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

Consolidated Financial Statements

December 31, 2011 and 2010; and January 1, 2010

(With Independent Auditors' Report Thereon)

(Translation from Spanish Language Original)

KPMG Cárdenas Dosal
Blvd. Díaz Ordaz 140 Pte. Piso 8
Col. Santa María
64650 Monterrey, N.L.

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

Independent Auditors' Report

(Translation from Spanish Language Original)

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

We have audited the accompanying consolidated statements of financial position of Axtel, S.A.B. de C.V. and subsidiaries (the Company) as of December 31, 2011 and 2010 (restated) and as of January 1, 2010 (restated); 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 2011, accounting changes were made as disclosed in note 4 to the consolidated financial statements. Therefore, the financial statements as of December 31, 2010 and the statement of financial position as of January 1, 2010 were adjusted to recognize the effects of the application of the accounting changes disclosed in note 4.

As mentioned in notes 23 (a) and 23 (b), the Company has contingencies related to interconnection rates with mobile operators and with long distance terminating calls with one of its main suppliers. On December 31, 2011, the differences between the amounts paid by the Company and the amounts billed by the mobile operators and one of its main suppliers amounted to approximately Ps. 1,979 million and Ps. 1,240 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, 2011 and 2010, and as of January 1, 2010; 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 Cardenas Dosal, S.C.

Leandro Castillo Parada

Monterrey, N.L., Mexico
February 29, 2012

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

Consolidated Statements of Financial Position

(Thousands of Mexican pesos)

Assets		**December 31, 2011**	**Restated (note 4) December 31, 2010**	**Restated (note 4) January 1, 2010**
Current assets:				
Cash and cash equivalents	Ps.	1,425,023	1,308,264	1,402,240
Accounts receivable, net (note 6)		2,018,013	2,240,534	1,851,688
Refundable taxes and other accounts receivable (note 23b)		344,080	401,682	197,946
Prepaid expenses		79,580	55,032	33,833
Inventories (note 9)		152,756	165,629	170,681
Financial instruments (note 7a and 7b)		323,278	272,013	574,132
Total current assets		4,342,730	4,443,154	4,230,520
Long-term accounts receivable		17,712	27,346	18,491
Property, systems and equipment, net (note 10)		15,517,788	15,769,472	15,264,454
Intangible assets, net (note 12)		447,879	515,331	582,782
Deferred income taxes (note 18)		1,526,009	1,332,960	1,180,761
Deferred employee statutory profit sharing (note 18)		18,082	18,581	9,707
Investment in shares of associated company and other permanent investments (note 11)		9,667	44,341	16,295
Other assets, net (note 13)		397,405	380,393	398,289
Total assets	Ps.	22,277,272	22,531,578	21,701,299
Liabilities and Stockholders' Equity				
Current liabilities:				
Accounts payable and accrued liabilities	Ps.	2,395,837	2,668,135	2,052,204
Accrued interest		297,107	261,692	215,538
Taxes payable		168,319	153,733	108,033
Short-term debt (note 14)		-	280,000	-
Current maturities of long-term debt (note 15)		380,880	375,996	944,553
Other accounts payable (note 16)		199,849	198,629	371,503
Deferred revenue		567,878	667,665	559,542
Derivative financial instruments (note 7a)		20,609	131,344	30,941
Total current liabilities		4,030,479	4,737,194	4,282,314
Long-term debt, excluding current maturities (note 15)		12,130,494	9,808,869	8,947,650
Asset retirement obligation and other long-term accounts payable (note 19)		265,362	242,359	192,370
Employee benefits (note 17)		76,891	75,788	70,630
Deferred revenue		33,900	33,900	87,117
Total liabilities		16,537,126	14,898,110	13,580,081
Stockholders' equity (note 20):				
Common stock		7,562,075	7,562,075	7,562,075
Additional paid-in capital		741,671	741,671	741,671
Reserves for own shares		162,334	162,334	162,334
Deficit		(2,703,703)	(660,781)	(353,641)
Change in the fair value of derivative financial instruments (note 7a)		(22,231)	(171,831)	8,779
Total stockholders' equity		5,740,146	7,633,468	8,121,218
Commitments and contingencies (note 23)				
Subsequent event (notes 23 and 24)				
Total liabilities and stockholders' equity	Ps.	22,277,272	22,531,578	21,701,299

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, 2011 and 2010

(Thousands of Mexican pesos)

		2011	2010 (note 4)
Telephone services and related revenues (note 21)	Ps.	10,829,405	10,651,961
Operating costs and expenses:			
Cost of revenues and services		(2,799,269)	(2,955,488)
Selling and administrative expenses		(4,455,551)	(4,468,693)
Depreciation and amortization		(3,137,098)	(2,993,357)
		(10,391,918)	(10,417,538)
Operating income		437,487	234,423
Comprehensive financing result:			
Interest expense (note 15)		(1,002,580)	(956,125)
Interest income		22,340	23,707
Foreign exchange (loss) gain, net		(1,181,567)	437,450
Change in the fair value of financial instruments (notes 7a and 7b)		(77,615)	(99,233)
Comprehensive financing result, net		(2,239,422)	(594,201)
Employee statutory profit sharing (note 18)		(4,955)	(6,051)
Deferred employee statutory profit sharing (note 18)		(499)	8,874
Other (expenses) income (note 22)		(419,450)	38,468
Other expenses income, net		(424,904)	41,291
Loss before income taxes and equity in earnings of associated company		(2,226,839)	(318,487)
Income taxes (note 18):			
Deferred income tax		273,963	(2,509)
Flat tax		(73,105)	(63,454)
Deferred flat tax		(16,800)	77,304
Total income tax benefit		184,058	11,341
Equity in earnings of associated company (note 11)		(141)	6
Net loss	Ps.	(2,042,922)	(307,140)
Weighted average of common shares outstanding		8,769,353,223	8,769,353,223
Basic and diluted loss per share (note 20)	Ps.	(0.23)	(0.03)

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

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

Consolidated Statements of Cash Flows

Years ended December 31, 2011 and 2010

(Thousands of Mexican pesos)

		2011	2010 (note 4)
Operating activities:			
Net loss	Ps.	(2,042,922)	(307,140)
Income taxes		(184,058)	(11,341)
Employee statutory profit sharing		5,454	(2,823)
Items related to investing activities:			
Depreciation		3,028,501	2,884,318
Amortization		108,597	109,039
Disposal of inventories of fixed assets		324,409	-
Loss on sale of property, system and equipment		71,493	13,637
Impairment of other permanent investments		36,938	-
Equity in earnings of associated company		141	(6)
Items related to financing activities:			
Interest expense		1,002,580	956,125
Amortization of bond issuing premium		(6,236)	(4,677)
Cancellation of intangible assets		-	8,613
Change in fair value of derivative financial instruments		77,615	99,233
Subtotal		2,422,512	3,744,978
Decrease (increase) in accounts receivable		35,826	(550,705)
Increase in allowance for doubtful accounts		186,695	161,860
Decrease in inventories		12,874	5,051
Decrease (increase) in other accounts receivable		98,651	(202,016)
(Decrease) increase in accounts payable		(272,119)	578,015
Taxes paid		(69,314)	(19,038)
(Decrease) increase in deferred revenue		(99,788)	54,907
Decrease in other accounts payable and other liabilities		(2,632)	(158,792)
Net cash flow from operating activities		2,312,705	3,614,260
Investing activities:			
Acquisition and construction of property, systems and equipment, net		(2,532,772)	(3,361,921)
Increase in financial instruments and other investments		(2,405)	(60,897)
Other assets		(78,780)	(41,593)
Net cash flow from investing activities		(2,613,957)	(3,464,411)
(Cash to be obtained from financing activities) Cash surplus to be applied in financing activities		(301,252)	149,849
Financing activities:			
Interest paid		(969,724)	(876,444)
Bond issuance		-	2,369,851
Payments of bank loans		(352,000)	(1,757,087)
Proceeds of bank loans		964,092	688,634
Other Long terms loans, net		(351,188)	(213,116)
Change in fair value of derivative financial instruments		(54,736)	(18,213)
Net cash flow from financing activities		(763,556)	193,625
Net (decrease) increase in cash and cash equivalents		(1,064,808)	343,474
Effects from cash value changes		1,181,567	(437,450)
Cash and cash equivalents at beginning of the year		1,308,264	1,402,240
Cash and cash equivalents at the end of the year	Ps.	1,425,023	1,308,264

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 Stockholders' Equity

Years ended December 31, 2011 and 2010

(Thousands of Mexican pesos)

		Capital stock	Additional paid-in capital	Reserves for own shares	Deficit	Valuation effects of derivative financial instrumentsl	Total stockholders' equity
Balances as of January 1, 2010, as previously reported	Ps.	7,562,075	741,671	162,334	(273,926)	8,779	8,200,933
Recognition of the cumulative effects of FRS C-18 "Obligations associated with the retirement of property, plant and equipment" (note 4)		-	-	-	(79,715)	-	(79,715)
Restated balances as of January 1, 2010 (note 4)		7,562,075	741,671	162,334	(353,641)	8,779	8,121,218
Comprehensive loss (note 20c)		-	-	-	(307,140)	(180,610)	(487,750)
Balances as of December 31, 2010		7,562,075	741,671	162,334	(660,781)	(171,831)	7,633,468
Comprehensive loss (note 20c)		-	-	-	(2,042,922)	149,600	(1,893,322)
Balances as of December 31, 2011	Ps.	7,562,075	741,671	162,334	(2,703,703)	(22,231)	5,740,146

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

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

(1) Financial statement authorization and presentation

On February 29, 2012, the Chief Financial Officer 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.

