

***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

Consolidated Financial Statements

December 31, 2016 and 2015

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

Index

December 31, 2016 and 2015

---

<u>Contents</u>	<u>Page</u>
Independent Auditors' Report .....	1 to 7
Consolidated financial statements:	
Consolidated statements of financial position .....	8
Consolidated statements of income .....	9
Consolidated statements of comprehensive income .....	10
Consolidated statements of changes in shareholders' equity .....	11
Consolidated statements of cash flows .....	12
Notes to the consolidated financial statements .....	13 to 80

## **Independent Auditors' Report**

Monterrey, N. L., February 21, 2017

To the Shareholders and Directors of  
Axtel, S. A. B. de C. V. and subsidiaries

### **Opinion**

We have audited the consolidated financial statements of Axtel, S. A. B. de C. V. and subsidiaries (the "Company"), which comprise the consolidated statements of financial position at December 31, 2016 and the related consolidated statements of income, of comprehensive income, of changes in shareholders' equity and of cash flows for the period then ended, and the explanatory notes to the consolidated financial statements that include a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the Company's consolidated financial position at December 31, 2016, and its financial performance and its cash flows for the period then ended, in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB").

### **Basis of the opinion**

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the "Auditor's Responsibilities for the Audit of the Consolidated Financial Statements" section in this report. We are independent from the Company in accordance with the Ethics Code of the Mexican Institute of Public Accountants, together with ethical requirements applicable to our audit of the consolidated financial statements in Mexico, and we have complied with our ethical responsibilities in accordance with those requirements and said Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### **Key Audit Matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the current period. These matters were addressed in the context of our audit of the overall consolidated financial statements and in forming our opinion thereon, and we express no separate opinion on these matters.



---

**Key audit matter****Business combination**

As described in Note 2 to the consolidated financial statements, during the year ended December 31, 2016, the Company conducted the following business combination:

On February 15, 2016, Onexa, S. A. de C. V. ("Onexa"), a 100% direct subsidiary of Alfa, S. A. B. de C. V. ("Alfa") was merged into Axtel, S. A. B. de C. V. ("Axtel"), the surviving company.

Onexa was incorporated in the Axtel financial statements by using the predecessor method, and the difference between the book value of Onexa's net assets of \$3,368 million and the fair value of the issuance of Axtel shares of \$4,850 million was recognized as an effect of the merger on retained earnings.

Under IFRS, for the purpose of determining the acquiring party in a merger, it must be determined which entity obtains control, requiring significant judgments by Management with regard to the power to conduct its relevant activities, exposure to rights to variable returns stemming from its involvement and the link between power and yield.

Additionally, we focused on recognition of this acquisition during our audit, due mainly to the importance of the impact of the merger on the entity's financial position and because the determination of fair value of the shares issued requires applying significant judgments.

---

**How our audit addressed the matter**

Due to the significant judgments required to determine that the entity has obtained control, we:

- Obtained the analysis conducted by Management that includes the criteria used for determining the power to conduct its relevant activities, exposure or rights to variable returns stemming from its involvement and the link between power and returns.
- Compared the criteria used to determine the power to conduct its relevant activities, exposure or rights to variable returns stemming from its involvement and the link between power and returns with the terms of the "Master Operating Agreement", "Agreement between shareholders" and "Collaboration Agreement", as well as the minutes of Board of Directors' Meetings and other relevant information. Moreover, we attended meetings with Management and corroborated these decisions.
- We obtained confirmations from attorneys with regard to the preceding criteria.
- We evaluated the Company's power to designate key officers taking into consideration the points above.

Additionally, due to the significant judgments used by management in the valuation models for the determination of the consideration given, we involved our valuation experts to selectively evaluate the premises and criteria used by Management and their independent expert on said models. Specifically:

- We reviewed the reasonableness of the consideration given, with respect to the market ranges, conducting calculations in parallel to estimate the value of the majority interest in the company based on the total value of the business acquired.



## Assessment of impairment of long-lived assets

As mentioned in Notes 4k and 4m to the consolidated financial statements, the Company conducts annual impairment testing of intangible assets with an indefinite useful lifetime, and of property, plant and equipment and remaining intangible assets with a definite useful lifetime when there are events and circumstances that indicate that there are signs of impairment.

We have focused on this matter due mainly to the importance of the balance of property, plant and equipment of \$19,619 million and of intangible assets of \$1,838 million for the Company's consolidated financial statements, and due to the fact that the impairment testing involves applying significant judgments by the Company's Management in determining the assumptions and premises related to the estimation of the recovery value of cash generating units ("CGUs").

In particular, we focused on the following significant assumptions considered by the Company upon estimating the future projections to evaluate the recoverability of intangible assets and property, plant and equipment: estimates of future projections, growth rates, gross margins and discount rates used.

As part of our audit, we assessed future cash flows projections prepared by Management, and the processes used for preparation thereof. In particular, we assessed whether all relevant CGUs were identified and the internal processes was carried out by Management to perform the projections, including timely oversight from those charged with governance, and if the projections are consistent with the budgets approved by them.

Due to the significant judgments used in the valuation models for the determination of recovery values, and with the support of our valuation experts, we questioned the premise and criteria used by Management on said models, following the procedures set down below.

- We verified that the models applied in the determination of the recovery values of the assets are methods used and recognized in valuing assets with similar characteristics.
- We challenged the financial projections, including the terminal value, comparing them to the performance and historical trends, obtaining Management and explanations of variations.
- We compared actual results for the current year with the figures budgeted for the current year, to determine whether any of the assumptions included in the projections could be considered to be very optimistic.
- We compared the most significant valuation assumptions (growth rates, gross margins and discount rates used) with those commonly used and accepted for assets of this nature for the industry in which the Company operates.

- We discussed with Management the sensitivity calculations for all CGUs and evaluated the extent to which the assumptions would need to be modified for impairment to be required. Moreover, we discussed with Management the probability of those changes being made.

#### Evaluation of the recoverability of the deferred income tax asset

As described in Note 3.o), Note 6c.) and Note 19 to the consolidated financial statements, the Company recorded a deferred income tax asset arising from tax losses and therefore, Management performed a recoverability assessment thereof prior to recognizing it in its financial statements.

We have focused on this line item in our audit due to the importance of the balance of the deferred income tax asset arising from tax losses at December 31, 2016 (\$2,797 million) and because the estimate of its recoverable value involves application of significant judgments by the Company's Management; specifically, upon determining expected future income, future projections, as well as the Company's future tax results.

In particular, we focused our audit efforts on the significant assumptions that the Company considered in estimating the recoverability of the deferred tax asset, based on assumptions similar to those set out in the point above.

As part of our audit, we evaluated the projections used to determine the recoverability of the deferred income tax asset from tax losses. We compared these projections to those used to determine the recoverable value of the aforementioned goodwill, over which we applied procedures similar to those indicated above.

With the support of experts, we evaluated and also considered the projected tax results prepared by Management, as well as the processes used to prepare them.

We also challenged, with the support of our tax experts, the assumptions used by Management in tax projections.

We compared the actual results for the current year with the figures budgeted for the current year, to determine whether or not any of the assumptions included in the projections could be considered to be very optimistic.

Also, as mentioned above, we discussed with Management the sensitivity calculations and assessed the degree to which the assumptions would need to be modified to require adjustment.

---

#### Additional information

Company management is responsible for the additional information presented. This additional information comprises the Annual Report presented to the National Banking and Securities Commission ("CNBV" from Spanish) and the Annual Report presented to the shareholders (but does not include the consolidated financial statements and our audit report thereon), which is expected to be made available to us after the date of this report.

Our opinion on the consolidated financial statements does not cover the additional information and we will not express any form of assurance conclusion thereon.

However, in connection with our audit of the Company's consolidated financial statements, our responsibility is to read this additional information, when available, and determine whether it is materially inconsistent with the consolidated financial statements or with our knowledge acquired during the course of our audit, or otherwise appears to be materially misstated.

When we read the additional information that we have not yet received, we must issue a formal statement on the Annual Report required by the CNBV and if we conclude that there are any material misstatements therein, we must communicate this finding to those charged with governance and if required describe the issue in such statement.

#### **Responsibilities of Management and those charged with governance in connection with the Consolidated Financial Statements**

The Company's Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with IFRS and for the internal control structure considered by Management to be necessary to allow for ensuring that the consolidated financial statements are free of material misstatement due to fraud or error.

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

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

#### **Responsibilities of the auditors for the audit of the consolidated financial statements**

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatements arising from fraud or error, and to issue an audit report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted as per ISAs, will detect any material mistakes when they exist. Errors arise from fraud or error and are considered to be material if, either individually or in the aggregate, it can be reasonably concluded that they influence the economic decisions made by users based on the consolidated financial statements.





When conducting an audit in accordance with ISA, we exercise our professional judgment and apply our professional skepticism. We also:

- Identify and assess the risks of material misstatements in the consolidated financial statements whether due to fraud or error, design and perform audit procedures in response to those risks, and obtain sufficient and adequate audit evidence to provide a basis for our opinion. The risk of failing to detect a material misstatement arising from fraud is higher than that one resulting from an unintentional error, because fraud may involve collusion, forgery, intentional omissions, misrepresentations, or overriding of internal controls.
- Obtain an understanding of internal controls relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of the accounting policies applied and the reasonableness of the accounting estimates and of the related disclosures made by Management.
- Conclude on the appropriateness of Management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exist, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events, thus achieving a fair presentation.
- Obtain sufficient and adequate audit evidence in relation to the financial information of the entities or business operations within the company to express an opinion on the consolidated financial statements. We are responsible for directing, supervising and conducting the audit of the consolidated financial statements. We are the only party responsible for our audit opinion.

We communicate to those charged with governance, among other matters, the scope and timing and significant findings of the audit, as well as any significant internal control deficiency identified during the course of our audit.

We also provide those charged with governance with a statement declaring that we have complied with all relevant ethics requirements concerning independence and have advised them of all the relationships and other matters that could reasonably influence our independence, as well as the corresponding safeguards applied.





From the matters communicated to those charged with governance, we determine those considered to be the most significant in the audit of the consolidated financial statements for the current period and consequently, the audit key matters. We describe those matters in our audit report, unless the legal and regulatory provisions prohibit public disclosure thereof or, under extremely rare circumstances, we determine that a matter should not be communicated in our report, because the adverse consequences of doing so are expected to exceed the benefits of public interest.

The name of the audit partner assigned to conduct the audit of the Company is Ricardo Noriega Navarro.

PricewaterhouseCoopers, S. C.

A handwritten signature in black ink, appearing to be "RN", written over a faint, stylized PwC logo.

