5 | 105.750% |
| October 1, 2009 | | 2.2 | 102.750% |
| December 15, 2009 | | 31.8 | 103.667% |
| | $ | 162.5 | |

(2) Additionally, the Company paid all accrued interest at the date of redemption. The premium paid in these transactions was U.S. $8.6 million, which was included in the comprehensive financial result ("CFR").

(3) On September 25, 2009, the Company prepaid U.S. $85.0 million of the portions in USD of the Syndicated Loan, including accrued interest at the date of redemption.

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 $7^{5}/_{8}$% 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. All the subsidiaries of Axtel are guarantors for this issuance.

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, 2009, the Company was in compliance with all of its covenants.

(Thousands of Mexican pesos)

## (16) Other accounts payable

As of December 31, 2009 and 2008 other accounts payable consist of the following:

| | | 2009 | 2008 |
|---|---|---|---|
| Guarantee deposits (note 21(c)) | Ps. | 169,763 | 175,998 |
| Interest payable (note 21(c)) | | 108,925 | 103,709 |
| Guarantee deposit (SR Telecom) | | 10,300 | 10,678 |
| Other | | 82,515 | 67,629 |
| | Ps. | 371,503 | 358,014 |

## (17) Employee benefits

The cost, obligations and other elements of pensions, seniority premiums and severance compensations plans for reasons other then restructuring have been determined based on computations prepared by independent actuaries at December 31, 2009 and 2008. The components of the net periodic cost for the years ended December 31, 2009 and 2008 are as follows:

| | | 2009 | | |
|---|---|---|---|---|
| | | Termination | Retirement | Total |
| Net periodic cost: | | | | |
| Service cost | Ps. | 9,917 | 626 | 10,543 |
| Interest cost | | 4,946 | 288 | 5,234 |
| Amortization of transition obligations | | 2,300 | - | 2,300 |
| Amortization of prior service cost and plan modifications | | (3,596) | (27) | (3,623) |
| Net periodic cost | Ps. | 13,567 | 887 | 14,454 |

| | | 2008 | | |
|---|---|---|---|---|
| | | Termination | Retirement | Total |
| Net periodic cost: | | | | |
| Service cost | Ps. | 9,231 | 500 | 9,731 |
| Interest cost | | 3,884 | 192 | 4,076 |
| Amortization of transition obligation | | 2,301 | - | 2,301 |
| Variances in assumptions and experience adjustments | | (2) | 23 | 21 |
| Amortization of prior service cost and plan modifications | | (3,596) | (27) | (3,623) |
| Prior service cost (2007 unamortized items) | | 4,136 | - | 4,136 |
| Net periodic cost | Ps. | 15,954 | 688 | 16,642 |

(Thousands of Mexican pesos)

The actuarial present value of benefit obligations of the plans at December 31, 2009 is as follows:

| | | 2009 | | |
|---|---|---|---|---|
| | | **Termination** | **Retirement** | **Total** |
| Accumulated benefit obligation (ABO) | Ps. | 51,021 | 8 | 51,029 |
| Projected benefit obligation (PBO) | Ps. | 63,055 | 3,388 | 66,443 |
| Unrecognized items: | | | | |
| Transition asset | | (6,903) | - | (6,903) |
| Variances in assumptions | | 10,788 | 494 | 11,282 |
| Actuarial loss | | - | (192) | (192) |
| Net projected liability | Ps. | 66,940 | 3,690 | 70,630 |

The actuarial present value of benefit obligations of the plans at December 31, 2008 is as follows:

| | | 2008 | | |
|---|---|---|---|---|
| | | **Termination** | **Retirement** | **Total** |
| Accumulated benefit obligation (ABO) | Ps. | 55,238 | - | 55,238 |
| Projected benefit obligation (PBO) | Ps. | 55,238 | 2,759 | 57,997 |
| Unrecognized items: | | | | |
| Transition asset | | (9,204) | - | (9,204) |
| Variances in assumptions | | 14,385 | 521 | 14,906 |
| Actuarial loss | | - | (354) | (354) |
| Net projected liability | Ps. | 60,419 | 2,926 | 63,345 |