The aforementioned financial statements are presented in Mexican pesos (reporting currency), which is the same as the recording currency and the functional currency.

(2) Description of business and significant transactions

Description of business

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, domestic and international long-distance calls. A concession is required to provide these services and carry out the Company's activity, (see notes 23 (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.

Significant transactions

- On November 17, 2011, the Company closed a syndicated loan with Banco Nacional de Mexico, SA, a member of Grupo Financiero Banamex; Banco Mercantil del Norte SA, Institución de Banca Múltiple, Grupo Banorte; Credit Suisse AG, Cayman Islands Branch; ING Bank NV, Dublin Branch and Standard Bank Plc. The total amount of the line is US$ 100 million with a four year period, two year grace period of principal and made up of a funded amount and a committed short term revolving facility. The loan is secured by the accounts receivable of certain corporate customers of the Company. As of December 31, 2011 US$ 44.5 million and Ps. 216.9 million have been funded, while the revolving facility has not been disbursed. This loan contemplates a variable interest rate, going from LIBOR+3.0% to LIBOR+4.5% in dollars and a TIIE+3.0% to TIIE+4.5% in pesos, according to the leverage of the Company. Interest payments are on a quarterly basis and the purpose of the loan is to strengthen liquidity, capital investments, debt repayment and other corporate general purposes.

(Thousands of Mexican pesos)

- On March 22, 2010, the Company completed an issuance of senior unsecured notes, for U.S. $190 million with due date on September 22, 2019 and with an annual interest rate of 9.0% which will be paid semiannually starting September 22, 2010. The proceeds of this issuance were used mainly to prepay the remaining balance of the USD and Ps. portions of the Syndicated loan that amounted to U.S. $ 22.7 million and Ps. 938.1 million, respectively. The remaining proceeds were used to pay other short-term debt and for general corporate purposes.

- In order to implement the strategic plans, the Company is restructuring some of the operational areas. The costs of restructuring, which consists of compensation and employee severance payments amounted to Ps. 63,500 and Ps. 163,215 and is included in the statement of operations for the years ended December 31, 2011 and 2010, respectively, as part of the other expenses.

(3) Summary of significant accounting policies

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, asset retirement obligations, valuation allowances for receivables, inventories and deferred income tax assets; valuation of derivative instruments; and assets and obligations related to employee benefits. Actual results could differ from those estimates and assumptions.

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

Significant accounting policies and practices applied in the preparation of the accompanying financial statements follow:

(a) 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
2011	103.551	3.80%	12.26%
2010	99.742	4.40%	15.19%
2009	95.536	3.57%	14.48%

(Thousands of Mexican pesos)

(b) 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 based on the audited financial statements of the issuing companies as of December 31, 2011 and 2010, which have been prepared in accordance with the Mexican 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 network given in concession, 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”).

(c) Cash and cash equivalents

Cash equivalents of Ps. 628,062, Ps. 1,184,280 and Ps. 1,335,670 at December 31, 2011 and 2010 and January 1, 2010, 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 statement of financial position date and net estimated realizable value. Interest and foreign currency exchange fluctuation are included in the statements of operations as part of the comprehensive financing result.

As of December 31, 2011 and 2010, the Company restricted cash amounted to of Ps. 52,127 and Ps. 58,121, respectively, derived from various financial instrument contracts mentioned in note 7, and the syndicated loan mentioned in note 15.

		2011	2010
Financial instruments (note 7)	$	28,104	58,121
Syndicated loan (note 15)		24,023	-
Restricted cash	$	52,127	58,121

(d) 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 on a monthly basis. Account balances are charged to the allowance after all means of collection have been exhausted and the potential recovery is considered remote. Additionally, the realizable value of long-term receivables is determined considering their present value.

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

Permanent investment in the associated company in which the Company holds 50% of its capital stock, are accounted for by the equity method based on the audited financial statements of the investees as of December 31, 2011, 2010 and January 1, 2010.

Other permanent investments in which the Company holds between 10% and 20% of the investees' capital stock are recorded at cost.

(f) Inventories and cost of sales

Inventories are carried at the lower of historical cost and 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.

(g) Property, systems and equipment

Property, systems and equipment, including capital leases, are initially recorded at acquisition cost and the present value of total payments, respectively, and through December 31, 2007, adjusted for inflation by using NCPI factors.

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

Depreciation on property, systems and equipment is calculated using the straight-line method, over the estimated useful lives of the assets as determined by the Company's 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 minor repairs, including the cost of replacing minor items not constituting substantial improvements are expensed as incurred and charged mainly to selling and administrative expenses.

(h) Telephone concession rights

Telephone concession rights that are included in intangible assets were restated by NCPI factors through December 31, 2007 and amortized under the straight-line method over a period of 20 to 30 years (the initial term of the concession rights).

(i) Other and intangible assets

Other assets include mainly costs related to Telmex / Telnor infrastructure costs, guarantee deposits, prepaid expenses and notes issuance costs (see note 13).

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 12).

(j) 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, 2011 and for purposes of recognizing benefits upon retirement, the remaining average service life of employees entitled to plan benefits approximates 21 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 amortized based on the remaining service life of the employees, for the retirements benefits.

(k) 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 flow hedging.

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 ineffective 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 and it's subsidiaries 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).

Embedded derivatives arise from contractual covenants contained in non-derivative contracts, implicitly or explicitly having features of one or more derivatives. In some instances, these embedded derivatives must be segregated from the host contracts and be valued, recognized, presented and reported as if they were free-standing derivative financial instruments. To determine and analyze whether the embedded derivatives must be segregated from the host contracts, the Company reviews the contracts entered into for identifying the potential existence of embedded derivatives. Embedded derivatives so identified are subject to assessment to determine whether they are to be segregated. If so, they are segregated from the host contract and recorded at fair value, with changes in fair value reported in comprehensive financial results. If a decision is made that the embedded derivative is to be designated and qualifies for hedge accounting purposes, one of the three permissible hedge accounting models is followed.

(l) Income taxes (IT), 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, 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 carryforwards and other recoverable tax credits. 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 the consolidated income in the period that includes the enactment date.

(m) Comprehensive loss

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

(n) 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 statement of financial position date. Exchange differences arising from assets and liabilities denominated in foreign currencies are recognized in the results of operations.

(o) Revenue recognition

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

- *Telephony Services* - Customers are charged a flat monthly fee for basic service, a per-call fee for local calls, a per-minute usage fee for calls completed on a cellular line and domestic and international long distance calls, and a monthly fee for value-added services.
- *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.

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.

(p) Business risk concentration

The Company rendered services to three clients that represented approximately 14% and 19% of total net telephone services and related revenues during 2011 and 2010, respectively. Also, the Company mainly receives interconnection services from Telmex.

(q) 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 cannot 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.

(r) 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 statement of financial position and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

(s) Segment information

The Company considers that it operates in a single business segment. Management oversees the business as two revenue 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.

(t) Accruals

Based on management's estimates, the Company recognizes accruals for present obligations where the transfer of assets or the rendering of services is virtually inevitable and arises as a consequence of past events, mainly interests, salaries and other payments to employees.

(u) Advertising expenses

Advertising costs are expensed as incurred.

(4) Accounting changes

The FRS and improvements mentioned below, issued by the Mexican Board for Research and Development of Financial Reporting Standards (Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera or CINIF) became effective for fiscal years beginning on or after January 1, 2011, with the respective prospective or retrospective application being specified in each case.

(a) FRS C-4 "Inventories" – FRS C-4 is effective beginning January 1, 2011 with retrospective application, supersedes Bulletin C-4 and establishes new valuation, presentation and disclosure rules for initial and subsequent recognition of inventories on the statement of financial position. The principal changes are as follows:

- FRS C-4 eliminates: a) direct cost as a valuation system and, b) the inventory cost formula (formerly method) referred to as Last In – First Out (LIFO).
- Inventory cost can only written down under the base of net realizable value.
- For inventories acquired on an installment payment basis, the difference between the purchase price under normal credit conditions and the amount paid must be recognized as financial cost during the financing period.
- Under certain circumstances, estimates of impairment losses on inventories recognized in a prior period may be deducted or charged off against results of operations for the period in which such modifications occur.
- Items whose benefits and risks have already been transferred to the entity must be recognized as inventories; therefore, prepayments are not part of inventory.

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

(b) FRS C-5 "Prepayments" – FRS C-5 is effective beginning January 1, 2011, with retrospective application, supersedes Bulletin C-5, and includes primarily the following changes:

- Advances for purchase of inventories (current assets) or property, plant and equipment and intangible assets (non-current assets), among others, must be reported under prepayments provided the benefits and risks inherent in the assets to be acquired or the services to be received have not yet been transferred to the entity. Furthermore, prepaid expenses must be reported based on the nature of the item to be acquired, either under current assets or non-current assets.