C.P.C. Ricardo Noriega Navarro  
Audit Partner

**Axtel, S. A. B. de C. V. and subsidiaries**  
(a subsidiary of Alfa, S. A. B. de C. V.)  
**Consolidated Statements of Financial Position**  
**At December 31, 2016 and 2015**

Thousands of Mexican pesos

		<u>December 31,</u>	
<u>Assets</u>		<u>2016</u>	<u>2015</u>
Current:			
Cash and cash equivalents	7	\$ 1,447,118	\$ 2,575,222
Trade receivables and other receivables, - Net	9	4,066,826	3,208,265
Inventories	10	109,388	53,069
Financial instruments	21	152,978	378,099
Prepayments		<u>517,455</u>	<u>151,511</u>
<b>Total current assets</b>		<b><u>6,293,765</u></b>	<b><u>6,366,166</u></b>
Noncurrent:			
Restricted cash	8	153,040	-
Non-current account receivable	9	8,642	128,613
Property, plant and equipment - Net	11	19,619,451	13,216,179
Goodwill and intangible assets - Net	12	1,838,727	124,999
Deferred income tax	19	4,056,773	2,235,469
Other non-current assets	13	<u>205,305</u>	<u>127,798</u>
<b>Total non-current assets</b>		<b><u>25,881,938</u></b>	<b><u>15,833,058</u></b>
<b>Total assets</b>		<b><u>\$ 32,175,703</u></b>	<b><u>\$ 22,199,224</u></b>
<u>Liabilities and Shareholders' equity</u>			
<u>Liabilities</u>			
Current:			
Debt	17	\$ 1,028,588	\$ 1,050,864
Trade payables and other payables	14	5,645,436	3,893,666
Provisions	15	129,647	190,100
Other liabilities	16	<u>1,022,605</u>	<u>509,415</u>
<b>Total current liabilities</b>		<b><u>7,826,276</u></b>	<b><u>5,644,045</u></b>
Noncurrent:			
Debt	17	20,485,861	12,475,950
Derivative financial instruments	21	-	65,222
Other non-current accounts payable	14	985,975	112,340
Employee benefits	18	467,036	28,231
Deferred income tax	19	<u>10,318</u>	<u>-</u>
<b>Total non-current assets</b>		<b><u>21,949,190</u></b>	<b><u>12,681,743</u></b>
<b>Total liabilities</b>		<b><u>29,775,466</u></b>	<b><u>18,325,788</u></b>
<u>Shareholders' equity</u>			
Controlling interest:			
Capital stock	20	10,233,841	6,861,986
Premium on issuance of shares		644,710	644,710
Reserve for the repurchase of shares		-	90,000
Retained earnings		(8,484,717)	(3,719,469)
Other reserves		<u>6,398</u>	<u>(3,791)</u>
<b>Total controlling interest</b>		<b>2,400,232</b>	<b>3,873,436</b>
Non-controlling interest		<u>5</u>	<u>-</u>
<b>Total shareholders' equity</b>		<b><u>2,400,237</u></b>	<b><u>3,873,436</u></b>
<b>Total liabilities and shareholders' equity</b>		<b><u>\$ 32,175,703</u></b>	<b><u>\$ 22,199,224</u></b>

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

Dr. Sergio Rolando Zubirán Shetler  
Chief Executive Officer

Lic. Adrián de los Santos Escobedo  
Chief Financial Officer

Ing. Manuel Ramírez López  
Corporate Controller

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Consolidated Statements of Income**

**For the years ended December 31, 2016 and 2015**

*Thousands of Mexican pesos*

		<u>Year ended December 31,</u>	
	<u>Note</u>	<u>2016</u>	<u>2015</u>
Net revenue		\$ 13,937,320	\$ 10,150,438
Cost of sales	22	<u>(5,944,104)</u>	<u>(4,143,378)</u>
Gross profit		7,993,216	6,007,060
Administration and selling expenses	22	(7,364,867)	(4,980,456)
Other (expenses) income - Net	23	<u>(837,729)</u>	<u>437,321</u>
Operating (loss) profit		(209,380)	589,283
Financial income	24	234,505	696,769
Financial expenses	24	<u>(5,090,904)</u>	<u>(3,391,508)</u>
Financial result - Net		<u>(4,856,399)</u>	<u>(2,694,739)</u>
Share of results in associates- Net		<u>(5,189)</u>	<u>(5)</u>
Pretax loss		(5,070,968)	(2,105,461)
Income tax	26	<u>1,471,706</u>	<u>373,194</u>
Consolidated loss - Net		<u>(\$ 3,599,262)</u>	<u>(\$ 1,732,267)</u>
Loss attributable to:			
Controlling interest		(\$ 3,599,267)	(\$ 1,732,267)
Non-controlling interest		<u>5</u>	<u>-</u>
		<u>(\$ 3,599,262)</u>	<u>(\$ 1,732,267)</u>
Loss per basic and diluted share*		<u>(\$ 0.20)</u>	<u>(\$ 0.19)</u>
Weighted average of common outstanding shares (thousands)		<u>18,415,933</u>	<u>9,185,205</u>

\* The impact of including the effect of convertible bonds and the financial liability as a result of the merger is anti-dilutive, thus the basic and diluted profit remains unchanged. See Note 20.

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

  
Dr. Sergio Rolando Zubirán Shetler  
Chief Executive Officer

  
Lic. Adrian de los Santos Escobedo  
Chief Financial Officer

  
Ing. Manuel Ramírez López  
Corporate Controller

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Consolidated Statements of Comprehensive Income**

**For the years ended December 31, 2016 and 2015**

*Thousands of Mexican pesos*

		<u>Year ended</u> <u>December 31,</u>	
	<u>Note</u>	<u>2016</u>	<u>2015</u>
Consolidated loss - net		(\$ 3,599,262)	(\$ 1,732,267)
Items to be reclassified to the statement of income:			
Effect of currency conversion	26	10,189	-
Items not to be reclassified to the statement of income:			
Remeasurement of defined benefit liability, net of taxes	26	<u>(17,617)</u>	<u>(1,182)</u>
Total comprehensive income for the period		<u>(\$ 3,606,690)</u>	<u>(\$ 1,733,449)</u>
Attributable to:			
Controlling interest		(3,606,695)	(1,733,449)
Non-controlling interest		<u>5</u>	<u>-</u>
Total comprehensive income for the year		<u>(\$ 3,606,690)</u>	<u>(\$ 1,733,449)</u>

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

  
Dr. Sergio Rolando Zubirán Shetler  
Chief Executive Officer

  
Lic. Adrián de los Santos Escobedo  
Chief Financial Officer

  
Ing. Manuel Ramírez López  
Corporate Controller

For the years ended December 31, 2016 and 2015

Page 11

**Axtel, S. A. B. de C. V. and subsidiaries**  
(a subsidiary of Alfa, S. A. B. de C. V.)  
**Statements of Cash Flows**  
**At December 31, 2016 and 2015**

Thousands of Mexican pesos

		Year ended December 31,	
	Note	2016	2015
Pretax loss		(\$ 5,070,968)	(\$ 2,105,461)
Adjustments from:			
Depreciation and amortization	22	3,829,589	2,618,567
Exchange loss, net	29, 24	2,778,679	1,659,066
Allowance for doubtful accounts	9	209,930	154,621
Profit from sale of property, systems computer equipment	23	4,483	(113,734)
Estimate of the realizable fair value of inventories		558	12,047
Interest income	24	(24,381)	(36,929)
Interest expenses	24	1,805,661	1,236,309
Amortization of premium on issuance of debentures		-	(2,213)
Employees Profit Sharing (PTU) currently payable		13,192	13,736
Equity in net results of associated companies		5,189	5
Disposal of property, plant and equipment	23	52,795	-
Provisions and other	15	(92,390)	190,100
Change in unrealized fair value and liquidation of financial instruments	24	296,439	(163,706)
Changes in working capital:			
Trade receivables and other accounts receivable, net	9	480,889	(410,685)
Inventories	10	(16,134)	14,028
Suppliers, related parties	14, 27	(789,846)	368,558
Employee benefits	18	180,175	3,104
Employees Profit Sharing (PTU) paid		(6,507)	(10,774)
Deferred income		474,117	(220,352)
Income Tax paid		(233,816)	(85,964)
<b>Net cash flows provided by operating activities</b>		<b>3,897,654</b>	<b>3,120,333</b>
<b>Investing activities:</b>			
Acquisitions of property, plant and equipment	11	(3,185,729)	(2,011,430)
Disposal of property, plant and equipment	11	80,772	129,823
Acquisition of intangible assets	12	(960,034)	-
Increase in financial instruments		-	(34,918)
Interest income		24,381	36,919
Notes receivable		51,544	(45,812)
Effect of merger, net	2	450,708	-
Disposal of investment in associated company		11,234	-
<b>Net cash flows used in investing activities</b>		<b>(3,527,124)</b>	<b>(1,925,418)</b>
<b>Financing activities</b>			
Current and non-current debt obtained		16,133,066	-
Payment of current and non-current debt		(15,421,366)	(399,611)
Paid interest and other financial expenses	24	(2,386,734)	(1,165,405)
<b>Net cash flows provided by financing activities</b>		<b>(1,675,034)</b>	<b>(1,565,016)</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(1,304,504)</b>	<b>(370,101)</b>
Exchange fluctuation of cash and cash equivalents		176,400	247,488
<b>Cash and cash equivalents at beginning of year</b>		<b>2,575,222</b>	<b>2,697,835</b>
<b>Cash and cash equivalents at end of year</b>		<b>\$ 1,447,118</b>	<b>\$ 2,575,222</b>
<b>Investment operations not requiring the use of cash flows:</b>			
Issuance of shares, indemnification, financial liability arising from merger and transfer of capital reserves (see Note 2 and Note 20)	20	\$ 36,094	\$ 133,644
Conversion of bonds		\$ 174,201	\$ 647,734
Capital leasing			

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

Dr. Sergio Rolando Zubiran Shetler  
Chief Executive Officer

Lic. Adrián de los Santos Escobedo  
Chief Financial Officer

Ing. Manuel Ramírez López  
Corporate Controller

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

Notes to the Consolidated Financial Statements

At December 31, 2016 and 2015

---

*Thousands of Mexican pesos, unless otherwise specified*

## **Note 1- General Information:**

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

Axtel is a publicly owned corporation, whose shares are registered at the National Securities Registry and are traded at the Mexican Stock Exchange (the "Bolsa" from Spanish) through Certificates of Participation ("COPs") issued under the Trust, whose trustee is Nacional Financiera, S. N. C., a subsidiary of Alfa, S. A. B. de C. V. ("ALFA"), direct controlling and last company of the Group, which exercises control and holds 50.19% through the Trust Administration Agreement No. 2673 entered into with Banco Invex, S. A. ALFA has control over the Company's relevant activities.

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

Axtel conducts its activities through subsidiary companies of which it is the owner or of which it controls, either directly or indirectly, most of the common shares representing their capital stock. See Note 4. The term "the Company", as used in this report, refers to Axtel and its subsidiaries in the aggregate.

In the notes to the financial statements, reference to pesos or "\$" stands for thousands of Mexican pesos. The captions dollars or "US\$" refer to thousands of U.S. dollars, unless otherwise specified.

## **Note 2 - Relevant events:**

### **2016**

#### **a. Merger**

On December 3, 2015, the Company, ALFA and Onexa, S. A. de C. V. ("Onexa"), a subsidiary of ALFA and a group of the main shareholders of Axtel signed a cooperation agreement, as well as an agreement among shareholders ("the Agreements") to merge Onexa into Axtel. Onexa holds the capital stock of Alestra, S. de R. L. de C. V. (Alestra) and 100% direct subsidiary of ALFA.

On December 15, 2015, the Company published an informative brochure at the Mexican Stock Exchange, through which, it officially declared its intention to enter into an agreement for the merger of Onexa into Axtel.