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

| | **2009** | **2008** |
|---|---|---|
| Discount rate (net of inflation) used to reflect the present value of obligations | 8.50% | 8.00% |
| Rate of increase in future salary levels | 5.50% | 5.00% |
| Amortization period of unrecongized items | 5 years | 5 years |
| Average remaining labor life of employees | 20.5 years | 20.6 years |

(Thousands of Mexican pesos)

## (18) Income (IT) and asset taxes (AT), Flat Tax (IETU) and employee statutory profit sharing (ESPS).

According to the actual tax laws, companies will be required to pay the greater of their IETU or IT. If IETU is payable, the payment will be considered final and not subject to recovery in subsequent years. The actual IT tax law on December 31, 2009, establish a rate applicable of 28% and, according to the actual tax laws and beginning January 1, 2010, the IT rate is 30% from 2010 to 2012, 29% for 2013 and 28% for 2014 and thereafter. The IETU rate is 17% for 2009 and 17.5% for 2010 and thereafter.

According to financial accounting standards, management performed an evaluation of the tax that the Company and its subsidiaries will be subject for the years ended December 31, 2009 and 2008. The Company determined that certain subsidiaries will be subject to IETU. As a result, the Company canceled IT recorded for an amount of Ps. 214,003 and registered deferred IETU for an amount of Ps. 32,046 as of December 31, 2008. For presentation purposes of deferred taxes, deferred IETU and IT are presented jointly.

The income tax expense attributable to income (loss) before income taxes differed from the amounts computed by applying the Mexican statutory rates of 28% for IT to income (loss), as a result of the items mentioned below:

| | | 2009 | 2008 |
|---|---|---|---|
| Computed "expected" tax (expense) benefit | Ps. | (102,271) | 281,304 |
| Increase (decrease) resulting from: | | | |
| Effects of inflation, net | | 124,088 | 210,221 |
| Change in valuation allowance | | (119,882) | 86,450 |
| Accelerated depreciation | | - | (76,829) |
| Non-deductible expenses | | 9,958 | (22,903) |
| Deferred IETU | | 11,127 | 32,046 |
| Cancellation of the deferred IT | | - | (214,003) |
| Expired operating loss carryforwards | | (154,250) | - |
| Adjustments to deferred tax assets and liabilities for enacted changes in tax rates | | 44,114 | - |
| Other | | 5,695 | 5,287 |
| IT and IETU (expense) benefit | Ps. | (181,421) | 301,573 |

(Thousands of Mexican pesos)

The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31, 2009 and 2008 are presented below:

| | | 2009 | 2008 |
|---|---|---|---|
| Deferred tax assets: | | | |
| Net operating loss carryforwards | Ps. | 726,134 | 1,071,970 |
| Allowance for doubtful accounts | | 432,925 | 363,091 |
| Accrued liabilities and others | | 136,986 | 169,693 |
| Recoverable AT | | 382,104 | 423,003 |
| Deferred IETU | | 61,098 | 32,046 |
| Premium on bond issuance | | - | 2,656 |
| Property, systems and equipment | | 422,543 | 55,459 |
| Total gross deferred tax assets | | 2,161,790 | 2,117,918 |
| Less valuation allowance | | 726,245 | 606,363 |
| Net deferred tax assets for IT and Deferred IETU | | 1,435,545 | 1,511,555 |
| Deferred tax liabilities: | | | |
| Telephone concession rights | | 149,889 | 211,331 |
| Fair value of derivative instruments | | 58,067 | 45,339 |
| Intangible and other assets | | 77,082 | 62,562 |
| Total deferred tax liabilities | | 285,038 | 319,232 |
| Deferred tax assets, net for IT and deferred IETU | Ps. | 1,150,507 | 1,192,323 |

The rollforward for the net deferred tax asset for the years ended December 31, 2009 and 2008 is presented below:

| | | 2009 | 2008 |
|---|---|---|---|
| Balances at beginning of year | Ps. | 1,192,323 | 936,089 |
| Deferred IT (expense) benefit | | (119,431) | 286,045 |
| Deferred IETU benefit | | 29,052 | 32,046 |
| Deferred IT from the application effect of FRS C-8 | | 7,558 | - |
| Deferred IT of derivative financial instruments | | 41,005 | (61,857) |
| Balances at end of year | Ps. | 1,150,507 | 1,192,323 |

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 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. 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, 2009. 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.