- Among other things, the following must be disclosed in notes to financial statements: breakdown of prepayments, accounting policies for recognition and impairment losses, as well as relevant reversal of impairments.

The application of this FRS resulted in a reclassification in the consolidated financial statements from property, systems and equipment to other assets amounting Ps. 13,428 and Ps. 14,128 as of December 31, 2010 and January 1, 2010, respectively.

(c) FRS C-6 "Property, plant and equipment" – FRS C-6 is effective beginning January 1, 2011. The accounting changes resulting from the initial application of this FRS must be prospectively recognized. The principal changes with respect to the superseded Bulletin include the following:

- The bases for determination of the residual value of a component are added.

- The requirement to assign an appraised value to property, plant and equipment acquired at no cost or at an inadequate cost is eliminated.

- Depreciation for components representative of a property, plant and equipment item is mandatory, independently of the depreciation of the rest of the item as if it were a single component.

- Depreciation of idle components must continue, unless depreciation is determined based on the activity.

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

(Thousands of Mexican pesos)

***(d) FRS C-18* "Property, plant and equipment retirement obligations" –** FRS -18 is effective beginning January 1, 2011 and primarily provides for the following:

- Requirements that must be considered for valuation of a obligation associated with the retirement of a component of fixed assets.
- Requirement to recognize retirement obligations as a provision that increases the acquisition cost of a component.
- How changes in the valuation of retirement obligations (provisions) resulting from revisions to the cash flows, the periodicity for settlement and the suitable discount rate to be used must be recognized for accounting purposes.
- Use of a suitable discount rate on estimated future cash flows, incorporating the cost of money and the entity's credit risk.
- Use of the expected present value technique to determine the best estimate for retirement obligations.
- Disclosures that are to be made in case an entity has component retirement obligation.

Based on the requirements of the NIF C-18, the Company conducted an analysis of the obligations associated with the retirement of property, systems and equipment, mainly identifying sites built on leased land on which it has a legal obligation or assumed the retirement thereof.

Accounting changes resulting from the initial application of this standard were recognized retrospectively, affecting the financial statements as follows:

December 31, 2010		Previously reported amounts	Accounting change	Adjusted amounts
Assets				
Property, systems and equipment, net	$	15,698,182	84,717	15,782,899
Deferred income taxes		1,294,679	38,281	1,332,960
Total assets	$	22,408,580	122,998	22,531,578
Asset retirement obligation and other long-term accounts payable		18,535	223,824	242,359
Total liabilities	$	14,674,286	223,824	14,898,110
Stockholders' equity		7,734,294	(100,826)	7,633,468
Total liabilities and stockholders' equity	$	22,408,580	122,998	22,531,578

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Year ended December 31, 2010		Previously reported amounts	Accounting change	Adjusted amounts
Depreciation and amortization	$	(2,986,997)	(6,360)	(2,993,357)
Interest expense		(933,347)	(22,778)	(956,125)
Deferred income tax		(10,536)	8,027	(2,509)
Net loss	$	(286,029)	(21,111)	(307,140)

January 1, 2010		Previously reported amounts	Accounting change	Adjusted amounts
Assets				
Property, systems and equipment, net	$	15,210,619	67,963	15,278,582
Deferred income taxes		1,150,507	30,254	1,180,761
Total assets	$	21,603,082	98,217	21,701,299
Asset retirement obligation and other long-term accounts payable		14,438	177,932	192,370
Total liabilities	$	13,402,149	177,932	13,580,081
Stockholders' equity		8,200,933	(79,715)	8,121,218
Total liabilities and stockholders' equity	$	21,603,082	98,217	21,701,299

(e) ***2011 FRS Improvements*** **–** In December 2010, the CINIF issued the document referred to as "2011 FRS Improvements", which contains precise modifications to some FRS. The modifications that bring about accounting changes are listed below:

- **FRS B-1 "Accounting Changes and Error Corrections"-** FRS B-1 requires the presentation of the initial statement of financial position when there are retrospective adjustments, as well as the presentation in the statement of changes in stockholders' equity of previously reported initial balances, the effects of retrospective application and restated initial balances. These improvements were effective beginning January 1, 2011 and were retrospectively applicable.

- **FRS B-2 "Statement of cash flows"-** The requirement to present in the statement of cash flows the line item "cash surplus to be applied in financing activities or, cash to be obtained from financing activities" is eliminated and is left at a recommendation level. This revision was effective for fiscal years beginning January 1, 2011 and was retrospectively applicable.

- **Bulletin C-3 "Accounts receivable" -** Interest income on accounts receivable is recognized when accrued, provided the relevant amount is reliably determined and likely to be recovered. Furthermore, it is provided that interest income on accounts receivable unlikely to be recovered must not be recognized. These improvements are effective beginning January 1, 2011 y are prospectively applicable.

- **FRS C-10 "Derivative financial instruments and hedging activities" –** The improvements to this new FRS are effective beginning January 1, 2011, with retrospective application. The principal improvements include the following:

    - Certain effects of hedge effectiveness may be excluded.

    - An intra-group transaction may be recognized as hedging only when the functional currencies of the related parties are different from each other.

    - Reporting of the effect of the hedged interest rate risk is required, when a portfolio portion is the hedged position.

    - Account margins must be reported separately.

    - In a hedge relationship, a proportion of the total amount of the hedging instrument may be designated as the hedging instrument. The impossibility of designating a hedge relationship for a portion of the term of the hedging instrument is specified.

- **FRS C-13 "Related parties"-** The definition of "immediate family" is now more specific as it was limited to providing a list of the family members that fell within such definition. This revision was effective for fiscal years beginning January 1, 2011 and was retrospectively applicable.

- **Bulletin D-5 "Leases"-** The discount rate to be used on capital leases is established, disclosures related to such leases are added, and the timing for recognition of the gain or loss on a sale and leaseback transaction is modified. Application is on a prospective basis, except for the changes in disclosures, which must be retrospectively recognized and are effective beginning January 1, 2011.

The application of this improvements did not result in accounting changes to the consolidated financial statements of the Company, except for the application of the improvements to FRS B-1.

(5) Foreign currency exposure

Monetary assets and liabilities denominated in dollars as of December 31, 2011, 2010 and January 1, 2010 are as follows:

	(Thousands of dollars)		
	2011	**2010**	**January 1, 2010**
Current assets	117,550	131,409	94,360
Current liabilities	(125,882)	(177,566)	(138,535)
Long-term liabilities	(820,471)	(780,642)	(617,908)
Foreign currency liabilities, net	(828,803)	(826,799)	(662,083)

As of December 31, 2011 and 2010, the Company recorded Ps. (1,181,567) and Ps. 437,450 of foreign exchange (loss) gain, respectively.

The U.S. dollar exchange rates as of December 31, 2011, 2010 and 2009 were Ps. 13.99, Ps. 12.35 and Ps. 13.05, respectively. As of February 29, 2012, the exchange rate was Ps. 12.87.

As of December 31, 2011, the Company had foreign exchange derivative instruments (see note 7).

Following is a summary for the years ended December 31, 2011 and 2010, of transactions carried out with foreign entities, excluding imports and exports of systems and equipment:

	(Thousands of dollars)	
	2011	**2010**
Interest expense	70,267	66,517
Administrative and technical advisory services	3,740	4,077
Commissions	2,481	2,030
Cost of services	7,983	7,477
	84,471	80,101

(6) Accounts receivable

Accounts receivable consist of the following:

		2011	**2010**	**January 1, 2011**
Trade	Ps.	4,025,091	4,059,229	3,509,743
Less allowance for doubtful accounts		2,007,078	1,818,695	1,658,055
Accounts receivable, net	Ps.	2,018,013	2,240,534	1,851,688

The activity in the allowance for doubtful accounts for the years ended December 31, 2011 and 2010 was as follows:

		2011	**2010**
Balances at beginning of year	Ps.	1,818,695	1,658,055
Bad debt expense		188,383	160,640
Balances at year end	Ps.	2,007,078	1,818,695

(7) Financial instruments

(a) Derivative Financial instruments

The Company and its subsidiaries are exposed, thrurgh their normal business relations, to some financial risks denominated as interest rate risk and currency exchange rate risk, mainly. To reduce 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 is exposed to credit risk and market risk. Credit risk is the failure of the counterpart to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterpart owes the Company, which creates credit counterpart risk for the Company. When the fair value of a derivative contract is negative, the Company owes the counterpart 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 counterparts.

The Company and its subsidiaries recorded derivative financial instruments with hedging purposes, that are designated as cash flows hedges, relating to asset or liability risk exposures recognized in the balance sheet or forecast future transactions, where the effective portion of the changes in the fair value of the derivative, adjusted for deferred income taxes, are reported under comprehensive income within stockholders' equity, without affecting the income statement, and reclassified into earnings in the same period or periods during which the hedged forecasted transaction affects earnings.

For derivative financial instruments that are designated as hedges, 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.