On January 15, 2016, Axtel and Onexa held extraordinary shareholders' meetings to approve the merger, designating the members of the Board of Directors, the CEO and the Audit and Corporate Practices Committees. After completing the process pertaining to the legal, operating and financial review, and obtaining authorizations from the authorities, the transaction became effective on February 15, 2016, when Alfa became Axtel's majority shareholder, with the merged company



## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

disappearing and surviving company subsisting under its current business name Axtel, S. A. B. de C. V. As a result of the aforementioned merger, ALFA holds 50.19% of Axtel outstanding shares. According to the assessment of control conducted by Management, it was determined that the acquiring party was ALFA, due to which, goodwill arising from the merger and any other related effect were recorded in ALFA.

Onexa was a holding company whose only asset was its 99.98% interest in Alestra's capital stock. In turn, Alestra is a lead supplier in the IT and telecommunications service market in Mexico. Alestra focuses on the business segment, including multinational companies, institutional customers, as well as small and medium companies. Through its extensive optic-fiber and data-center network, Alestra offers administrative network, IT, data and internet services, as well as local and international long-distance services. In recent years, Alestra has refocused its business strategy by concentrating on the segment pertaining to administrative networks and IT service such as data centers, cloud services, systems integration and network security.

Under the merger agreements, in exchange for 100% of Onexa voting shares, Axtel issued 9,668,965,488 shares for ALFA, at the rate of 0.8027 per Onexa share, acquiring 50.19% of the combined entity's voting shares. The Agreements established a series of rights and obligations for the parties involved in terms of corporate governance and decision making, that granted ALFA the ability to direct activities related to the merged entity, mainly due to the fact that ALFA appoints most of the members of the Board of Directors and the main Directors who hold the power to direct the merged entity's relevant operations. Alestra's CEO, who prior to the transaction was a 100% subsidiary of ALFA, is the Company's CEO as from February 15, 2016.

As from the merger date, Alestra is a subsidiary of Axtel. Its inclusion in the consolidated financial statements was not recognized as a business combination due to the fact that Alestra is controlled by ALFA both before and after the merger. Alestra's net book value was recognized using the predecessor method and no profit or loss was recognized in the statement of income as a result of the transaction.

The difference between the book value of Alestra net assets of \$3,368,099 and the fair value of the issue of shares of \$6,850,122 was recognized as an effect of the merger in the merger reserve of \$3,482,023. See note 20.

As part of the merger, on the date the transaction took effect, in a separate operation but related to the merger, and based on the Agreements, Alestra paid \$809,793 as compensation for assuming certain obligations to do and not to do (confidentiality and abstaining from certain activities, among others), which has been recognized as an intangible asset. See Note 12.

The aforementioned Agreements included certain indemnity payments in the event of default by any of the parties, such as: a consequence of the lack of integrity, inaccuracy or falsehood, solely with respect to their own statements and/or failure to comply with their respective obligations. On the basis of the foregoing and in accordance with the obligations assumed under the aforementioned Agreements, an agreement was reached for ALFA to receive compensation from Axtel for the negative economic effects that resulted in the uncollectibility of certain accounts receivable of \$983,747. See Notes 20 and 27. Said amount was recorded with a charge to capital, as it pertained to operations between the holding company, ALFA, and its subsidiary, Axtel, at the period close, the liability has been recorded in related parties in the Suppliers and other accounts payable line item.

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

As a result of the aforementioned merger agreements, the parties agreed to an adjustment to the fair value assigned to the issuance of shares to ALFA, related to the exchange rate of the Mexican peso to the U.S. Dollar, as published in the Official Gazette. In said agreement expiring on July 14, 2017, ALFA is required to pay a minimum US\$0 and up to US\$65 million, in the event the average exchange rate is between \$16 and \$14.50 pesos or less to the U.S. dollar up to the date of expiration. Otherwise, ALFA would receive between 0% and 2.50% additional shareholding interest in Axtel, with a maximum cap of up to 53.5%, if said exchange rate were between \$17.01 and \$18.50 pesos or more to the U.S. dollar. In accordance with IFRS (IAS 32), this agreement represents a financial liability to be liquidated with own shares presented in the short term in the Suppliers and other accounts payable line item. At December 31, 2016, Axtel has applied \$246,396, corresponding to the value of the instrument, to retained earnings. Upon exercising this instrument, at maturity, the conversion will result in a variable number of shares, increasing the capital stock and canceling the corresponding liability.

As a result of the merger, the Company incurred a number of expenses totaling \$835,200, which it classified as merger expenses in the other operating expenses line item. See Note 23.

Income contributed for Alestra assets included in the consolidated statement of income from the effective acquisition date at December 31, 2016 amounted to \$5,889,266 and a net profit of \$228,812. Had the acquisition taken place on January 1, 2016, income would have increased by \$780,759 and net income would have decreased by approximately \$91,383.

#### **b. Borrowings**

As a result of the above-mentioned transaction, the Company conducted the following operations:

- i. On January 15, 2016, the Company signed a loan of US\$500,000 and \$4,759,000 to refinance all of the senior notes expiring on 2017, 2018 and 2020. Redemption took effect on February 19, 2016. The entire new loan expires in January 2019 for the portion in pesos and quarterly payments to the capital as from April 2018 and up to February 2021 for the dollar portion, at the interbank interest rate (TIIE from Spanish) for the portion in pesos, plus 2% in the first year, TIIE plus 2.25% in the second and TIIE plus 2.5% in the third and an initial interest rate for the dollar portion at the Libor, plus 2.25%, to be increased up to the Libor plus 3.25%. Management analyzed the effects of this operation and determined it had acquired a new debt.

During April 2016, the Company obtained an additional portion of said loan, for \$1,500 million, to refinance the debt maturing in the short term. This portion matures at 5 years, quarterly payments on the capital as from 2018 at the TIIE + 2.25%, to be increased to the TIIE + 2.75%.

In order to obtain these resources, expenses were incurred in the amount of \$270,168, of which, during 2016, \$98,108 has been recognized as part of the effective interest expense related to the new debt. Moreover, in 2016, the Company exercised its option for prepayment and incurred a penalty for early cancellation of \$758,064, which was recognized as part of the interest expense on financing. The Company charged a net total \$83,527 to income for the year, corresponding to costs, discounts and premiums on the original debt.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

On January 31, 2013, the Company completed an exchange of unsecured bonds maturing in 2017 and 2019, for bonds and a secured convertible bond, respectively, maturing in 2020, plus a payment in cash to the participating holders. The holders of the convertible bonds could opt to convert the notes in American Depositary Shares ("ADSs") or in Certificate of participation (COPs). An embedded derivative was recorded, arising from the conversion option. Said derivative of \$71,318 was extinguished at the date of prepayment of the debt and was applied to financial income for the period.

### **2015**

#### **c. Dispute resolution**

During 2015, the Company entered into a number of agreements related to disputes with other telephone service operators, as follows:

- On March 18, 2015, the Company signed a transaction agreement with América Móvil, S. A. B. de C. V., ("AMX") and its affiliate Radiomóvil Dipsa S. A. de C. V. ("Telcel"), whereby it was agreed to terminate a number of disputes related to interconnection services. As part of the agreement, the Company and Telcel entered into an interconnection agreement for the period from 2005 to 2015. Moreover, the Company, Telcel and Teléfonos de México S. A. B. de C. V. ("Telmex") agreed to voluntarily dismiss a number of disputes involving interconnection matters.

As a result of the agreements and after settling, for and against, the different amounts in dispute and/or pending payment, the Company entered into agreements to market and resell telecommunications services and for shared access and use of idle infrastructure with Telcel and Telmex, respectively.

- In another act that took place that same day, the Company and companies pertaining to the Iusacell Group ("Iusacell") signed an agreement whereby both parties end the disputes related to interconnection services for the 2005-2010 period. During said act, the Company and Iusacell signed a number of commercial agreements involving telecommunications infrastructure for their mutual benefit.
- Lastly, on May 27, 2015, the Company signed an agreement with Pegaso PCS, S. A. de C. V. ("Telefónica México"), whereby both parties terminate the disputes related to interconnection services for the period from 2005 to 2011.

As a result of the above agreements and having settled, for and against, the different amounts in dispute and/or pending payment, the Company obtained net income in cash of \$534,240, shown in the statement of income in the Cost of sales line item.

### **Note 3 - Revised financial statements**

The Company has corrected its consolidated financial statements at December 31, 2015, due to an immaterial correction in the determination of the provision for impairment of trade receivables, which was determined inaccurately. Management conducted an evaluation under IAS 8 "Accounting policies, changes in accounting estimates and errors", concluding that qualitatively and quantitatively, the effect is not material for the Company to reissue its historical information and therefore, decided to correct the figures following the revised model.

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

Following are the comparative figures in the financial statements at December 31, 2015 pertaining to the revision described in the above paragraph:

	<u>Previously reported</u>	<u>Revised balance</u>
<u>Statement of financial position</u>		
Accounts receivable, net (Note 9)	\$ 2,893,017	\$ 2,454,656
Value added tax and other taxes payable (Note 14)	(642,530)	(582,066)
Deferred income tax, net (Note 19)	2,103,961	2,235,469
Retained earnings and other reserves	<u>(3,476,871)</u>	<u>(3,723,260)</u>
<u>Statement of income</u>		
Administrative and selling expenses	(\$ 4,960,582)	(\$ 4,980,456)
Deferred tax	428,537	434,499
Consolidated net loss	<u>(1,718,355)</u>	<u>(1,732,267)</u>
<u>Consolidated statement of comprehensive income</u>		
Comprehensive loss	<u>(\$ 1,719,537)</u>	<u>(\$ 1,733,449)</u>
<u>Statement of cash flows</u>		
Cash flows provided by operating activities		
Loss before taxes on income	(\$ 2,085,587)	(\$ 2,105,461)
Increase in trade receivables and other accounts receivable	<u>(430,559)</u>	<u>(410,685)</u>

Additionally, the following notes to the consolidated financial statements were modified for the aforementioned review. See Notes 9, 14 and 19

#### **Note 4 - Summary of significant accounting policies:**

The accompanying consolidated financial statements and notes thereto were authorized for issuance on February 21, 2017 by the undersigned officers.

Following is a summary of the most significant accounting policies followed by the Company and its subsidiaries, which have been applied consistently in preparing its financial information in the years presented, unless otherwise specified:

##### **a. Basis of preparation**

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

The consolidated financial statements have been prepared on the basis of historical cost.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

Preparation of the consolidated financial statements in accordance with IFRS requires the use of certain critical accounting estimates. It also requires that Management exercise its judgment in the process of applying the Company's accounting policies. The areas involving a greater degree of judgment or complexity, as well as the areas in which the judgments and estimates are significant for the consolidated financial statements are disclosed in Note 6.

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

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

The following standards and modifications have been adopted by the Company for the first time for the period started on January 1, 2016:

- Clarification of acceptable depreciation and amortization methods - Revisions of IAS 16 and IAS 38.
- Annual revisions of cycle 2012 - 2014 IFRS
- Initiative of disclosures - Amendments to IAS 1.

Adoption of these amendments has had no impact in the current period or any preceding period and is unlikely to affect any future periods.