(Thousands of Mexican pesos)

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, 2009, the tax loss carryforwards and AT pending of recovery expire as follows:

| Year | | Inflation-adjusted tax loss carryforwards | Tax on assets |
|---|---|---|---|
| 2010 | Ps | 403,238 | - |
| 2011 | | 156,547 | 75,478 |
| 2012 | | 424,919 | 52,962 |
| 2013 | | 497,554 | 83,367 |
| 2014 | | 98,989 | 80,010 |
| 2015 | | - | 34,370 |
| 2016 | | 21,648 | 29,776 |
| 2017 | | - | 77,855 |
| 2018 | | 965,902 | - |
| | Ps. | 2,568,797 | 433,818 |

Tax loss carry forwards and AT pending of recovery includes Ps. 125,166 and Ps. 51,714, respectively from companies in which deferred IETU was calculated.

The tax effects of temporary differences that gave rise to deferred employee's profit sharing as of December 31, 2009 and 2008 are presented below:

| | | 2009 | 2008 |
|---|---|---|---|
| Deferred ESPS assets: | | | |
| Accrued liabilities | Ps. | 2,016 | 1,606 |
| Accrued for labor obligations | | 7,063 | 6,334 |
| Other payroll accruals | | 4,352 | 3,808 |
| Net deferred ESPS asset | | 13,431 | 11,748 |
| Deferred ESPS liabilities: | | | |
| Deferred income | | 2,079 | 1,243 |
| Property, systems and equipment | | 907 | 2,481 |
| Other | | 738 | 209 |
| Total deferred ESPS liability | | 3,724 | 3,933 |
| Deferred ESPS asset, net | Ps. | 9,707 | 7,815 |

(Thousands of Mexican pesos)

The rollforward for the net deferred employee's profit sharing asset for the years ended December 31, 2009 and 2008 is presented below:

| | | 2009 | 2008 |
|---|---|---|---|
| Balances at beginning of year | Ps. | 7,815 | 14,180 |
| Deferred ESPS benefit (expense) | | 1,892 | (6,365) |
| Balances at end of year | Ps. | 9,707 | 7,815 |

As of December 31, 2009 and 2008 employee's profit sharing was Ps.11,152 and Ps.7,974, respectively.

## (19) Stockholders' equity

The principal characteristics of stockholders' equity are described below:

### *(a) Capital stock structure*

At December 31, 2009, 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, 2009 the Company has only issued Class "I" shares. Also, at December 31, 2009 all shares issued are part of the fixed portion.

The following represents a rollforward of Company's shares for the years ended December 31, 2009 and 2008:

| | Subscribed and paid shares | | Common stock | Additional paid-in capital |
|---|---|---|---|---|
| Balances as of December 31, 2007 | 8,769,353,223 | Ps. | 8,870,062 | 741,671 |
| Absorption of accumulated deficit from prior years in 2008 | - | | (1,307,987) | - |
| Balances as of December 31, 2008 and 2009 | 8,769,353,223 | Ps. | 7,562,075 | 741,671 |

As of December 31, 2009 and 2008, 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.

At an ordinary stockholders meeting held on April 23, 2008, the stockholders approved the reduction of the caption named "Restatement of capital stock" on Ps. 1,307,987 to reclassify the absorption of accumulated deficit of prior years.

(Thousands of Mexican pesos)

During July 2008 the Company began a own shares repurchase program which was approved at an ordinary shareholders' meeting held on April 23, 2008 for up to Ps. 440 million. As of December 31, 2008 the Company had repurchased 26,096,700 CPO's (182,676,900 shares). During the months of July, August and September the CPOs purchased through the repurchase program were resold in the market.

The 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, the Company obtained stockholder approval (i) to increase its capital by issuing Series B Shares in a number that was sufficient for Tel Holding to subscribe and pay 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 by Tel Holding and any shares subscribed 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, the Company received 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.