Margins calls and collaterals are established also in the contract of financial derivative instruments or International Swap Derivatives Association (ISDA). These are established by the counterparties depending on the authorized credit lines. The Company does not operate with counterparts that do not offer reasonable lines of credit.

As of December 31, 2011 and 2010 the Company has U.S. $ 2.0 million and U.S. $ 4.7 million, respectively, posted as collateral.

The Company and its subsidiaries undertake prospective and retrospective tests of effectiveness to ascertain at all times whether the hedging employed remains effective according to applicable accounting standards. At such time 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 on the balance sheet or income statement of the following derivative financial instruments are presented below. In contrast to financial instruments for 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

On March 22, 2007, the Company contracted a CCS (Currency Swap) to hedge 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, whereby the Company will receive payments of 3 months Libor plus 150 base points over U.S. $110.2 million notional and will pay a monthly rate of TIIE 28 days plus 135 base points over Ps. 1,215.5 notional which includes the amortizations of principal. Due to this transaction's characteristics, it is registered under the fair value hedge accounting model. During 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. During March 2010, the Company prepaid the Syndicated Term Loan which was hedged by a "full cross currency swap"; therefore, this derivative was treated as a negotiation hedge until December 2010, when there was a restructuring of the operation with counterpart Credit Suisse canceling this negotiations hedge derivative and modifying some basic conditions of the others contracts with the counterpart.

For the year ended December 31, 2010 the change in the fair value of the hedging activity of the syndicated term loan resulted in a loss of U.S. $1.1 million recognized in the comprehensive financial result, offset by the change in the fair value of the debt valuated at December 31, 2010 in U.S. $3.2 million.

Cash flow hedge

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 hedge 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 million (notional value) at a fixed annual rate of 8.43%.

The CCS information is as follows:

(Amounts in charts are expressed in millions)

Counterpart	Notional	Basic conditions	Estimated fair value (USD) 2011	2010	January 1, 2010
Credit Suisse	Ps. 3,039 Ps $275 USD	The Company pays fixed annual rate of 8.43% and receives fixed annual rate of 7.625%	$ 1.3	$ 1.0	$4.3

During October 2010, the Company decided to enter into a new derivative to hedge the exchange rate derived from the issuance mentioned in the preceding paragraph, for the period between February 2012 and August 2014, under these agreements, the Company will receive and will make the payments listed in the following table:

Counterpart	Notional	Basic conditions	Estimated fair value (USD) 2011	2010	January 1, 2010
Credit Suisse	Ps. 2,480 Ps $200 USD	The Company pays fixed annual rate of 8.16% and receives fixed annual rate of 7.625%	$ 3.7	$ 1.0	-
Citibank	Ps. 929 Ps $75 USD	The Company pays fixed annual rate of 8.57% and receives fixed annual rate of 7.625%	$ 0.6	($ 0.5)	-

In September 2009 and March 2010, the Company issued senior unsecured notes for U.S. $ 300 million and U.S. $190 million, respectively, on a fixed rate. The Company decided to hedge the risk of exchange rate derived from this issuance with some derivative financial instruments. Under these agreements, the Company will receive and will make the payments listed in the following table.

During the last quarter of 2011, the Company got rid of the notional hedging of U.S. $65 million of the bonus contracted with Deutsche Bank A.G. and engaged such hedging with Citibank.

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Counterpart	Notional	Conditions	Estimated Fair Value (USD) 2011	2010	2009
Credit Suisse	Ps.2,885 Ps $225 USD	The Company pays fixed rate in pesos of 9.059% and receives fixed rate in usd of 9.00%	$7.1	$2.4	$11.9
Deutsche Bank	Ps.1,320 Ps $100 USD	The Company pays fixed rate in pesos of 10.107% and receives fixed rate in usd of 9.00%	($0.7)	($4.7)	($1.4)
Citibank	Ps. 861 Ps $65 USD	The Company pays fixed rate in pesos of 9.62% and receives fixed rate in usd of 9.00%	$0.5	-	-
Deutsche Bank	Ps.819 Ps $65 USD	The Company pays fixed rate in pesos of 9.99% and receives fixed rate in usd of 9.00%	-	($1.6)	-
Merrill Lynch	Ps.658 Ps $50 USD	The Company pays fixed rate in pesos of 10.0825% and receives fixed rate in usd of 9.00%	($0.3)	($2.2)	($0.5)
Merrill Lynch	Ps.315 Ps $25 USD	The Company pays fixed rate in pesos of 9.98% and receives fixed rate in usd of 9.00%	$0.2	($0.6)	-
Morgan Stanley	Ps.327 Ps $25 USD	The Company pays fixed rate in pesos of 10.080% and receives fixed rate in usd of 9.00%	($0.1)	($1.0)	($0.2)

On November, 2011, the Company closed a syndicated loan up to an amount of US$ 100 million; as of December 31, 2011 US$ 44.4 million and Ps. 216.9 million have been funded. Therefore, the Company decided to hedge the risk related to interest rate and exchange rate through a "Cross Currency Swap" contracted with Credit Suisse to hedge the interest of the first year of the dollar tranche.

(Amounts in charts are expressed in millions)

Counterpart	Notional	Conditions	Estimated Fair Value (USD) 2011	2010	2009
Credit Suisse	Ps.614 MXP $44.4 USD	The Company pays fixed rate in pesos of 5.06% and receives LIBOR + 400	($0.1)	-	-

For the year ended December 31, 2011 and 2010, the change in the fair value of these CCS is an unrealized gain (loss) amounted to U.S. $10.7 and U.S. ($14.6) million. This gain (loss) was recognized within the other comprehensive income section of equity, net of deferred taxes.

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. ($0.25), U.S. $0.01 and U.S. ($0.11) million within the current (liabilities) assets from embedded derivatives effects as of December 31, 2011, 2010 and January 1, 2011, respectively.

(b) Other financial instruments.

During July, August and September 2009, the Company acquired call options denominated "Zero Strike Call" that have a notional of 26,096,700 CPOs of Axtel. During the months of June and July of 2010, the Company acquired additional call option for 4,288,000 CPOs of Axtel, on the same conditions, obtaining a total of 30,384,700 CPOs as of December 31, 2010. The underlying of these instruments is the market value of the CPOs previously 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 listed in the following table:

			Fair value (Millions of pesos)		
Counterpart	**Notional**	**Conditions**	**2011**	**2010**	**January 1, 2010**
Bank of America Merrill Lynch	30,384,700 CPOs	The Company receives in cash the market value of the notional	Ps.135.2	Ps.216.0	Ps. 309.5

For the years ended December 31, 2011, 2010 and 2009 the change in the fair value of the Zero Strike Call resulted in an unrealized (loss) gain of (Ps.80,823), (Ps.126,327) and Ps. 86,911, respectively, recognized in the CFR.

(8) Related parties transactions and balances

The transactions with related parties during the years ended December 31, 2011 and 2010, are mainly with Banamex, and are as follows:

		2011	**2010**
Telecommunication service revenue	Ps.	596,517	570,324
Commission and administrative services		14,811	14,127
Interest expense		28,400	4,694
Rent expense		37,061	31,182
Deferred revenue		452,925	570,324
Installation service expense		26,696	24,562
Others		21,691	15,376

(Thousands of Mexican pesos)

The balances with related parties as of December 31, 2011, 2010 and January 1, 2010, included in accounts receivable and accounts payable, respectively, are as follows:

		2011	2010	January 1, 2010
Due from:				
Inversiones DD, S.A. de C.V.	Ps	-	2,343	-
Due to:				
Instalaciones y Desconexiones Especializadas, S.A. de C.V.	Ps	843	949	132
GEN Industrial, S.A. de C.V.		54	162	-
Total	Ps	897	1,111	132

Compensation paid to key directors for the years ended December 31, 2011 and 2010 amounted to approximately Ps. 67 million and Ps. 68 million, respectively. At December 31, 2010 the Company has debt with a related party as described in note 14.