#### **ii. New standards and interpretations yet to be adopted by the Company.**

A number of new standards, amendments and interpretations thereof have been published, and are not effective for reporting periods at December 31, 2016, and have not been adopted in advance by the Company.

Following is the Company's evaluation of the effects of these new standards and interpretations:

IFRS 9 "Financial instruments". This standard addresses classification, measurement and recognition of financial assets and liabilities and introduces new hedge accounting rules. In July 2014, the IASB made additional changes to classification and measurement rules and introduced a new impairment model. These latest changes now make up the overall new financial instrument regulation. The new hedge accounting rules require that a company's hedge accounting be in line with risk management thereof. As a general rule, hedge accounting is easier to apply, as the standard introduces a principles-based approach. The new standard also introduces extensive disclosure requirements and presentation changes, which continue to be evaluated by the Company. The new impairment model is a model of expected loan losses, which would therefore result in early recognition of credit losses. The Company will continue assessing the impact of adopting this standard. This standard is effective for annual periods beginning on or after January 1, 2018. Early adoption is allowed.

In May 2014, the IASB issued IFRS 15 "Revenue from contracts with customers" ("IFRS 15"). Under IFRS 15, an entity recognizes revenue as evidence of the transfer of goods or services promised to customers, for an amount that reflects the compensation that the entity expects to earn in exchange, following the five-step model: Step 1: identifying the contract(s) with the customer, reflected under agreements between two or more parties that create rights and obligations payable; Step 2: identifying the deliverables set down in the contract, considering the fact that if a contract includes promises, they

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

are different deliverables and must be recorded separately; Step 3: determining the transaction price, representing by the amount established in the contract that the company expects in return for the transfer of goods and services promised to the customer; Step 4: distributing the price of the transaction to the deliverables under the contract, on the basis of the selling price related individually considered for each of the goods or for each service promised in the contract; and Step 5: recognizing revenue when (to the extent that) the entity satisfies the deliverables, through the transfer to the customer of the promised goods and services (when the customer obtains control of the goods or services). A deliverable can be satisfied at the point in time (commonly in promises to deliver goods to the customer) or during a period of time (commonly in promises to provide services to the client). IFRS 15 includes the disclosure requirements to provide comprehensive information with respect to the nature, amount, periodicity and uncertainty of the income and cash flows resulting from the contracts of an entity with its customers. IFRS 15 will replace all existing standards for revenue recognition.

This standard is effective for annual periods beginning on or after January 1, 2018. For the transition, the standard allows for a complete retrospective approach and a modified retrospective approach for adoption thereof. The Company has evaluated the two approaches and the modified retrospective approach is that used for the adoption. Under this approach, adjustments are recognized for the initial application effect (January 1, 2018) on retained earnings in the financial statements at December 2018, without reformulating the comparative period, applying the new rules to contracts in effect as from January 1, 2018 or those which, although pertaining to prior years, remain in effect at the date of initial application.

For the purposes of disclosure of the 2018 financial statements, the amounts of line items credited or debited must be mentioned, taking into account application of the current Revenue standard, as well as an explanation of the reason underlying the significant changes made.

The Company is currently implementing a project to evaluate the impact of IFRS 15 on its financial information and the matters considered more relevant are:

- The Company identified that there are contracts with customers under which different performance obligations could need to be recognized separately, resulting in changes in the timing and form of recognizing revenue. Due to the complexity of certain contracts with companies and government, the effort and level of judgment required for this evaluation is high.
- Upon distributing revenue among each of the performance obligations that differs from the current standard, the revenue amount to be recognized for each compliance obligation could also change, thus possibly changing the timing of revenue recognition.
- In some cases, the agent and principal evaluation could change with respect to the current analysis, upon including the matter of control in the evaluation. This is why an evaluation is being conducted to determine whether or not the presentation of revenue from the sale of licenses to third parties could have a change.
- Commission currently paid for the acquisition of contracts are applied to income as they are incurred, under the new standard for revenue, these payments could qualify as subject to capitalization and are amortized during the expected time of the contract.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

Management considers that the effort made for implementation and the impact of this standard could be relevant. During 2017, the Company will work on identifying impacts.

**IFRS 16 - "Leases"** In January 2016, the IASB issued a new rule for accounting for leases. That rule replaces current IAS 17, which classifies leasing as either financial or operating. IAS 17 identifies leases as financial when the risks and benefits of an asset are transferred, and all others as operating leases. IFRS 16 eliminates classification of leases as either financial or operating and requires recognition of a liability by reflecting future payments and an asset for "right to use" in most leases.

The IASB has included certain exceptions for short-term leases and leases of low-value assets. The above modifications are applicable to accounting for leases, while rules for the lessor remain similar to current rules. The most significant effect of the new requirements is reflected in the increase in leasing assets and liabilities, which also affects the statement of income under depreciation and financing expenses for assets and liabilities recognized, respectively, and reduces expenses pertaining to leases previously recognized as operating. At the date of issuance of these financial statements, the Company has not quantified the impact of the new requirements. The rule is effective for periods beginning on or after January 1, 2019, with early adoption allowed, provided IFRS 15 is also adopted.

There are no other IFRS or interpretations thereof yet to take effect or still expected to have a significant impact on the entity in the reporting periods, either current or future, and in foreseeable future transactions.

### **c. Consolidation**

#### **i. Subsidiaries**

Subsidiaries are all entities over which the Company exercises control. The Company controls an entity when it is exposed or is entitled to variable yields arising from an interest in the entity and is capable of affecting yields through its power over the entity. When the Company's interest in the subsidiaries is under 100%, the interest attributed to the external shareholders is reflected as non-controlling interest.

The subsidiaries are consolidated in their entirety from the date on which control is transferred to the Company and up to the date on which said control is lost.

The accounting method used by the Company for business combinations is the acquisition method. The Company defines a business combination as a transaction in which control of a business is obtained and through which it has the power to direct and manage the activities relevant to the body of assets and liabilities pertaining to said business, for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to the investors.

The consideration transferred in the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interest issued by the Company. The consideration paid includes fair value of any asset or liability arising from a contingent consideration agreement. The identifiable assets acquired, the liabilities and contingent liabilities assumed in a combination of businesses are initially measured at their fair value on the acquisition date. The Company recognizes any non-controlling interest in the acquired entity based on the proportional part of the non-controlling interest in the acquired entity's identifiable net assets.



# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

Acquisition-related costs related to the acquisition are recorded as expenses in the statement of income as they are incurred.

Goodwill is initially measured as the excess of the consideration paid and fair value of the non-controlling interest in the subsidiary acquired over the fair value of identifiable net assets and liabilities acquired. If the consideration transferred is below the fair value of the acquired subsidiary's net assets in a purchase at a bargain price, the difference is directly recognized in the consolidated statement of income.

The Company applies the accounting of the predecessor method for business combinations between entities under common control as from the date on which the transaction was conducted. The predecessor method consists of including the book value of the acquired entity, which includes goodwill recorded at the consolidated level with respect to the acquired entity. Any difference between the consideration paid by the Company and the book value of the net assets acquired at the subsidiary level is applied to capital.

Intercompany transactions and balances, as well as unrealized earnings from transactions between Axtel companies are eliminated in the preparation of the consolidated financial statements. Unrealized losses are eliminated. In order to ensure consistency with Company policies, the amounts reported of the subsidiaries have been modified when considered necessary.

At December 31, 2016 and 2015, the companies that comprise Axtel's consolidated financial statements are as follows:

<u>Company</u>	<u>País</u>	<u>Shareholding percentage (%)</u>		<u>Functional currency</u>
		<u>2016</u>	<u>2015</u>	
Axtel, S. A. B. de C. V. (Controlling company) <sup>(3)</sup>	México			Peso
Servicios Axtel, S. A. de C. V. <sup>(1)</sup>	México	100.00%	100.00%	Peso
Alestra Comunicación, S. de R. L. de C. V. <sup>(3) (d)</sup>	México	100.00%	100.00%	Peso
Avantel, S. de R. L. de C. V. ("Avantel") <sup>(3)</sup>	México	100.00%	100.00%	Peso
Telecom Network, Inc. <sup>(3) (4) (a)</sup>	USA	-%	100.00%	Dollar
Avantel Networks, S. A. de C. V. <sup>(3) (4) (b)</sup>	México	-%	100.00%	Peso
Axes Data, S. A. de C. V. <sup>(1) (4)</sup>	México	100.00%	100.00%	Peso
Contacto IP, S. A. de C. V. <sup>(1)</sup>	México	100.00%	100.00%	Peso
Instalaciones y Contrataciones, S. A. de C. V. <sup>(1)</sup>	México	100.00%	100.00%	Peso
Axtel Track, S. A. P. I. de C. V. <sup>(1) (c)</sup>	México	-%	100.00%	Peso
Alestra, S. de R. L. de C. V. ("Alestra") <sup>(3)</sup>	México	100.00%	-	Peso
Servicios Alestra, S. A. de C. V. <sup>(1)</sup>	México	99.98%	-	Peso
Ingeniería de Soluciones Alestra, S. A. de C. V. <sup>(1)</sup>	México	100.00%	-	Peso
Alestra USA, Inc. <sup>(2) (4)</sup>	USA	100.00%	-	Dollar
G-Tel Comunicación, S. A. P. I. de C. V. ("G-Tel") <sup>(3) (d)</sup>	México	-	-	Peso
S&C Constructores de Sistemas, S. A. de C. V. ("S&C")	México	100.00%	-	Peso
Alesre Insurance Pte, Ltd. <sup>(4)</sup>	Singapore	100.00%	-	Dollar
Cogeneración de Querétaro, S. A. de C. V. <sup>(1)</sup>	México	99.99%	-	Peso
Estrategias en Tecnología Corporativa, S. A. de C. V. ("Estratel") <sup>(3)</sup>	México	100.00%	-	Peso
Servicios Alestra TI, S. A. de C. V. <sup>(1)</sup>	México	99.90%	-	Peso

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

- (a) Company liquidated on November 29, 2016.
- (b) Company liquidated on September 21, 2016.
- (c) Company liquidated on November 17, 2016.
- (d) On July 25, 2016, the merger of G-Tel Comunicación, S. A. P. I. de C. V. into Alestra Comunicación, S. de R. L. de C. V., (formerly Avantel Infraestructura, S. de R. L. de C. V.) was agreed. This merger became effective on August 1, 2016.

- (1) Provider of administrative services.
- (2) Leasing of telecommunications and infrastructure equipment.
- (3) Provider of telecommunications services.
- (4) Company with no operations.

At December 31, 2016 and 2015, there are no restrictions in the subsidiaries over the Company's capability to use the assets or liquidate the liabilities.

Balances and operations between group companies have been eliminated in preparing the consolidated financial statements.

### **ii. Associated companies**

Associated companies are those over which the Company has significant influence, but not control, generally from holding between 20% and 50% of the voting rights in the associated company. The Company's investment in associated companies includes the goodwill identified in the acquisition, net of accumulated impairment losses.

If equity in an associated company is reduced but significant influence is retained, only a portion of the amounts previously applied to comprehensive income will be reclassified to income for the year, when appropriate.