### *(b) Stockholders' equity restrictions*

Stockholders' contributions, restated for inflation as provided in the tax law, totaling Ps. 7,701,697 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 15 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 FRS, are reported directly in stockholders' equity, except for net income.

| | | 2009 | 2008 |
|---|---|---|---|
| Net income (loss) | Ps. | 176,400 | (700,324) |
| Fair value of derivative instruments | | (147,342) | 220,918 |
| Deferred IT of derivative financial instruments | | 41,005 | (61,857) |
| Comprehensive income (loss) | Ps. | 70,063 | (541,263) |

(Thousands of Mexican pesos)

## (20) Telephone services and related revenues

Revenues consist of the following:

| | | 2009 | 2008 |
|---|---|---|---|
| Local calling services | Ps. | 4,649,467 | 5,242,577 |
| Long distance services | | 1,188,669 | 1,286,127 |
| Data services | | 2,451,951 | 2,500,473 |
| International traffic | | 1,323,810 | 982,937 |
| Other services | | 1,354,980 | 1,560,287 |
| | Ps. | 10,968,877 | 11,572,401 |

## (21) Commitments and contingencies

As of December 31, 2009, the Company has the following commitments and contingencies:

(a) On September 1, 2008, the Ministry of Communications and Transport (*Secretaría de Comunicaciones y Transportes* "SCT"), issued four rulings resolving four administrative review proceedings regarding interconnection disagreements that were previously filed before the Federal Telecommunications Commission (*Comisión Federal de Telecomunicaciones* "COFETEL") against the following companies: Radiomovil Dipsa, S.A. de C.V. ("Telcel"), Iusacell PCS, S.A. de C.V. and others ("Grupo Iusacell"), Pegaso PCS, S.A. de C.V. and others ("Grupo Telefonica") and Operadora Unefon, S.A. de C.V. ("Unefon").

The resolutions issued by the SCT, consider, firstly, the application of new rates regarding consumption beginning in September 2008, and secondly, the retroactive application of those rates. In the case of Telcel being effective since January 1, 2008, and for the case of the other mobile operators (Grupo Iusacell, Grupo Telefonica and Unefon), being effective since October 2006.

Therefore, effective as of September 2008, the mobile carriers are obligated to bill the Company for the termination of calls in mobile phones under the modality of "Calling Party Pays" according to the terms of the resolutions (using rates based on the real duration of the call), and in addition, according to such resolutions, the Company could claim the amounts that the Company has paid in excess during the periods referred to under the resolutions mentioned, that is, the difference between the interconnection rates applied by the mobile carriers and paid by the Company during such period, and the rates established by the SCT in the resolutions.

As of December 31, 2009, according to the resolutions of the SCT and using some preliminary information of the Company, both Axtel and Avantel would have paid in excess to Telcel approximately the amount of Ps. 397.7 million, and to the rest of the mobile operators, the amount of Ps. 396.6 million, as shown in the following table:

**Telcel**

| | | Axtel | Avantel | Total |
|---|---|---|---|---|
| 2006 | | - | - | - |
| 2007 | | - | - | - |
| January - July 2008 | Ps. | 355.0 | 42.7 | 397.7 |
| Total | Ps. | 355.0 | 42.7 | 397.7 |

**Other Operators**

| | | Axtel | Avantel | Total |
|---|---|---|---|---|
| 2006 | Ps. | 53.5 | 7.7 | 61.2 |
| 2007 | | 181.7 | 25.9 | 207.6 |
| January – July 2008 | | 112.8 | 15.0 | 127.8 |
| Total | Ps. | 348.0 | 48.6 | 396.6 |

As a result of the resolutions issued by the SCT, the Company acknowledged that since August 2008 and thereafter, the interconnection rate for termination authorized for 2008, was of Ps. 0.5465 per minute for Telcel and Ps. 0.6032 per minute for the rest of the carriers; and the authorized rates for 2009 were Ps. 0.5060 per real minute for Telcel, and Ps. 0.6032 per real minute for the rest of the carriers. Applying the concept of non-discriminatory treatment, Avantel also adopted the rates mentioned above. The rates that Axtel and Avantel were paying before the resolutions, amounted to Ps. 1.3216 for each real minute for Telcel and Ps. 1.21 for each rounded minute for the rest of the mobile carriers. Nevertheless, the mobile carriers remain invoicing the Company for the termination of traffic under the modality of "Calling Party Pays" applying the rates previous to the resolutions mentioned above. As of December 31, 2009, the difference between the amounts paid by the Company according to the new rates established by the SCT, and the amounts invoiced by the mobile carriers, amounted to approximately Ps. 950 million not including Value Added Tax.