(9) Inventories

Inventories consist of the following:

		2011	2010	January 1, 2010
Routers	Ps.	38,552	41,022	36,695
Installation material		24,276	33,723	32,731
Network spare parts		20,796	26,510	27,156
Tools		13,332	15,261	19,745
Telephones and call identification devices		9,122	11,024	19,849
Others		46,678	38,089	34,505
Total inventories	Ps.	152,756	165,629	170,681

(10) Property, systems and equipment

Property, systems and equipment are as follows:

		2011	2010	January 1, 2010	Useful lives
Land	Ps.	167,331	167,331	167,331	
Building		263,659	263,659	263,659	25 years
Computer and electronic equipment		3,040,278	2,717,392	2,482,616	3 years
Transportation equipment		378,071	355,631	200,373	4 years
Furniture and fixtures		215,919	207,057	183,577	10 years
Network equipment		27,518,874	26,312,273	23,476,290	6 to 28 years
Leasehold improvements		417,957	391,134	372,363	5 to 14 years
Construction in progress		2,536,711	2,088,815	2,011,216	
		34,538,800	32,503,292	29,157,425	
Less accumulated depreciation		19,021,012	16,733,820	13,892,971	
Property, systems and equipment, net	Ps.	15,517,788	15,769,472	15,264,454	

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		December 2010	Additions	Writte off	Capitalization	December 2011
Land	$	167,331	-	-	-	167,331
Building		263,659	-	-	-	263,659
Computer and electronic equipment		2,717,392	163	-	322,723	3,040,278
Transportation equipment		355,631	7,635	9,987	24,792	378,071
Furniture and fixtures		207,057	797	-	8,065	215,919
Network equipment		26,312,273	631,188	806,363	1,381,776	27,518,874
Leasehold improvements		391,134	179	-	26,644	417,957
Construction in progress		2,088,815	2,440,896	229,000	(1,764,000)	2,536,711
		32,503,292	3,080,858	1,045,350	-	34,538,800
Less accumulated depreciation		16,733,820	3,025,469	738,277	-	19,021,012
Property, systems and equipment, net	$	15,769,472	(173,611)	78,073		15,517,788

		January 1, 2010	Additions	Writte off	Capitalization	December 2010
Land	$	167,331	-	-	-	167,331
Building		263,659	-	-	-	263,659
Computer and electronic equipment		2,482,616	-	154	234,930	2,717,392
Transportation equipment		200,373	9,045	2,988	149,201	355,631
Furniture and fixtures		183,577	226	-	23,254	207,057
Network equipment		23,476,290	154,071	255,510	2,937,422	26,312,273
Leasehold improvements		372,363	-	-	18,771	391,134
Construction in progress		2,011,216	3,441,177	-	(3,363,578)	2,088,815
		29,157,,425	3,604,519	258,652	-	32,503,292
Less accumulated depreciation		13,892,971	2,886,904	46,054	-	16,733,820
Property, systems and equipment, net	$	15,264,454	717,615	212,598	-	15,769,472

The Company has capitalized CFR as a complement of the acquisition cost, of Ps.151,922 and Ps.17,938 for the years ended December 31, 2011 and 2010, respectively.

As of December 31, 2011, certain financial leases amounting to approximately Ps.19 million were guaranteed with the equipment acquired with those leases.

(Thousands of Mexican pesos)

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

As of December 31, 2011, 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., amounting to $9,667. The operation of this company consists of 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.

Other permanent investments

The other permanent investments are as follows:

		2011	2010	January 1, 2010
Opanga Networks	Ps.	17,798	17,798	-
Eden Rock Communications		16,735	16,735	6,493
		36,938	34,533	6,493
Less impairment of other permanent investments		36,938	-	-
Other permanent investments	Ps.	-	34,533	6,493

(12) Intangible assets

Intangible assets with defined useful lives consist of the following:

		2011	2010	January 1, 2010
Telephone concession rights Axtel	Ps.	1,073,135	1,073,135	1,073,135
Telephone concession rights Avantel		114,336	114,336	114,336
Customers relationships		324,183	324,183	324,183
Trade name “Avantel”		186,074	186,074	186,074
		1,697,728	1,697,728	1,697,728
Less accumulated amortization		1,249,849	1,182,397	1,114,946
Intangible assets, net	Ps.	447,879	515,331	582,782

Concessions rights of the Company

The main concessions of the Company are as follows:

- 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;

- Concessions of different frequencies of radio spectrum for 20 years and renewable for additional periods of 20 years, as long as Axtel complies with all of its obligations, and with all conditions imposed by the law and with any other condition that Secretaria de Comunicaciones y Transporte (SCT) imposes.

Concessions allow the Company to provide basic local telephone service, domestic long distance telephony, purchase or lease network capacity for the generation, transmission or reception of data, signals, writings, images, voice, sounds and other information of any kind, the purchase and leasing network capacity from other countries, including digital circuits income, value added services, operator services, paging and messaging services, data services, video, audio and video conferencing, except television networks, music or continuous service digital audio services, and credit or debit phone cards.

In 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.

In 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, 2010 the values of the trade name "Avantel" and of customer relationships were totally amortized.

(Thousands of Mexican pesos)

(13) Other assets

Other assets consist of the following:

		2011	2010	January 1, 2010
Notes issuance costs	Ps.	172,062	172,062	131,348
Long-term prepaid expenses		55,142	75,765	85,054
Telmex / Telnor infrastructure costs		68,279	68,279	68,279
Guarantee deposits		48,357	41,983	43,730
World Trade Center concession rights		22,474	22,474	22,474
Deferred financing costs		66,849	-	41,016
Rights of use		31,159	31,159	31,159
Advances to suppliers		10,204	13,428	14,128
Others		142,695	138,959	136,965
		617,221	564,109	574,153
Less accumulated amortization		219,816	183,716	175,864
Other assets, net	Ps.	397,405	380,393	398,289

Notes issuance costs

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

Telmex / Telnor infrastructure costs

As part of the opening of the telecommunications market in Mexico, new telecommunications companies must have interconnection with Telefonos de Mexico (Telmex) and Telefonos del Noroeste (Telnor). These two companies made agreements with the new entrants by which they must compensate Telmex and Telnor for their 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

During 2011 Ps. 66,849 were capitalized from costs related to the new syndicated loan mentioned in note 15.

The deferred financing costs incurred in the acquisition of Avantel will be amortized based upon the terms of the loans to which they are related. During 2010, derived from the prepayment of the syndicated loan mentioned in note 15, the Company cancelled approximately Ps. 41,016 of deferred financing costs related to those obligations less their accumulated amortization of Ps. 32,403.

(Thousands of Mexican pesos)

(14) Short-term debt

Short-term debt as of December 31, 2010 consists of a revolving unsecured credit agreement with Banamex in Mexican pesos, due in March 2011 and renewable on a quarterly basis. The interest rate is TIIE + 375 base points and it is due monthly. On November 2011 this loan was paid in full.

(15) Long-term debt

Long-term debt as of December 31, 2011, 2010 and January 1, 2010 consist of the following:

		2011	2010	January 1, 2010
U.S. $275,000,000 in aggregate principal amount of 7 $^{5}/_{8}$ % Senior Unsecured Notes due in 2017. Interest is payable semiannually on February 1 and August 1 of each year.	Ps.	3,847,360	3,398,203	3,591,143
U.S. $300,000,000 in aggregate principal amount of 9% Senior Unsecured Notes due in 2019. Interest is payable semiannually in arrears starting on March 22, 2010.		4,197,120	3,707,130	3,917,610
U.S. $190,000,000 in aggregate principal amount of 9 % Senior Unsecured Notes due in 2019. Interest is payable semiannually in arrears starting on September 22, 2010.		2,658,176	2,347,849	-
Premium on Senior Unsecured Notes with an aggregate principal of U.S. $190,000,000 with an interest rate of 9%, due in 2019.		48,332	54,569	-
Syndicated loan totaling U.S. $100 million with variable interest rate from LIBOR + 3.0% to LIBOR + 4.5% and from TIIE + 3.0% to TIIE + 4.5% according to the leverage of the Company. Interest payments are made quarterly. As of December 31, 2011 U.S. $ 44.5 million and Ps. 216.9 million have been funded.		838,904	-	-
Subtotal continued next page	Ps.	11,589,892	9,507,751	7,508,753

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Subtotal to coming of previous page	Ps.	11,589,892	9,507,751	7,508,753
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 base points, and the tranche in U.S. dollar of LIBOR + 150 base points.		-	-	1,371,770
Change in the fair value of syndicated loan (mencioned above)		-	-	39,740
Capacity lease agreement with Teléfonos de Mexico, S.A.B. de C.V. of approximately Ps. 800,000 payable monthly and expiring in 2011. Renewed in 2011.		453,237	127,642	280,336
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.		468,245	549,472	691,604
Total long-term debt		12,511,374	10,184,865	9,892,203
Less current maturities		380,880	375,996	944,553
Long-term debt, excluding current maturities	Ps.	12,130,494	9,808,869	8,947,650

Annual installments of long-term debt are as follows:

Year		Amount
2013	Ps.	389,124
2014		600,975
2015		389,406
2016 and thereafter		10,750,989
	Ps.	12,130,494

For the years ended December 31, 2011 and 2010, the debt interest expense was Ps. 976,819 and Ps. 888,926, respectively.

Most significant changes in the long-term debt during 2011, 2010 and 2009 are as follows:

On November 17, 2011, the Company closed a syndicated loan with Banco Nacional de Mexico, SA, a member of Grupo Financiero Banamex; Banco Mercantil del Norte SA, Institución de Banca Múltiple, Grupo Banorte; Credit Suisse AG, Cayman Islands Branch; ING Bank NV, Dublin Branch and Standard Bank Plc. The total amount of the line is US$ 100 million with a four year period, two year grace period of principal and made up of a funded amount and a committed short term revolving facility. The loan is secured by the accounts receivable of certain corporate customers of the Company. As of December 31, 2011 US$ 44.5 million and Ps. 216.9 million have been funded, while the revolving facility has not been disbursed. The operation contemplates a variable rate from LIBOR+3.0% to LIBOR+4.5% in dollars and a TIIE+3.0% to TIIE+4.5% in pesos, according to the leverage of the Company. Interest payments are on a quarterly basis and the purpose of the loan is to strengthen liquidity, capital investments, debt repayment and other corporate general purposes.