The Company's equity in the profits or losses of the associated company following the acquisition is recognized in the statement of income and its equity in the comprehensive results following the acquisition is recognized directly in other components of comprehensive income. Post-acquisition accumulated movements are adjusted against the book value of the investment. When the Company's equity in the associated company's losses is equal to or exceeds its equity in the associated company, including any unsecured account receivable, the Company does not recognize future losses, unless it has incurred obligations or has made payments on behalf of the associated company.

The Company assesses, at each reporting date, whether or not there is objective evidence that the investment in the associated company is impaired. If so, the Company calculates the impairment loss as the difference between the recoverable value of the associated company and its book value, and recognizes the amount in "Equity in losses of associated companies recognized by the equity method" in the statement of income.

The unrealized gains on transactions between the Company and its associated companies are eliminated according to the interest the Company has in each. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. In order to ensure consistency with Company policies, the associated companies' accounting policies have been modified.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

When the Company ceases to have significant influence over an associated company, any difference between the fair value of the retained investment, including any consideration received from disposal of part of the equity, and the book value of the investment.

During 2016, the only associated company was Conectividad Inalámbrica 7 GHz, S. de R. L. de C. V. ("Conectividad Inalámbrica"), which was liquidated during the period. At December 31, 2015, the company had no associated companies.

### **c. Foreign currency conversion**

#### **i. Functional and reporting currency**

The amounts included in the financial statements of each of the Company's entities must be measured using the currency of the primary economic environment in which the entity operates (functional currency). The consolidated financial statements are shown in Mexican pesos, which is the Company's reporting currency. Note 4c. contains a description of the functional currency of the Company and its subsidiaries.

#### **ii. Transactions and balances**

Foreign currency transactions are converted to the functional currency using the exchange rate in effect on the transaction or valuation dates, when the amounts are re-measured. Exchange gains and losses resulting from settlement of said transactions and from conversion of monetary assets and liabilities denominated in a foreign currency at the closing exchange rates are recognized as exchange fluctuation in the statement of income, except for those deferred in the comprehensive income and which qualify as cash flow hedges.

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

#### **iii. Consolidation of foreign subsidiaries**

The financial statements of the subsidiary companies that maintain a recording currency other than the functional currency, were converted to the functional currency, as per the following procedure:

- a. The balances shown for monetary assets and liabilities stated in the recording currency are converted at the closing exchange rates.
- b. The historical balances of non-monetary assets and liabilities and of shareholders' equity converted to the functional currency are increased by the movements occurred during the period, which were converted at the historical exchange rates. Movements of non-monetary items recognized at fair value, occurring during the period and stated in the recording currency, are converted using the historical exchange rates at the date on which said fair value was determined.
- c. Income, costs and expenses for the periods stated in the recording currency (euro), were converted at the historical exchange rates of the date on which they arose and were recognized in the statement of income, unless they originated from non-monetary items, in which case, the historical exchange rates of non-monetary items were used.

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

- d. The exchange differences arising from conversion from the recording currency to the functional currency were recognized as income or expenses in the statement of income in the period in which they arose.

Following is a summary of the main accounting principles:

	<u>Local currency unit in Mexican pesos</u>			
	Exchange rate prevailing at the close of <u>December 31,</u>		Average annual exchange rate	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
US dollar	20.66	17.21	18.66	15.85
United States				

d. Cash and cash equivalents

Cash and cash equivalents include cash on hand, bank deposits available for the operation and other high-liquidity short-term investments with original maturities of three months or less, all subject to immaterial risks of changes in value.

e. Restricted cash

Cash, whose restrictions resulted in failure to meet the aforementioned definition of cash and cash equivalents, is shown in the line item shown separately in the statement of financial position and are excluded from cash and cash equivalents in the statement of cash flows.

f. Financial instruments

Financial assets

The Company classifies its financial assets in the following categories: at fair value through income, loans and accounts receivable, investments held to maturity and available for sale. Classification depends on the intended purpose of the financial assets. Management determines the classification of its financial assets upon initial recognition thereof. Purchases and sales of financial assets are recognized on the settlement date.

Financial assets are initially recognized on a fair value basis. Transaction costs directly attributable to the acquisition or issuance of financial assets (other than financial assets at fair value with changes in income) are added or deducted from the fair value of financial assets, as applicable, in their initial recognition. Transaction costs directly attributable to the acquisition of financial assets at fair value with changes in income are immediately applied to income.

Financial assets are canceled in their entirety when the right to receive related cash flows expires or is transferred and the Company has substantially transferred all of the risks and benefits inherent to ownership thereof, as well as control over the financial asset.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

### **i. Financial assets at fair value through income**

Financial assets at their fair value through income are financial assets held for trading. A financial asset is classified in this category if it was mainly acquired to be sold in the short-term. Derivative financial instruments are also classified as held for trade, unless they are designated as hedges.

Financial assets recorded at fair value through income are initially recognized at their fair value and transaction costs are recorded as expenses in the statement of income. Gains or losses arising from changes in the fair value of these assets are applied to income for the period in which they were incurred, in the Other expenses, net line item.

### **ii. Loans and accounts receivable**

Accounts receivable are non-derivative financial assets with fixed or determined payments that are not traded in an active market. They are included as current assets, except for maturities of over 12 months after the date of the statement of financial position. They are classified as non-current assets.

Loans and accounts receivable are initially valued at fair value, plus transaction costs incurred, and are subsequently recognized at amortized cost, using the effective interest rate method. When circumstances arise that indicate that receivables will not be collected in the amounts initially agreed or will but at a different term, said accounts receivable are impaired.

### **Financial liabilities**

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

Accounts payable are obligations to pay for goods or services either acquired or received from suppliers in the normal course of business. Loans are initially recognized at fair value, net of transaction costs incurred. Loans are subsequently recorded at their amortized cost. Any differences between the amounts received (net of transaction costs) and the settlement value is recognized in the statement of income during the term of the loan, using the effective interest method.

### **Impairment of financial instruments**

#### **a. Financial assets valued at their amortized cost**

At the end of every reporting year, the Company evaluates whether or not there is objective evidence of impairment of each financial assets or group of financial assets. An impairment loss is recognized only if there is objective evidence of impairment resulting from one or more events occurring after initial recognition of the asset (a "loss event") and provided the loss event or events have an impact on the estimated future cash flows arising from the financial asset or group of financial assets that can be reliably estimated.

The aspects evaluated by the Company to determine whether or not there is objective evidence of impairment is:

- Significant financial difficulties of the issuer or debtor.

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

- Noncompliance with the contract, such as late payment of interest or principal.
- The Company's granting of a concession to the issuer or debtor as a result of the issuer's or debtor's financial difficulties not considered under other circumstances.
- The issuer or debtor is likely to declare bankruptcy or some other type of financial reorganization.
- The disappearance of an active market for the financial asset is due to financial difficulties.
- Verifiable information indicating that there is a quantifiable decrease in future estimated cash flows relative to a group of financial assets subsequent to initial recognition, although the decrease cannot yet be identified with individual financial assets, such as:
  - i. Adverse changes in the status of debtor payments on the group of assets.
  - ii. Domestic or local conditions related to noncompliance on the part of issuers of the group of assets.

Based on the aforementioned aspects, the Company evaluates the objective evidence of impairment, if any, the book value of the asset is decreased by said amount, and is recognized in the statement of income.

If the interest rate of a loan or investment held to maturity is variable, the discount rate to measure any impairment loss is the current effective interest rate determined according to the terms of the contract. Alternatively, the Company could determine the impairment of the asset considering its fair value determined on the basis of its current observable market price.

If the impairment loss is reduced in subsequent years due to objective verification of an event occurred subsequent to the date on which said impairment was recorded (such as an improvement in the debtor's credit rating), the reversal of the impairment loss is recorded in the statement of income.

Information on impairment of accounts receivable is set out in Note 9.

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

All derivative financial instruments contracted and identified, classified as fair value hedging or cash flow hedging for trading purposes, or market risk hedging, are recognized in the statement of financial position as assets and/or liabilities at fair value and are subsequently measured at fair value. Fair value is determined on the basis of recognized market prices and when they are not traded in the market, it is determined based on valuation techniques accepted in the financial sector, using inputs and variables observable in the market, such as interest rate and exchange rate curves obtained from reliable sources of information.

The fair value of derivative financial instruments used as hedging instruments is classified as a non-current asset or liability if maturity of the remaining hedge amount is over 12 months, and as a current asset or liability if maturity of the remaining hedge amount is under 12 months.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

Derivative instruments hedges are contracted to cover risks and there is compliance with all coverage requirements. Designation is documented at the outset of the coverage operation, describing the purpose, the primary position, risks to be covered, types of derivatives and measurement of the effectiveness of the relationship, features, accounting recognition and the manner in which effectiveness is to be measured in the case of that operation.

### **h. Inventories**

Inventories are shown at the lesser of its cost and net realization value. The cost of the products includes only the purchase price of the products. The net realization value is the selling price estimated in the normal course of the business, less the applicable corresponding variable selling costs. The cost is determined by the First-in, first-out (FIFO) method.

Physical inventory counts are conducted periodically and inventory records are adjusted according to the results of said counts. Historically, shortages have been immaterial, as the Company has implemented strict inventory control procedures.

### **i. Prepayments**

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

### **j. Property, plant and equipment**

The components of property, plant and equipment are recorded at their cost, less accumulated depreciation and the accrued amount corresponding to impairment losses. The cost includes expenses directly attributable to acquisition of the asset.

Subsequent costs are included in the book value of the asset or recognized as an asset separately, as appropriate, only when the Company is likely to obtain future economic benefits from the asset, and the cost of the component can be calculated reliably. The carrying amount of the replaced part is derecognized. Repairs and maintenance are recognized in the statement of income during the year in which they are incurred. Significant improvements are depreciated during the remaining useful lives of the related asset.

Depreciation is calculated by the straight-line method, separately considering each of their components, except for land not subject to depreciation. The average useful life of families of assets are as follows:

	<u>Years</u>
Buildings	40 - 60
Computer equipment	3 - 5
Transportation equipment	4
Office equipment	10
Telecommunications network	6 to 28



## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

Spares and parts for use at more than a year and attributable to specific machinery are classified as property, plant and equipment in other fixed assets.

Costs pertaining to general and specific loans, attributable to the acquisition, construction and production of qualifying assets, which necessarily take a substantial period of time to get ready for their intended use or sale, are not capitalized to form part of the acquisition cost of said qualifying assets until such time as they are ready for their intended use or sale.

If the carrying value exceeds the estimated recovery value, impairment of an asset's carrying value is recognized and the asset is immediately recognized at its recovery value.

Assets classified as property, plant and equipment is tested for impairment when there are facts and circumstances that indicate there are signs of impairment. Impairment losses are recognized on the basis of the amount by which the book value of the assets exceeds their recovery value.

The residual value, useful life and method for depreciation of assets are reviewed, at least at the end of each reporting period and if expectations differ from prior estimates, the changes are recognized as a change in an accounting estimate.

Gains or losses on asset disposals are determined comparing the selling value and the carrying value and are recognized in the other expenses, net in the statement of income.

#### **k. Leasing**

Classification of leases as financial or operating depends on the substance of the transaction more so than the contract form.

Leasing, in which a significant portion of the risks and benefits pertaining to the property are retained by the lessor, is classified as straight leasing. Payments made under straight leasing (net of any incentive received from the lessor) are charged to the statement of income by the straight line method over the leasing period.