The Company is aware that Telcel and the other mobile carriers have filed before the Federal Courts, their non-conformity with respect to the resolutions issued by the SCT mentioned, and there is a contingency for the Company (Axtel and Avantel) in case that the Courts rule against these resolutions, and that as a result, different rates are established in comparison to those established by the SCT. The contingency would be the difference between the rates established by SCT, and those rates established by the Courts under the respective resolutions, such contingency in case that these rates are higher than Ps. 0.5465 for each real minute for Telcel and Ps. 0.6032 for each real minute for the rest of the mobile carriers. The Company's management believes that the Company has the necessary elements to prevail under these proceedings before the Court, therefore, since August 2008 and thereafter, it has recognized the cost based on Ps. 0.5465 per each real minute for Telcel and Ps. 0.6032 per each minute for the rest of the mobile carriers.

With respect to the possibility of the Company to recover the payments made in excess of applicable amounts due under the resolutions for periods prior to August 2008, it is important to mention that collection or recovery of such amounts is not automatic, therefore, in order to collect or recover, among other alternatives, the Company may initiate ordinary mercantile trials against the mobile carriers. In this case any claimed amounts by the Company in such litigation will be subject to the interpretation of the Judges based upon the evidence and documents presented by the parties, that in case that the Company decides to follow this alternative. The above mentioned, considering the characteristics and complexity of the resolutions of the SCT and their effects, plus the fact that there is little or no precedents, it is very likely that these proceedings will be lengthy. As of December 31, 2009, the Company has not recognized the benefit of any such possible recovery.

After evaluating the actual status of the foregoing proceedings and according to the available information and information provided by the legal advisors, the management of the Company considers that there are enough elements to maintain the actual accounting treatment, and that at the end of the legal process the interests of the Company will prevail.

The management of the Company aware of the fact that Telcel and the other mobile operators have asked the federal courts for the suspension of the resolutions by the SCT, but those suspensions are still not binding or compulsory for the Company, except for the case of Grupo Telefonica, which suspension was served to the Company, nevertheless, it ceased to be in effect due to the fact that the Company decided to present a bail. Due to the above, the actual interconnection rates applicable to the Company are the ones established in the SCT's resolution dated September 1 2008.

(b) In March 2009, the COFETEL resolved an interconnection disagreement proceeding existing between the Company (Axtel) and Teléfonos de México, S.A.B. de C.V. ("Telmex") related to the rates for the termination of long distance calls from the Company to Telmex with respect to year 2009. In such administrative resolution, the COFETEL approved a reduction in the rates for termination of long distance calls applicable to those cities where Telmex does not have interconnection access points. These rates were reduced from Ps. 0.75 per minute to US$0.0105 or US$0.0080 per minute depending on the place where the Company delivers the long distance call.

Nevertheless, Telmex remains invoicing the Company for the termination of long distance calls applying the rates that were applicable prior to the resolutions mentioned above. As of December 31, 2009, the difference between the amounts paid by the Company to Telmex according to the new rates, and the amounts invoiced by Telmex, amount to approximately to Ps. 764 million, not including VAT.

Telmex filed for a nullification proceeding before the Federal Tax and Administrative Court (*Tribunal Federal de Justicia Fiscal y Administrativa*) requesting the nullification of COFETEL's administrative resolution. The Company (Axtel and Avantel) have a contingency in case that the Federal Tax and Administrative Court rules against the Company, and that as a result, establishes different rates compared to those established by COFETEL. Telmex obtained a suspension for the application of the interconnection rates established by COFETEL, such suspension was effective beginning on January 26, 2010, but ceased to be in force and effect as of February 11, 2010, since the Company decided to exercise its right to leave without effect the suspension by guaranteeing any damages that could be caused to Telmex.