On March 22, 2010, the Company completed an issuance of senior unsecured notes, for an amount of U.S. $190 million with due date on September 22, 2019 and with an annual interest rate of 9.0% which will be paid semiannually starting September 22, 2010. The proceeds of this issuance were mainly used to prepay the remaining balance of the USD and Ps. portions of the Syndicated loan that amounted to U.S. $ 22.7 million and Ps. 938.1 million, respectively. The remaining proceeds will be used to pay other short-term debt and in general corporate purposes.

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.

During September, October and December 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 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	

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”).

(Thousands of Mexican pesos)

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.

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 and the compliance with certain financial ratios. As of December 31, 2010 and February 29, 2011, the Company was in compliance with all of its covenants.

(16) Other accounts payable

As of December 31, 2011, 2010 and January 1, 2010 other accounts payable consist of the following:

		2011	2010	January 1, 2010
Restructuring accruals	Ps.	59,855	100,000	-
Guarantee deposit (SR Telecom)		11,034	9,746	10,300
Guarantee deposits (note 23(c))		-	-	169,763
Interest payable (note 23(c))		-	-	108,925
Liabilities derived from payroll and other accounts payable		128,960	88,883	82,515
	Ps.	199,849	198,629	371,503

(17) Employee benefits

The cost, obligations and other elements of pensions, seniority premiums and severance compensations plans for reasons other than restructuring have been determined based on computations prepared by independent actuaries at December 31, 2011 and 2010. The components of the net periodic cost for the years ended December 31, 2011 and 2010 are as follows:

		2011		
		Termination	Retirement	Total
Net periodic cost:				
Service cost	Ps.	10,557	756	11,313
Interest cost		4,390	290	4,680
Amortization of transition obligations		2,301	-	2,301
Net actuarial gain		(6,232)	-	(6,232)
Amortization of prior service cost and plan modifications		(3,596)	(27)	(3,623)
Net periodic cost	Ps.	7,419	1,019	8,439

(Thousands of Mexican pesos)

		2010		
		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		2,301	-	2,301
Net actuarial loss		6,228	-	6,228
Amortization of prior service cost and plan modifications		(3,596)	(28)	(3,624)
Net periodic cost	Ps.	19,796	886	20,682

The actuarial present value of benefit obligations of the plans at December 31, 2011, 2010 and January 1, 2010 are follows:

		2011		
		Termination	**Retirement**	**Total**
Accumulated benefit obligation (ABO)	Ps.	-	424	424
Projected benefit obligation (PBO)	Ps.	70,001	4,719	74,720
Unrecognized items:				
Transition asset		(2,301)	-	(2,301)
Variances in assumptions		3,596	441	4,037
Actuarial loss		-	435	435
Net projected liability	Ps.	71,296	5,595	76,891

		2010		
		Termination	**Retirement**	**Total**
Accumulated benefit obligation (ABO)	Ps.	54,214	71	54,285
Projected benefit obligation (PBO)	Ps.	68,622	4,140	72,762
Unrecognized items:				
Transition asset		(4,602)	-	(4,602)
Variances in assumptions		7,192	468	7,660
Actuarial loss		-	(32)	(32)
Net projected liability	Ps.	71,212	4,576	75,788

(Thousands of Mexican pesos)

		January 1, 2010		
		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 most significant assumptions used in the determination of the net periodic cost of plan are the following:

	2011	**2010**	**January 1, 2010**
Discount rate (net of inflation) used to reflect the present value of obligations	7.5%	7.00%	8.50%
Rate of compensation increase	4.00%	4.00%	5.50%
Amortization period of unrecognized items	5 años	5 años	5 años
Average remaining labor life of employees	20.6 años	21.1 años	20.5 años

(18) Income tax (IT), Flat Rate Tax (IETU) and employee statutory profit sharing (ESPS)

Under the current tax legislation, companies must pay the greater of their IT or IETU. If IETU is payable, the payment will be considered final and not subject to recovery in subsequent years. In accordance with the tax reforms effective as of January 1, 2010, the IT rate for fiscal years 2010 to 2012 is 30%, 29% for 2013 and 28% for 2014 and thereafter. The IETU rate is 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, 2011 and 2010. In 2008, the Company determined that certain subsidiaries will be subject to IETU. For presentation purposes of deferred taxes, deferred IETU and IT are presented jointly.

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The income tax benefit attributable to loss before income taxes differed from the amounts computed by applying the Mexican statutory rates of 30% for IT in 2011 and 2010 to loss, as a result of the items mentioned below:

		2011	2010
Computed "expected" tax benefit	Ps.	668,052	95,546
Increase (decrease) resulting from:			
Effects of inflation, net		82,102	126,525
Change in valuation allowance		(163,520)	(49,288)
Accelerated depreciation		(48,613)	(123,938)
Non-deductible expenses		(136,007)	(10,000)
Deferred IETU		(89,905)	13,850
IT cancellation from subsidiarie		(52,534)	-
Effects on base for IETU and IT rate		(63,138)	(43,571)
Other		(12,379)	2,217
IT and IETU benefit	Ps.	184,058	11,341

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, 2011, 2010 and January 1, 2010 are presented below:

		2011	2010	January 1, 2010
Deferred tax assets:				
Net operating loss carryforward	Ps.	1,024,651	619,924	726,134
Allowance for doubtful accounts		513,353	477,701	432,756
Fair value of derivative financial instruments		-	94,744	-
Accrued liabilities and others		166,688	315,275	186,807
Recoverable tax on assets		330,363	398,084	382,104
Deferred IETU		121,602	138,402	61,098
Premium on bond issuance		14,500	16,371	-
Property, systems and equipment		358,001	217,276	402,976
Total gross deferred tax assets		2,529,158	2,277,777	2,191,875
Less valuation allowance		822,953	765,361	726,076
Net deferred tax assets for IT and IETU		1,706,205	1,512,416	1,465,799

		2011	2010	January 1, 2010
Deferred tax liabilities:				
Telephone concession rights		103,301	123,920	149,889
Fair value of derivative financial instruments		37,360	-	58,067
Intangible and other assets		39,535	55,536	77,082
Total deferred tax liabilities		180,196	179,456	285,038
Deferred tax assets, net for IT and IETU	Ps.	1,526,009	1,332,960	1,180,761

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The rollforward for the net deferred tax asset for the years ended December 31, 2011, 2010 and January 1, 2010 is presented below:

		2011	2010	January 1, 2010
Balances at beginning of year	Ps.	1,332,960	1,180,761	1,222,577
Deferred IT benefit (expense)		273,963	(2,509)	(119,431)
Deferred IETU (expense) benefit		(16,800)	77,304	29,052
Deferred IT from the application effect of FRS C-8		-	-	7,558
Deferred IT of derivative financial instruments		(64,115)	77,404	41,005
Expiration of tax loss		24,117	-	-
Expiration of tax on assets		81,811	-	-
Change in valuation allowance		(105,928)	-	-
Balances at end of year	Ps.	1,526,009	1,332,960	1,180,761

The valuation allowance as of January 1, 2011, 2010 and January 1, 2010 was Ps. 822,953, Ps. 765,361 and Ps. 726,076, respectively.

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, 2011. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

As of December 31, 2011, the tax loss carryforward and the refundable tax on assets expire as follows:

Year		Inflation-adjusted tax loss carryforward	Tax on assets
2012	Ps	460,535	52,743
2013		539,257	84,977
2014		107,286	81,522
2015		-	29,823
2016		23,378	26,942
2017		-	54,356
2018		990,239	-
2019		-	-
2020		172,758	-
2021		1,722,284	-
	Ps.	4,015,737	330,363

(Thousands of Mexican pesos)

The recoverable tax loss carry - forwards includes Ps. 487,845 from companies in which deferred IETU was calculated.

The tax effects of temporary differences that gave rise to deferred employee profit sharing as of December 31, 2011, 2010 and January 1, 2010 are presented below:

		2011	2010	January 1, 2010
Deferred ESPS assets:				
Accrued liabilities	Ps.	6,175	3,817	2,016
Accrued for labor obligations		7,689	20,238	7,063
Other payroll accruals		10,972	-	4,352
Net deferred ESPS asset		24,836	24,055	13,431
Deferred ESPS liabilities:				
Deferred income		6,200	3,278	2,079
Property, systems and equipment		554	274	907
Other		-	1,922	738
Total deferred ESPS liability		6,754	5,474	3,724
Deferred ESPS asset, net	Ps.	18,082	18,581	9,707

The rollforward for the net deferred employee profit sharing asset for the years ended December 31, 2011, 2010 and January 1, 2010 is presented below:

		2011	2010	January 1, 2010
Balances at beginning of year	Ps.	18,581	9,707	7,815
Deferred ESPS (expense) benefit		(499)	8,874	1,892
Balances at end of year	Ps.	18,082	18,581	9,707

During the years ended December 31, 2011 and 2010 employee profit sharing was Ps.4,955 and Ps.6,051, respectively.

(19) Asset retirement obligation and other long-term accounts payable

As of December 31, 2011, 2010 and January 1, 2011 is as follows:

		2011	2010	January 1, 2010
Asset retirement obligation (note 4)	Ps.	253,129	223,824	177,932
Other long-term accounts payable		12,233	18,535	14,438
	Ps.	265,362	242,359	192,370

Based on the requirements of the NIF C-18, the Company conducted an analysis of the obligations associated with the retirement of property, systems and equipment, mainly identifying sites built on leased land on which it has a legal obligation or assumed the retirement thereof.