Leasing under which all the risks and rewards of ownership are transferred to the Company are classified as financial leases. Financial leases are capitalized at the outset of the lease at least between the fair value of the property under lease and the present value of minimum payments. If determination thereof is determined to be practical to discount minimum payments at their present value, the interest rate embedded in the lease is used; otherwise, the lease's incremental rate must be used. Any initial direct cost of the lease will be added to the original amount recognized as an asset.

Each payment on the lease is allocated between the liability and the financial charges, until a constant rate is reached in the current balance. The corresponding rent obligations are included in non-current debt, net of the financial charges. Financial cost interest is charged to income for the year during the lease period, with a view to producing a constant periodic interest rate in the remaining balance of the liability for each period. Property, plant and equipment acquired through financial leases is depreciated between the lesser of the useful lifetime of the asset and term of the lease.

Indefeasible Right of Use (IRU) leases are considered to qualify as financial leasing.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

### **1. Intangible assets**

Intangible assets are recognized when they are identifiable and provide future economic benefits and when there is control over those benefits.

Intangible assets are classified as follows:

- i. **Definite useful life** - The definite useful life of an asset is recognized at cost, less accumulated amortization and impairment losses recognized. They are amortized by the straight-line method, according to the useful life, determined based on expected future economic benefits, and are subject to impairment testing when there is evidence of such.

#### **Trademarks and licenses**

Trademarks and licenses acquired individually are recognized at their historical cost. Trademarks and licenses acquired through business combinations are recognized at fair value at the acquisition date. Trademarks and licenses have an indefinite useful life and are recorded at cost, less their accumulated amortization. Amortization is calculated by the straight-line method to distribute the cost of trademarks and licenses based on the estimated useful lives.

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

	<u>Years</u>
Software and licenses	3 - 7
Concessions	20 - 30
Capacity of communications network	13
Other	4
Obligations to do and not to do	3
Trademarks	5
Customer relation	15

- ii. **Defined useful life** - These intangible assets are not amortized and are subject to annual impairment testing. At December 31, 2016 and 2015, no factors have been determined that might limit the useful life of these intangible assets.

#### **Goodwill**

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

For the purpose of substantiating impairment, goodwill generated in a business combination is allocated to each of the operating segments, which is expected to benefit from the synergies of the business combination. Each business segment to which goodwill is allocated represents the lowest level within the Company at which goodwill is monitored for internal management purposes.

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

Goodwill impairment is tested annually, or more frequently if events or changes in circumstances indicate possible impairment. Goodwill book value is compared with the recoverable amount, which is the greater of the value in use and fair value, less the cost of sales. Impairment, if any, is recorded immediately as an expense and is not subsequently reversal in the future.

#### **Intangible assets acquired in a business combination**

An intangible asset acquired through a business combination is recognized at its fair value at the acquisition date. Subsequently, intangible assets acquired in a business acquisition of intellectual property, such as: trademarks, customer relations, intellectual property rights, obligations to do and not to do, among others, are recognized at their cost, less accumulated amortization and the accrued amount of impairment losses.

#### **m. Impairment of non-financial assets**

Assets without an indefinite useful life, such as goodwill, are not subject to depreciation or amortizable, as well as to annual impairment testing. Assets subject to amortization are tested for impairment when events or changes in circumstances indicate that the book value might not be recoverable. An impairment loss corresponds to the amount by which the carrying value of the non-financial asset exceeds its recovery value. Recovery value is the greater of the fair value of an asset less costs incurred for its sale and its value in use. For the purpose of evaluating impairment, assets are grouped in the minimum levels where there are identifiable cash flows separately (cash generating units). Non-financial long-lasting assets other than goodwill that have been impaired are reviewed for possible reversal of impairment on each reporting date.

#### **n. Taxes on income**

The income taxes caption in the statement of income represents the sum of currently-payable and deferred taxes on income.

The amount shown for income taxes reflected in the statement of income represents the tax incurred in the year, as well as the effects of deferred income taxes determined by the assets and liabilities method, applying the rate enacted or substantially enacted in effect at the date of the balance sheet where the Company operates and generate taxable income to total temporary differences resulting from comparing the book and tax values of assets and liabilities expected to apply when the deferred tax asset is realized or the deferred tax liability is settled, taking into account unamortized tax losses, if any, following an analysis of their recovery. The effect of changes in tax rates in effect is applied to income for the period in which said rate change is determined.

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

The deferred tax asset is recognized only when a future taxable profit is likely to exist against which temporary difference deductions can be used.

Deferred income taxes on temporary differences arising from investments in subsidiaries and associated companies are recognized, except when the reversal period of the temporary differences is controlled by Axtel and the temporary differences are unlikely to be reversed in the foreseeable future.

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

Deferred tax assets and liabilities are offset when there is a legal right and when the taxes are collected by the same tax authority.

**o. Employee benefits**

The Company grants the following plans:

**i. Pension plans**

Defined contribution plans:

A defined contribution plan is a pension plan through which the Company pays fixed contributions to an entity on a separate basis. The Company has no legal or assumed obligation to pay additional contributions if the fund has insufficient assets to pay the benefits related to the services to all its employees in the current or past periods. Contributions are recognized as expenses arising from employee benefits at the date of the obligation to make the contribution.

Defined benefit plans:

A benefit plan is defined as the pension-related benefit amount to be received by an employee at retirement, usually reliant on one or more factors such as age, the number of years of service and compensation.

The liability recognized in the statement of financial position with respect to defined benefit plans is the present value of the defined benefit obligation at the date of the statement of financial position, along with the adjustments for unrecognized past services. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligations is determined by discounting the estimated future cash flows using the discount rates, in accordance with IAS 19, denominated in the currency in which the benefits will be paid, and that have maturity terms approximating the terms of the related pension liability. The discount rate reflects the value of money over time but not the actuarial or investment risk. Additionally, the discount rate reflects no credit risk pertaining to the entity, or the risk that future experience could differ from the actuarial assumptions. The Company uses the government CETES rate as the discount rate.

Re-measurements of employee obligations are recorded directly in shareholders' equity under other components of comprehensive income in the year in which they occur.

The costs of past services are immediately recognized in the statement of income.

The current cost of services under the defined benefit plan, applied to income as an employee-benefit expense, unless it is included in the cost of an asset, reflects the increase in the defined benefit obligation stemming from the employee's service during the year. The benefit modifies layoffs and severance payments.

The net interest cost is calculated applying the discount rate for the net balance of defined benefit obligations. This cost is included in the employee benefits account in the statement of income.

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

Actuarial gains and losses arising from experience adjustments and changes in actuarial hypotheses are charged or credited to shareholders' equity in "Other components of comprehensive income for the year" in the period in which they arise.

#### **ii. Other post-employment benefits**

The Company provides benefits such as post-employment medical care to its retired employees. The right to access said benefits generally depends on whether the employee worked up to the age of retirement and completed a minimum period of years of service. The expected cost of these benefits is recognized during the period services were provided, using the same criteria as those described for defined benefit plans.

#### **iii. Termination benefits**

Termination benefits are payable when employment is terminated by the Company before the normal retirement date, or whenever an employee voluntarily accepts the termination of the work relationship in exchange for these benefits. The Company recognizes termination benefits when there is a verifiable commitment to conclude the work relationship of certain employees and a formal detailed plan providing so and that can not be surrendered. If there is an offer promoting termination of the labor relationship voluntarily by the employees, the termination benefits are valued based on the expected number of employees estimated to accept said offer. Benefits paid in a term of 12 months after the period close are discounted at their present value.

#### **iv. Short-term benefits**

The Company provides short-term employee benefits, which can include, wages, salaries, annual bonuses and bonuses payable over the following 12 months. The Company recognizes a provision without discount, when is it contractually obligated or when the former practice has created an obligation.

#### **v. Deferred employees' statutory profit-sharing (ESPS) and Bonuses**

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

#### **p. Provisions**

Liability provisions represent a present legal obligation or a constructive obligation arising from past events, likely to require the use of resources to settle the obligation and the amount thereof has been reliably estimated. No provisions are recognized for future operating losses.

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

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

In the event of similar obligations, the probability of requiring the use of economic resources to settle said obligations is determined considering them as a whole. In such cases, the provision so estimated is recognized even though the probability of using of cash flows with respect to a specific item considered in the whole is remote.

Provisions for legal claims are recognized when the Company has a present obligation (legal or assumed) resulting from past events, likely to require the use of economic resources to settle the obligation and the amount thereof can be reliably estimated.

A reserve for restructuring is recognized when the Company has developed a formal detailed plan to conduct a restructuring, and a valid expectation is created among the affected parties, that the restructuring will take place, either for having started implementation of the plan or for having announced its main features thereof to the affected parties.

### **q. Share-based payments**

The Company has compensation plans based on the market value of ALFA shares granted to certain Company directors. The conditions for granting the compensation to illegible executives includes, meeting certain metrics, such as the level of profits reached, at least 5 years seniority in the company, and others. ALFA's Board of Directors has put together a Technical Committee to manage the plan. The board reviews the estimate of the liquidation in cash of this compensation at the year end. Payment of the plan is always subject to the discretion of ALFA management. The adjustments to said allowance are charged or credited to the statement of income.

The fair value of the amount payable to employees with respect to share-based payments, which are settled in cash, is recognized as an expense, with the corresponding increase in the liability, during the period of services required. The liability is included in the Other liabilities line item and is updated on each reporting date and at the settlement date. Changes, if any, in the fair value of the liability are recognized as a compensation expenses in the statement of income.

### **r. Capital stock**

Axtel's common stock is classified as capital stock under shareholders' equity. The incremental costs directly attributable to issuance of new shares are included in the capital as a deduction of the consideration received, net of taxes; however, the company has incurred no such costs.

### **s. Comprehensive income**

Comprehensive income is comprised of net income, plus other capital reserves, net of taxes, which are comprised of the effects of conversion of foreign entities, re-measurement of obligations arising from employee benefits, the effects of the change in fair value of financial instruments available for sale, as well as other items required by specific provisions to be reflected in shareholders' equity and which do not constitute capital contributions, reductions or distributions.

### **t. Segment reporting**

Segment reporting is presented consistently with the internal reports provided to the CEO, who is the highest authority for making operating decisions, assigning the resources and evaluating the operating segments' yield.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

### **u. Revenue recognition**

Revenue is comprised of the fair value of the compensation received or to be received on the sale of goods and services during the normal course of operations. Revenue is shown net of the estimated amount of returns from customers, value added tax, discounts and after eliminating intercompany sales.

Revenue from both domestic and international outgoing and incoming long-distance service is recognized based on the number of minutes processed by the Company, is recognized at the month end close once the service has been provided and the risks and benefits have been transferred to the customer.

Revenue arising from the provision of pay television, interconnection, data transmission, Internet and local services is recognized as the services are rendered.

Installation income and corresponding costs are deferred and recognized as income during the period of the contract established with the customer.

Interest income is recognized when the economic benefits are likely to flow to the Company and the amount corresponding to income can be valued reliably, applying the effective interest rate.

The Company recognizes income provisions at the end of each month on the basis of the use and enjoyment of services provided by the Company, taking into account the type of customer, the type of transaction and the specifications set out in each agreement.