On February 8, 2010, the COFETEL resolved an interconnection disagreement proceeding existing between the Company (Avantel) and Telmex related to the rates for the termination of long distance calls from the Company to Telmex with respect to year 2009. In such administrative resolution, the COFETEL approved a reduction in the rates for termination of long distance calls applicable to those cities where Telmex does not have interconnection access points. These rates were reduced from Ps. 0.75 per minute to US$0.0126, US$0.0105 or US$0.0080 per minute, depending on the place where the Company delivers the long distance call. Based on this resolution, the Company paid in excess approximately Ps. 20 million. The management of the Company considers that Telmex will likely challenge the resolution.

The Company believes that the rates under COFETEL's resolution will prevail, therefore has recognized the cost based on the tariffs approved by COFETEL. Due to the fact that the proceedings followed by Telmex are recent, the Company and its legal advisors are evaluating the steps to be followed .

(c) On January 24, 2001, an agreement was entered into with Global Towers Communications Mexico, S. de R.L. de C.V. (Formerly Spectrasite Communications Mexico, S. de R.L. de C.V.), which agreement contemplated an expiration date on January 24, 2004, whereby Global Towers was to provide to the Company with services for the location, construction, setting up and selling of sites within the Mexican territory. As part of the operation, the Company agreed to lease from Global Towers 650 sites in a time frame period of three years.

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. According to the agreement, these funds are not subject to restrictions with respect to their use and destination. However, the agreement contemplates the payment of interest at a Prime Rate in favor of Global Towers on the warranty amount corresponding to the number of sites that as of June 24, 2004, were not sold or leased in accordance with the terms of the agreement.

During 2002, Global Towers filed an Ordinary Mercantile Trial against the Company before the Thirtieth Civil Court of Mexico City, claiming the refund of the guarantee deposit mentioned above, plus interest and trial-related expenses; the Company counterclaimed Global Towers because the latter terminated the agreement unilaterally.

On April 1, 2008, the trial court ruled against us ordering Axtel to return the deposit and applicable interests. The Company appealed the trial court's order before the Superior Court of Appeal.

On August 4, 2008, the Superior Court of Appeal ruled in favor of the Company releasing and discharging it from any liability whatsoever under the contract signed with Global Towers and ordering the latter to pay the Company for any damages caused to the Company for the non-compliance by Global Towers to perform its obligations under said contract. Global Towers filed a Constitutional Trial (*Juicio de Amparo*) against the resolution of the Superior Court of Appeal.

On March 2009, the Superior Court of Justice ruled again in favor of the Company releasing and discharging the Company from any liability whatsoever under the contract with Global Towers and ordering Global Towers to pay the Company for any damages caused to the Company resulting from the non-compliance by Global Towers to perform its obligations under the contract. Global Towers filed a Constitutional Trial (*Juicio de Amparo*), and as of today the resolution is pending.

As of December 31, 2009, the Company recognized a liability to cover interests amounting to Ps. $108,925.00, plus the principal amount, recorded in the "other accounts payable" line item in the balance sheet.

(d) During September and November 2005, Avantel Infraestructura filed before the Federal Court of Tax and Administrative Justice a lawsuit against the resolution of the "*negativa ficta*" (automatic negative ruling as a result of lack of answer), arising due to the fact that there was no resolution during the 3 months period as stated under the Federal Tax Code (*Código Fiscal de la Federación*) with respect to the request for a confirmation of criteria in the sense that Avantel Infraestructura is not obliged to pay duties under article 232 Section I of the Federal Duties 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, and Quintana Roo.

The suit was turned for study and resolution to the 5th Metropolitan Regional Court of the Federal Court of Tax and Administrative Justice, who declared the annulment of the "*negative ficta*", in order for the authority being sued to issue another resolution legally supported, considering the terms of the resolution.

Not in conformity with the ruling pronounced by the Federal Court of Tax and Administrative Justice, Avantel filed an *Amparo Directo* (Constitutional Review), while at the same time, the authority started a Tax Review, proceedings that are still pending to be sent to the Federal Collegiate Court for their study and resolution.