As a result of the adoption of this new accounting standard, the financial statements previously reported were adjusted retrospectively.

(20) Stockholders' equity

The main characteristics of stockholders' equity are described below:

(a) Capital stock structure

During July 2008 the Company began a program to repurchase own shares which was approved at an ordinary shareholder 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 July, August and September 2009, the CPOs purchased through the repurchase program was 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. For this to come into effect, the Company obtained stockholder approval (i) to increase capital by issuing Series B Shares in a number that was sufficient for Tel Holding to issue and pay Series B Shares (in the form of CPOs) representing up to a 10% equity share in Axtel; and (ii) for the subscription and payment of the Series B Shares that represented the shares issued by Tel Holding and any shares issued by stockholders that elected to issue 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 issue 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 by Tel Holding through the CPOs Trust on January 4, 2007.

At December 31, 2011, the common stock of the Company is Ps. 6,625,536. 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, 2010 and 2009 all shares issued are part of the fixed portion.

(b) Stockholders' equity restrictions

Stockholders' contributions, restated for inflation as provided in the tax law, totaling Ps. 8,346,917 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.

(Thousands of Mexican pesos)

(c) Comprehensive loss income

The comprehensive loss 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 loss.

		2011	2010
Net loss	Ps.	(2,042,922)	(307,140)
Fair value of derivative financial instruments		213,715	(258,014)
Deferred IT of derivative financial instruments		(64,115)	77,404
Comprehensive loss	Ps.	(1,893,322)	(487,750)

(21) Telephone services and related revenues

Revenues consist of the following:

		2011	2010
Local calling services	Ps.	4,160,082	4,481,829
Long distance services		1,233,985	1,150,122
Data services		2,594,528	2,504,115
International traffic		1,246,418	1,175,293
Other services		1,604,392	1,340,602
	Ps.	10,829,405	10,651,961

(22) Other (expenses) income, net

Other (expenses) income consists of the following:

		2011	2010
Write off of fixed assets inventories	Ps.	(324,409)	-
Restructuring cost (note 2)		(63,500)	(163,215)
Gain on guarantee deposit cancelation (note 23 c)		-	196,302
Impairment of other permanent investments		(36,938)	-
Others, net		5,397	5,381
	Ps.	(419,450)	38,468

(Thousands of Mexican pesos)

(23) Commitments and contingencies

As of December 31, 2011, the Company has the following commitments and contingencies:

(a) On September 1, 2008, the Department of Communications and Transportation (*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, primarily consider the application of new rates regarding consumption beginning in September 2008, and secondly, the retroactive application of those rates. In the case of Telcel in effect since January 1, 2008, and for the case of the other mobile operators (Grupo Iusacell, Grupo Telefonica and Unefon), in effect since October 2006.

Therefore, effective 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 actual 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 above mentioned resolutions, 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, 2011, according to the resolutions of the SCT and using some preliminary information of the Company, both Axtel and Avantel would have paid approximately Ps. 397.7 million in excess to Telcel, and to the rest of the mobile operators, Ps. 396.6 million, as shown in the following table:

Telcel		**Axtel**	**Avantel**	**Total**
2006	Ps.	-	-	-
2007		-	-	-
January - July 2008		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

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 commercial lawsuit 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. 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, 2011, the Company has not recognized the benefit of any such possible recovery.

As a result of the resolutions issued by the SCT, the Company recognized from August 2008 and thereafter, the interconnection rate applicable for termination is: Ps. 0.5465, Ps. 0.5060, Ps. 0.4705 and Ps. 0.4179 for each actual minute for Telcel and Telefonica for the years 2008, 2009, 2010 and 2011, respectively; and Ps. 0.6032 per 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 actual minute for Telcel and Ps. 1.21 for each rounded minute for the rest of the mobile carriers. As of December 31, 2011, the difference between the amounts paid by the Company according to the new rates established by the SCT, and the amounts billed by the mobile carriers, amounted to approximately Ps. 1,979 million not including value added tax.

The Company is aware that Telcel and the other mobile carriers have filed before the Federal Courts, their disagreement with respect to the resolutions issued by the SCT, 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, Ps. 0.5060, Ps. 0.4705 and Ps. 0.4179 for each actual minute for Telcel and Telefonica for 2008, 2009, 2010 and 2011, respectively; and Ps. 0.6032 for each actual 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 actual minute for Telcel and Ps. 0.6032 per each minute for the rest of the mobile carriers.

In April 2010, with respect to Iusacell court case, a Federal Judge issued a resolution (in first instance) in which it determined, that the SCT was competent to resolve the respective administrative review proceeding filed by Axtel, but instead of having determined directly the interconnection rates, the SCT should have provided guidelines on this matter to Cofetel, in order for Cofetel to issue the disputed interconnection tariffs. Afterwards, a Federal District Court determined on this matter, that the administrative review proceeding had to be resolved by Cofetel, and not by the SCT, by means of which, now Cofetel is in the process of issuing a new ruling on this matter. This implies that the SCT's resolution regarding interconnection rates was revoked, and remitted to Cofetel for its determination of the applicable interconnection rates. On October 20, 2010, Cofetel issued resolution P/201010/492 by means of which, it determined the interconnection tariffs applicable between Axtel and Telefonica, for the period 2008 – 2011, considering the same amounts established by the SCT in its resolution dated September 01, 2008, this is, Ps. 0.5465 per actual minute for the year 2008, Ps. 0.5060 for the year 2009, Ps. 0.4705 for the year 2010, and Ps.0.4179 for the year 2011.

On February, 2012, the Supreme Court of Justice, ruled that the SCT had no standing to resolve the review proceedings filled by Axtel, and that the Cofetel is the Authority that should solve these review procedures. By means of the above, Cofetel must, in the following months, determine yet again, the interconnection tariffs applicable between Axtel and the Mobile Service Providers, mentioned in the precedent paragraphs. Therefore, the interconnection tariffs that Axtel has to pay to these Mobile Service Providers, are not definitely determined, due to the fact that these new resolutions could be, once again, contested by the Parties.

After evaluating the actual status of the foregoing proceedings and according to the available information and information provided by the legal advisors, 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.

Company's management is 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 the Supreme Court of Justice resolved that the resolutions regarding interconnection tariffs cannot be legally suspended.

Due to Cofetel resolution P/201010/492, whereby the interconnection rates applicable between Axtel and Telefonica for the period 2008 – 2011 were determined, these are the current rates between Telefonica and Axtel. Such rates are lower than the interconnection tariffs that were previously paid by Axtel to Telefonica. Telefonica contested this resolution by means of filing a Constitutional Trial (*Juicio de Amparo*), which is currently at its initial stage with a Federal District Judge.

(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.

Until June 2010, Telmex billed the Company for the termination of long distance calls applying the rates that were applicable prior to the resolutions mentioned above, and after such date, Telmex has billed the resultant amounts, applying the new interconnection rates. As of December 31, 2011, the difference between the amounts paid by the Company to Telmex according to the new rates, and the amounts billed by Telmex, amount to approximately to Ps. 1,240 million, not including value added tax.

Telmex filed for nullification of the proceeding with the Federal Court of Tax and Administrative Justice (*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 came into effect 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. Nonetheless, the Court revoked Telmex's guarantee, taking into consideration the issuance of resolution P/140410/189, whereby Cofetel resolved the same low rates between Axtel and Telmex for the year 2010.

In January 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 approximately Ps. 20 million in excess. Telmex challenged the resolution before the Federal Court of Tax and Administrative Justice, and such proceeding is in an initial stage.

On May 2011, the Cofetel issued a ruling resolving an administrative review proceeding regarding an interconnection disagreement between Telmex and the Company, related to the tariff applicable to the termination of long distance calls from the Company to Telmex, for the year 2011. In such administrative resolution, the Cofetel approved a reduction of the tariffs applicable for the termination of long distance calls. The above mentioned tariffs were reduced from US$0.0126, US$0.0105 or US$0.0080 per minute, to Ps.0.04530 and Ps.0.03951 per minute, depending on the place in which the Company is to deliver the long distance traffic. Telmex challenged this ruling before the SCT, but the request was dismissed by such authority. Nowadays, Telmex challenged such dismissal, before the Federal Court of Tax and Administrative Justice, and such proceeding is in an initial stage.

The Company believes that the rates under Cofetel resolution will prevail, therefore has recognized the cost based on the rates 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.

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, claiming that Avantel had debts with such company. As of December 31, 2011, Avantel has been able to recover Ps.335,883 from the amount mentioned above, through the compensation collection with regard to certain charges for services rendered by Telmex to Avantel on a monthly basis. The remaining balance of Ps. 139,790 is recognized in the "other accounts receivable" line item in the balance sheet.