Income from the sale of goods and the provision of services, when each and every one of the following conditions are met:

- The risks and benefits of ownership are transferred.
- The amount of the revenue can be measured reasonably.
- Future economic benefits are likely to flow to the Company.
- The Company retains no implication related to the property or effective control of the goods sold.
- Costs incurred or to be incurred in connection with the transaction can be measured reliably.

Costs for the acquisition of subscribers are applied to income as they are incurred.

#### **Advances from customers**

Customer prepayments for pay television, interconnection, data transmission, Internet and local services are billed monthly and applied to income as Income for the period as the services are provided. The Company's deferred charges are recorded on the basis of the commitment to provide a service to the customers. Said service is applied to income as it is provided.

### **v. Earnings per share**

Earnings per share are calculated dividing the earnings attributable to the shareholders by the weighted average of ordinary shares outstanding during the year. At December 31, 2016 and 2015, there are no effects of dilution per financial instrument potentially convertible to shares.



# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

### **w. Reclassifications**

Certain reclassifications have been made of 2015 figures to ensure they are in line with the current presentation.

### **Note 5 - Financial risk management:**

#### **5.1 Financial risk factors**

The Company's activities expose it to a number of financial risks; market risks (including exchange rate risks, interest rate risk on cash flows and interest rate risk on fair values), credit risks and liquidity risk. Risk management of the Company's general program considers the unpredictability of financial markets and seeks to minimize the potential adverse effects of the Company's financial performance.

The objective is to protect the businesses' financial health against the volatility of exchange and interest rates.

ALFA (holding company) has a Risk Management Committee (CAR from Spanish) comprised of the Chairman of the Board, the Managing Director, ALFA's Finance Director and a Finance executive of ALFA acting as technical secretary. The CAR supervises derivative operations proposed by the Company, in which the maximum possible loss exceeds US\$1 million. This committee supports both the Executive Director and the Chairman of the Company's Board of Directors. All of the derivative operations that Company intends to conduct, as well as renewal of existing derivatives, require the approval of both the Company and ALFA, as per the following authorizations program:

	<u>Maximum Possible Loss US\$ millions</u>	
	<u>Individual operation</u>	<u>Accumulated annual operations</u>
CEO	1	5
ALFA'S Risk Management Committee	30	100
Board of Finance Directors	100	300
ALFA Board of Directors	>100	>300

#### **a. Market Risk**

##### **i. Exchange rate risk**

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

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

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

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

Based on exposure to the exchange rate at December 31, 2016, a hypothetical 5% increase/decrease in the MXN/USD exchange rate and maintaining all of the other variables constant, would result in an effect on the statement of income of (\$541,790) and \$515,990, respectively.

Following is an analysis of the Company's exposure to the exchange risk at December 31, 2016 and 2015. The accompanying table reflects the book value of the Company's monetary assets and liabilities denominated in a foreign currency:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Monetary assets	US\$ 62,311	US\$ 124,523
Monetary liabilities	<u>(586,793)</u>	<u>(837,503)</u>
Net position	<u>(US\$ 524,482)</u>	<u>(US\$ 712,980)</u>

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

The Company's interest rate risk is associated to its long-term loans. Variable rate loans expose the Company to interest rate risks on cash flows, which are partially offset by the cash held at variable rates. Fixed rate loans expose the Company to interest rate risks related to changes in fair value.

At December 31, 2016, 95% of Axtel's total debt generates variable interest, whereas the remaining 5% generates fixed interest rates.

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

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

At December 31, 2016, if interest rates on variable rate loans were increased/decreased by 1%, the interest expense shown in income would be modified by (\$203,056) and \$203,828 respectively.

#### **b. Credit risk**

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

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

#### **Account receivables**

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

Axtel determined its provision for impairment of accounts receivable, taking into account the probability of recovery, based on past experiences, as well as current collection trends and overall economic factors. Accounts receivable are entirely reserved when there are specific collection problems, based on past experience, mass customers are completely reserved when those accounts are past due by over 270 days, and business customers, carriers and government more than 360. Moreover, collection problems such as bankruptcy or catastrophes are also taken into account. Accounts receivable are analyzed monthly, and the provision for impairment of accounts receivable is adjusted in income.

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

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

Company A accounts for 5% and 12% of the Company's total account receivable at December 31, 2016 and 2015, respectively. Additionally, income related to Company A for the years ended December 31, 2016 and 2015 was 7% and 4%, respectively.

Company B accounts for 1% and 1% of the Company's total account receivable at December 31, 2016 and 2015, respectively. Additionally, income related to Company B for the years ended December 31, 2016 and 2015 was 7% and 3%, respectively.

At December 31, 2016 and 2015, the reserve for impairment totaled \$1,920,753 and \$3,178,325 respectively. Axtel considers this reserve to be sufficient to cover the probable loss of accounts receivable; however, it can not ensure that it will not need to be increased. A 10% change in the amounts estimated as uncollectable would result in a change in the uncollectable expenses of approximately \$118,000.

#### **Investments**

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

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

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

### **c. Liquidity risk**

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

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

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

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

The figures shown in the chart are the contractual cash flows not discounted.

	<u>Less than 1 year</u>	<u>1 to 2 years</u>	<u>2 to 3 years</u>	<u>3 to 4 years</u>	<u>4 to 5 years</u>	<u>5+ years</u>
December 31, 2016						
Current debt	\$1,719,992	-	-	-	-	-
Suppliers, related parties and creditors	4,286,158	539,829	580,933	-	-	-
Non-current debt	-	1,456,283	11,039,101	6,033,816	1,975,554	2,500,844
Financial leases	408,965	238,992	135,681	213	-	-
	<u>Less than 1 year</u>	<u>1 to 2 years</u>	<u>2 to 3 years</u>	<u>3 to 4 years</u>	<u>4 to 5 years</u>	<u>5+ years</u>
December 31, 2015						
Current debt	\$1,203,000	-	-	-	-	-
Suppliers, related parties and creditors	3,254,257	-	-	-	-	-
Current debt	-	1,906,966	1,006,732	2,756,149	9,860,087	-
Other non-current accounts payable	-	112,340	-	-	-	-
Financial leases	442,546	329,518	181,369	97,809	6	-
Convertible debt derivative instruments	65,222	-	-	-	-	-

The Company expects to meet its obligations with the cash flows provided by operations and/or cash flows provided by its main shareholders.

### **5.2 Capital risk management**

The Company's objectives, in managing capital, are to safeguard its capacity to continue operating as a going concern, so as to be able to continue providing its shareholders with yields and benefits to other interested parties, as well as to maintain an optimal capital structure to reduce capital costs.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

In order to be able to maintain or adjust the capital structure, the Company can adjust the amount corresponding to dividends paid to the shareholders, return capital to the shareholders, issue new shares and sell assets to reduce the debt.

The Company's capital structure includes debt, which in turn includes bank loans, financial leases, cash and cash equivalents and shareholders' equity, which includes capital, retained earnings and reserves. Historically, the Company has invested substantial resources in capital goods to expand its operations, through reinvesting earnings. The Company has no policy in place for declaring dividends.

Axtel monitors its capital based on the degree of leverage. This percentage is calculated by dividing the Company's total debt, less cash and cash equivalents (net debt) by total shareholders' equity and the net debt.

The financial ratio of: net debt / total shareholders' equity plus the net debt, totals 88.34% and 73.87% at December 31, 2016 and 2015, respectively. The above gives rise to leverage that meets the Company's risk management policies.

### **Note 6 - Critical accounting estimates and significant judgments:**

Estimates and judgments are reviewed on a regular basis and are based on historical experience and other factors, including expectation of future events considered reasonable under the circumstances.

#### **Long-lived assets**

Estimates and assumptions indicating a significant risk of giving rise to a material adjustment to the book values of assets and liabilities within the following financial year are as follows:

#### **Useful lives of property, systems and equipment**

The Company reviews the estimated useful lives of property, systems and equipment at the end of every annual period. The level of uncertainty in connection with the estimated useful life is related to market changes and the use of assets of service volumes and technological development.

#### **Allowance for impairment of goodwill**

Identification and measurement of impairment of goodwill involves an estimate of fair values. These estimates and assumptions could have a significant impact on the decision to recognize or not an impairment charge and also on the magnitude of said charge. The Company conducts a valuation analysis with third-party assistance and considers relevant internal information, as well as other public market information.

Estimates of fair value are mainly determined using discounted cash flows and market comparisons. These approaches use significant estimates and assumptions, including projected cash flows (including terms), discount rates that reflect the risk inherent to future cash flows, perpetual growth rates, determination of proper market comparables and the determination of whether or not a premium or discount should be applied to the comparables. There is a certain level of risk inherent to the estimates and assumptions that the Company believes to have considered in its valuations. However, if the

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

current/future results differ from those estimated, a possible impairment charge can be recognized in future periods in connection with the decrease in the book value of goodwill, aside from the amounts previously recognized. See Note 12.

### **Taxes on income**

The charge corresponding to income taxes is the total sum of the currently-payable and deferred tax charges and credits. One important judgment is required in the determination of the global provision for income taxes. There are many transactions and calculations due to which the final tax determination is uncertain. The Company recognizes liabilities related to the early tax audit, based on estimates as to whether or not additional taxes will be paid. Because the final tax result for these purposes differs from the amounts initially recognized, said differences will impact both currently-payable and deferred income tax assets and liabilities in the period in which the determination was carried out.

As part of the processes for preparation of these financial statements, the Company is required to calculate its taxes on income. This process involves estimating the current exposure to currently-payable taxes, aside from evaluating the temporary differences resulting from according the items differently, such as impairment of accounts receivable from customers, deferred assets, inventories, property, plant and equipment, accumulated expenses and unamortized tax losses, for tax and book effects.

These differences result in deferred tax assets and liabilities included in the statement of financial position. The Company then evaluates the probability of its deferred tax assets being recovered. The Company recognizes deferred tax assets for all deductible temporary differences, to the extent the entity is likely to dispose of future tax benefits against which to apply these deductible temporary differences. The most recent projections of available earnings are used to determine future tax benefits.

### **Commitments and contingencies**

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

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

### **Note 7 - Cash and cash equivalents:**

Cash and cash equivalents shown in the statement of financial position are mainly comprised of cash funds, bank deposits and short-term investments, all highly liquid and subject to immaterial risks related to change in value. Following is the breakdown of said balances:

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Cash on hand and banks	\$ 620,862	\$ 250,695
Short-term investments	<u>826,256</u>	<u>2,324,527</u>
Total cash and cash equivalents	<u>\$ 1,447,118</u>	<u>\$ 2,575,222</u>

The credit quality of cash and cash equivalents has been evaluated using external credit ratings as reference:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
AAA	\$ 825,616	\$ 2,535,664
A-2	<u>621,502</u>	<u>39,558</u>
	<u>\$ 1,447,118</u>	<u>\$ 2,575,222</u>

#### **Note 8 - Restricted cash:**

The value of restricted cash is made up as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Current	\$ -	\$ -
Non-current	<u>153,040</u>	<u>-</u>
Restricted cash	<u>\$ 153,040</u>	<u>\$ -</u>

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

After the deposit described in Note 28, restricted cash represents the trust balance over applicable disputes for 2008 and 2010 and is shown in the statement of financial position under Non-current assets.