(e) 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.

(f) 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. 4,603 and to other service providers amounting to Ps. 669,269.

(g) 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.

(h) The Company leases some equipment and facilities under operating leases. Some of these leases have renewal clauses. Lease expense for 2009 and 2008 was Ps. 483,939 and Ps. 414,343, respectively.

The annual payments under these leases as of December 31, 2009 are as follows:

| | | **Contracts in:** | | |
|---|---|---|---|---|
| | | **Pesos (thousands)** | | **Dollars (thousands)** |
| 2010 | Ps. | 170,121 | $ | 7,144 |
| 2011 | | 127,368 | | 3,670 |
| 2012 | | 101,552 | | 2,195 |
| 2013 | | 86,002 | | 2,084 |
| 2014 | | 76,184 | | 2,043 |
| 2015 and thereafter | | 204,276 | | 1,742 |
| | Ps. | 765,503 | $ | 18,878 |

(i) As of December 31, 2009, the Company has placed purchase orders which are pending delivery from suppliers for approximately Ps. 950,637.

(j) As of December 31, 2009, there was a letter of credit for U.S. $34 million issued by Banamex in favor of Telmex for the purpose of guaranteeing the Company's acquired obligations in several interconnection agreements. The amounts under the letter of credit were drawn by Telmex in the month of January 2010, in respect of the amounts already owed by Avantel to Telmex. The Company, supported by its legal advisors, is evaluating the steps to be followed.

In January 15, 2010 Banamex granted Axtel a US $32 million working capital loan at market conditions which matures on July 15, 2010.

## (22) Recently issued accounting standards

The CINIF has issued the following FRS, applicable for years beginning on or after January 1, 2010 or 2011, as indicated.

**(a) FRS B-5 *"Segment information"*-** FRS B-5 is effective as of January 1, 2011. Changes as compared to superseded Bulletin B-5 "Segment Information" include the following:

- Senior management regularly discloses information by operating segment and does not require the segmentation of information into primary and secondary or into segments identified based on products or services (economic segments), geographical areas or uniform customer groups. Additionally, it requires disclosure by entity as a whole, information on its products or services, geographical areas and principal customers and suppliers).

- FRS B-5 does not require that the entity's business areas be subject to different risks to qualify as operating segments.

- FRS B-5 allows business areas in pre-operating stage to be catalogued as operating segments.

- FRS B-5 requires disclosure by segment and separately, revenue and interest expense as well as all other components of comprehensive financial results (CFR). In specific cases, the FRS B-5 permits disclosure of net interest income.

- FRS B-5 requires disclosure of the liability amounts included in the usual operating segment information normally used by senior management in making the entity's operating decisions.

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

**(b) FRS B-9 *"Interim financial reporting"*-** FRS B-9 is effective as of January 1, 2010. Changes as compared to superseded Bulletin B-9 "Interim financial reporting" include the following:

- FRS B-9 requires that the interim financial information includes a comparative and condensed balance sheet, income statement, statement of stockholders' equity and statement of cash flows and, for non-profit entities, it expressly requires the presentation of a statement of activities.

- FRS B-9 establishes that the financial information at the end of an interim period should be presented comparatively with the equivalent interim period of the immediately preceding year and, in the case of the balance sheet, compared also to such financial statement at the immediately preceding year-end date.

- FRS B-9 includes and defines new terminology.

**(c) FRS C-1 *"Cash and cash equivalents"*-** FRS C-1 supersedes Bulletin C-1 *"Cash"* and is effective as of January 1, 2010. The principal changes with respect to the former standard include the following:

- FRS C-1 requires the presentation of cash and cash equivalents, restricted, within the balance sheet caption of "Cash and cash equivalents".
- The term "demand temporary investments" is replaced by "available demand investments".
- To be identified as cash equivalents, the investments should be highly liquid, for example those with original maturities of three months or less when purchased.
- FRS C-1 includes the definition of the terms: acquisition cost, restricted cash and cash equivalents, highly liquid investments, net realizable value, nominal value and fair value.

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