(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.), with expiration 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, Spectrasite Communications México, S. de R.L. de C.V., filed an Ordinary Mercantile Trial against the Company before the Thirtieth Civil Court, which was filed under the number 203/2002, claiming the refund of the guarantee deposit for an amount of USD$13,000,000 (Thirteen million dollars 00/100 US currency), plus interest and trial-related expenses; the Company gave answer to this Law Suit, by opposing to the reimbursement of such deposit, and counterclaiming from its North American Holding Spectrasite Communications Inc., the payment of any and all losses incurred to Axtel as a result of the unlawful termination of the agreement, made unilaterally by Spectrasite.

Finally, after 3 *Amparo* Trial rulings, on December 15 2011, was confirmed the resolution issued by the Third Civil Chamber by means of the Appellate Court File 1242/2008, issued on September 22, 2010. Due to the above said, there is no liability against Axtel arising from the Agreement entered with Global Towers.

Additionally, Global Towers and Spectrasite Communicatrion Inc., were condemned to pay to Axtel, the amount of USD$13,000,000 (Thirteen million dollars 00/100 US currency), as a result of Damages caused to Axtel, due to their non-compliance with the obligation regarding to the construction or acquisition from Axtel, of the 650 specific contracts, that came as a result of the unlawful termination of the Agreement.

Global Towers Comunications México, S. de R.L. de C.V., formerly Spectrasite Comunications México, S. de R.L. de C.V., as well as its American holding, were condemned to the payment of interests in favor of Axtel, at a rate of six percent per year, accrued since the 28 day of February, 2002, date in which the Agreement was unlawfully terminated.

(d) During September and November 2005, Avantel Infraestructura filed a lawsuit against the resolution of the "*negativa ficta*" (automatic negative ruling as a result of lack of answer) with the Federal Court of Tax and Administrative Justice arising from 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 "*negativa ficta*", in order for the authority being sued to issue another resolution legally supported, considering the terms of the resolution.

In disagreement with the ruling pronounced by the Federal Court of Tax and Administrative Justice, Avantel Infraestructura filed an *Amparo Directo* (Constitutional Review), while at the same time, the authority started a Tax Review, proceedings that were already resolved, determining the obligation of Avantel to pay duties for to the use of the exclusive economic geographic zone mentioned above, at a rate of 7.5% of the value determined by the Administration and Valuation of National Property Institute (*Instituto de Administración y Avaluos de Bienes Nacionales*). As of this date, we are awaiting the issuance by the Administration and Valuation of National Property Institute, of the master valuation that allows payment.

(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 Department of Communications and Transportation amounting to Ps. 5,025 and to other service providers amounting to Ps. 1,011,226.

(g) The concessions granted by the Department 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 2011 and 2010 was Ps. 567,986 and Ps. 518,735, respectively.

The annual payments under these leases as of December 31, 2011 are as follows:

		Contracts in:	
		Pesos (thousands)	**Dollars (thousands)**
2012	Ps.	247,449	8,547
2013		359,813	11,019
2014		435,462	9,690
2015		459,210	7,285
2016		489,569	5,691
2017 and thereafter		360,198	9,279
	Ps.	2,351,701	51,511

(i) As of December 31, 2011, the Company has placed purchase orders which are pending delivery from suppliers for approximately Ps. 708,460.

(24) International Financial Reporting Standards

The National Banking and Securities Commission (CNBV) requires certain entities that disclose their financial information to the public through the Mexican Stock Exchange, that beginning in 2012, they must prepare and disclose their financial information according to International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB).

The consolidated financial statements for the year ending December 31, 2012 to be issued by the Company will be its first annual financial statements that comply with IFRS. The transition date is January 1, 2011 and, therefore, the year ended December 31, 2011 will be the comparative period established by IFRS 1, First-Time Adoption of International Financial Reporting Standards. According to IFRS 1, the Company will apply the relevant mandatory exceptions and certain optional exemptions.

The Company will apply the relevant mandatory exceptions to the retroactive application of IFRS as follows:

Calculation of estimates - Estimates at the date of transition are consistent with estimates at the same date under MFRS, unless there is evidence of error in these estimates.

Hedge accounting - Hedge accounting will be applied only if the hedge relationship meets the criteria established by IFRS as of the date of transition.

Non-controlling interests - The Company does not include a non-controlling interest in its financial statements requiring the application of the requirements of IAS 27, Consolidated and Separate Financial Statements, relating to non-controlling interest prospectively from the date of transition.

The Company chose the following optional exemptions to the retroactive application of IFRS:

Business combinations - The business combinations exemption will be applied; therefore, no reformulations have been made to business combinations that took place before the date of transition.

Deemed cost - The deemed cost exemption will be applied; therefore, the Company has opted for using the restated amounts according to Mexican Financial Reporting Standards of the items of property, systems and equipment, which include inflation adjustments until December 31, 2007, being the last period when FRS required the recognition of the effects of inflation on financial information by using general indexes.

Employee benefits - The employee benefits exemption will be applied; therefore, all cumulative actuarial gains and losses as of the date of transition are recognized on the cumulative losses from previous years.

Borrowing costs – The Company will apply the borrowing costs exemption to not modify the capitalized borrowing costs on qualified assets for a period that commenced and ended before the transition date.

The following is a summary of the main differences between Mexican Financial Reporting Standards and IFRS that the Company has identified as of the date of the accompanying consolidated financial statements:

Effects of inflation - Under IFRS, the inflationary effects are recognized in the financial statements when the economy of the currency used by the Company qualifies as hyperinflationary. The Mexican economy was no longer hyperinflationary in 1998 and, consequently, inflationary effects that were recognized by the Company until December 31, 2007 under NIF were reversed. The reduction of value in the intangible asset was Ps.210,005, other assets by Ps.7,483, the reclassification of the capital stock was Ps.936,539 and additional paid-in capital was Ps.96,961 against the accumulated losses from prior years at the transition date.

Employee benefits - Under IFRS, provisions for severance compensations are recognized until the Company has a demonstrable commitment to end the relationship with the employee or has made an offer to encourage voluntary retirement, therefore, the liability recognized under FRS of Ps.55,816 was eliminated. Also, IFRS does not allow the recognition of Deferred ESPS assets or liabilities; therefore, the Deferred ESPS asset recognized under FRS of Ps.18,581 was eliminated.

Deferred tax - The adjustments to be recognized by the Company represent an impact on the deferred income taxes calculation, according with the requirements established by IAS 12, *Income Taxes*. The impact resulted in an increase in deferred tax assets by Ps.287,194.

Embedded derivative financial instruments - IAS 39 *Financial Instruments: Recognition and Measurement,* establishes an exception to embedded derivatives in contracts that are denominated in foreign currency when the foreign currency is commonly used in the economic environment of the Company, which is the case of U.S. dollar, so the Company canceled the balance recognized under FRS in embedded derivatives for Ps.196.

Other differences in presentation and disclosures in the financial statements - IFRS disclosure requirements are, generally, wider in scope than those of FRS. This may result in a larger number of disclosures regarding accounting policies, significant judgments and estimates; financial instruments and risk management, among others. In addition, there may be differences in presentation.

The information contained in this note has been prepared in accordance with the standards and interpretations issued and in effect, or issued and adopted in advance of the date of preparation of these consolidated financial statements. Standards and interpretations that will be applicable as of December 31, 2012, including those that may be applied optionally, are not known with certainty at the time of preparation of the consolidated financial statements as of December 31, 2011 and 2010. In addition, the accounting policies selected by the Company could be modified as a consequence of changes in the economic environment or industry trends that occur after the issuance of these consolidated financial statements. The information contained in this note is not intended to comply with IFRS, as only a group of financial statements that includes the statements of financial position, comprehensive income, changes in stockholders' equity and cash flows, along with comparative information and explanatory notes, can provide an appropriate presentation of the financial position of the Company, the result of its operations and its cash flows in accordance with IFRS.

(25) Recently issued international standards

A series of new standards, amendments to standards and interpretations are applicable to the annual periods that start after January 1, 2012 and have not been applied in the preparation of these consolidated financial statements.

- In October 2010, the IASB issued NIIF 9 *Financial Instruments* (NIIF 9 (2010)) effective on January 1, 2013. NIIF 9 (2010) supersedes the previous version issued in November 2009 (NIIF 9 (2009)). Early adopters can choose to apply NIIF 9(2010) or NIIF 9 (2009) for periods starting before January 1, 2013.

- In December 2010, the IASB issued *Deferred Tax: Recovery of Relevant Assets – Modifications to NIC 12* that came into effect on January 1, 2012.

- In May 2011, the IASB issued NIIF 10 *Consolidated Financial Statements*, NIIF 11 *Joint Agreements*, NIIF 12 *Information to Disclose on Shares in Other Entities* and NIIF 13 *Fair Value Measuring* and all become effective on January 1, 2013. Besides, IASB issued NIC 27 *Separate Financial Statements* (2011), superseding NIC 27 (2008) and NIC 28 *Investments in Associated Companies and Joint Businesses* (2011) superseding NIC 28 (2008). All these standards come into effect on January 1, 2013.

- In June 2011, the IASB issued the *Presentation of Items of the Other Comprehensive Result* (Amendments to 1 *Presentation of Financial Statements*) effective on July 1, 2012.

  Company management is in the process of analyzing and evaluating possible effects, if any, that enforcing these changes could generate.