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

#### **Note 9 - Trade receivables and other accounts receivable, net:**

Trade receivables and other accounts receivable are comprised as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
<u>Current:</u>		
Trade receivables	\$ 5,049,799	\$ 5,632,981
Allowance for impairment of trade receivables (1)	<u>(1,920,753)</u>	<u>(3,178,325)</u>
Trade receivables, net	3,129,046	2,454,656
Taxes recoverable	859,477	597,262
Advances to suppliers	-	52,648
Notes and other accounts receivable	57,354	103,699
Related parties	<u>20,949</u>	<u>-</u>
	<u>\$ 4,066,826</u>	<u>\$ 3,208,265</u>
<u>Noncurrent:</u>		
Other account receivable	<u>\$ 8,642</u>	<u>\$ 128,613</u>

(1) Following is an analysis of the movements pertaining to the allowance for impairment of trade receivables:

	<u>2016</u>	<u>2015</u>
Initial balance (January 1)	\$ 3,178,325	\$ 3,021,130
Cancellation of accounts receivable (a)	(1,571,426)	-
Allowance for doubtful accounts for the year	209,930	154,621
Increase from merger	103,924	-
Effect of variations in exchange rates	<u>-</u>	<u>2,574</u>
Final balance (December 31)	<u>\$ 1,920,753</u>	<u>\$ 3,178,325</u>

To determine the recoverability of accounts receivable, the Company considers any change in the credit quality of account receivable from the date on which the credit is granted to the date of the financial statements. The credit risk concentration is moderate due to the number of customers and the fact that they are not related.

- a. During 2016, the Company canceled \$1,571,426 bad debts from customers that were already entirely impaired and reserved, as a result of which, said cancellation had no impact on the Company's financial position or results in 2016.



## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**At December 31, 2016 and 2015**

---

Trade receivables and account receivable include unimpaired past-due balances of \$1,367,754 and \$2,130,827 at December 31, 2016 and 2015, respectively.

	<u>2016</u>	<u>2015</u>
1 to 30 days	\$ 284,656	\$ 1,367,447
30 to 90 days	365,489	137,680
90 to 180 days	251,947	187,707
Over 180 days	<u>465,662</u>	<u>437,793</u>
	<u>\$ 1,367,754</u>	<u>\$ 2,130,827</u>

At December 31, 2016 and 2015, the maximum risk inherent to accounts receivable is their book value.

At December 31, 2016, customer credit quality, net of the allowance for impairment, is evaluated as follows:

	<u>Massive</u>
Low Risk < 60 days	\$ 279,115
Medium Risk 61-180 days	43,072
High Risk > 180 days	<u>149,401</u>
	<u>\$ 471,588</u>
	<u>Business</u>
Low Risk < 90 days	\$ 1,121,811
Medium Risk 91-270 days	101,735
High Risk > 270 days	<u>200,035</u>
	<u>\$ 1,423,581</u>
	<u>Government</u>
Low Risk < 180 days	\$ 963,594
Medium Risk 181-360 days	164,960
High Risk > 360 days	<u>105,324</u>
	<u>\$ 1,233,878</u>
Total	<u>\$ 3,129,047</u>

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

Notes to the Consolidated Financial Statements

At December 31, 2016 and 2015

---

### **Note 10 - Inventories:**

Inventories are analyzed as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Materials and consumables	\$ 109,145	\$ 52,725
Other	<u>243</u>	<u>344</u>
	<u>\$ 109,388</u>	<u>\$ 53,069</u>

The cost of inventories applied to income and included in the cost of sales was of \$207,441 and \$197,173 for 2016 and 2015, respectively.

For the period at December 31, 2016 and 2015, damaged, slow-moving and obsolete inventory was recognized in the cost of sales in the amount of \$558 and \$12,047, respectively.

At December 31, 2016 and 2015 there were no inventories given in guarantee.



## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

Assets under financial lease include the following amounts in which the Company acts as lessee:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Cost - capitalized financial leases	\$ 1,370,389	\$ 1,105,952
Accumulated depreciation	<u>(675,255)</u>	<u>(324,633)</u>
Carrying value, net	<u>\$ 695,134</u>	<u>\$ 781,319</u>

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

For the years ended December 31, 2016 and 2015, the Company capitalized \$27,770 and \$44,223, respectively, of loan costs related to rateable assets of \$858,114 and \$831,303. These amounts were capitalized based on an interest rate of 6.09% and 10.14%, respectively.

Of the depreciation expense for 2016 of \$3,416,716 (\$2,563,348 in 2015), \$3,095,736 (\$2,322,537 in 2015) was recorded in the cost of sales and in selling and administrative expenses of \$320,980 (\$240,811 in 2015).



## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

#### Company concessions

Its concessions allow the Company to provide local basic telephone service; national long-distance service, the purchase or rent of network capacity for the generation, transmission or reception of data, signals, text, script, images, voice, sound and any other type of information; rent of digital circuits; restricted TV and audio service.

The Company's principal concessions are as follows:

- Sole concession for commercial use for the purpose of providing any type of telecommunications and/or radio broadcasting that is feasible to be provided, granted for a 30-year period, expiring in 2046.
- Public telecommunications network concession granted for data transmission via satellite, granted for a 30-year period, expiring in 2042. (\*)
- Public telecommunications network concession granted for the provision of local telephone service, as well as national and international long-distance service, granted for a 30-year period, expiring in 2026. (\*)
- Public telecommunications network concession granted for the provision of point-to-multipoint microwave connection services, granted for a 20-year period, expiring in 2018. (\*)
- Public telecommunications network concession granted for the provision of service for fixed or mobile wireless access, granted for a 20-year period, expiring in 2018. (\*)

(\*) In November 2016, the Company obtained authorization to consolidate these concession into the Sole Concession for commercial use.

- Public telecommunications network concession granted to Avantel, to offer local and international long-distance service for a 30-year period, expiring in 2025.
- Public telecommunications network concession granted to Avantel, to offer basic local telephone service for a 30-year period, expiring in 2029.

#### **Concession under renewal**

- In 1998, Alestra obtained two concessions for the use, leasing and exploitation of frequency band pertaining to the radio-electric spectrum to provide capacity to establish point-to-point microwave connections and three point-to-multipoint concessions covering Mexico City, Monterrey and Guadalajara. The concessions are for 20 years as from 1998 and are amortized based on said period by the straight-line method.
- Concessions for a number of frequencies pertaining to the radio-electric spectrum granted to Axtel in 1998 for a 20-year period, renewable for additional periods of 20 years, provided the Company meets all of its obligations and the new conditions set forth in the law, and agreements are reached with respect to any condition imposed by the Federal Telecommunications Institute (IFT from Spanish).

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

The Company provides services, under an added value plan, which are authorized independently from said concessions, such as: Internet access.

In this regard, the Company expects the concessions to be extended, for which the IFT will require payment in advance of the corresponding consideration, which will be set taking into account, among other criteria, the bandwidth of the frequencies of the radio-electric spectrum under concession, the geographic coverage of the concession and the services that can be provide in said bands.

The Company must comply with the new conditions issued in this regard by the IFT. Current conditions are:

- i. Submitting a request at the IFT within a year prior to the start of the last fifth of the term of the concession;
- ii. Meeting the licensee's obligations in the terms of the Federal Telecommunications and Radio Broadcasting Law (LFTR from Spanish) and other applicable regulations, and the concession title;
- iii. Acceptance, by the Concession holder, of the new conditions for renewal thereof, as per the provisions of the IFT.

To date, the IFT has established no amount for the corresponding compensation, and has not yet determined the aforementioned conditions to be met. Revenue from concessions under renewal amounts to 8.4% of income for 2016.

During 2013, 2014 and 2015, the Company has submitted a request to the IFT to extend the concessions for the use and exploitation of frequency bands pertaining to the radio-electric spectrum. In the event said concessions are renewed, this will not be considered an additional period in the amortization of prior concessions.

It should be mentioned that this situation is not particular to the Company, but rather, of all licensees having obtained a concession for the use and exploitation of frequency bands pertaining to the radio-electric spectrum in 1998, 1999 and 2000.

Telecommunications network capacity consists of the right to use fiber optics, contracted with a private party on December 10, 2012 for a 10-year period.

One of the indefinite-life intangible assets held by the Company is goodwill, which has been assigned to the Business segment. The rest of its intangible assets are of defined life.

Of the \$412,874 and \$48,957 amortization expense, \$53,224 and \$41,838 was recorded in the cost of sales; and \$359,649 and \$7,119 in administration and sales expenses, in 2016 and 2015, respectively.

#### **Impairment testing of goodwill**

Goodwill is comprised of the value paid in excess of the book value of net assets and liabilities of \$488,232, which were allocated to the business segment.

At the date of issuance of these financial statements, no signs of impairment have been identified.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

Notes to the Consolidated Financial Statements

December 31, 2016 and 2015

---

Following are the percentages used for the companies' goodwill.

	<u>S&amp;C</u>	<u>G-Tel</u>	<u>Estratel</u>
Estimated gross margin	20.0%	7.5%	24.0%
Growth rate	1.3%	3.3%	12.6%
Discount rate	5.5%	5.5%	5.5%

## **Note 13 - Other non-current assets:**

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Investment in shares of associated company	\$ -	\$ 8,212
Rental of Connections	51,311	65,878
Guarantee deposit	68,237	49,628
Other	<u>85,757</u>	<u>4,080</u>
Total other non-current assets	<u>\$ 205,305</u>	<u>\$ 127,798</u>

## **Note 14 - Suppliers and other accounts payable:**

The Suppliers and other accounts payable line item is comprised as follows:

	<u>December 31,</u>	
<u>Current</u>	<u>2016</u>	<u>2015</u>
Suppliers	\$ 3,183,091	\$ 2,676,819
Related parties	680,546	-
Value added tax and other federal and local taxes payable (see Note 3)	990,198	582,066
Accrued expenses payable	668,917	577,438
Other	<u>122,684</u>	<u>57,343</u>
	<u>\$ 5,645,436</u>	<u>\$ 3,893,666</u>
<u>Noncurrent:</u>		
Other	\$ -	\$ 112,340
Related parties	<u>985,975</u>	<u>-</u>
Total	<u>\$ 985,975</u>	<u>\$ 112,340</u>



## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

#### **Note 15 - Provisions:**

	<u>Litigation</u>	<u>Restructuring <sup>(1)</sup></u>	<u>Other</u>	<u>Total</u>
At December 31, 2014	\$ -	\$ -	\$ -	\$ -
Additions	-	89,000	101,100	190,100
Payments	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
At December 31, 2015	<u>\$ -</u>	<u>\$ 89,000</u>	<u>\$ 101,100</u>	<u>\$ 190,100</u>
Addition	\$ 50,620	\$ 514,600	\$ -	\$ 565,220
Additions under merger	-	31,937	-	31,937
Payments	<u>-</u>	<u>(556,510)</u>	<u>(101,100)</u>	<u>(657,610)</u>
At December 31, 2016	<u>\$ 50,620</u>	<u>\$ 79,027</u>	<u>\$ -</u>	<u>\$ 129,647</u>

Provisions at December 31, 2016 and 2015 are short term.

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

#### **Note 16 - Other liabilities**

Other liabilities at December 31, 2016 and 2015 is comprised as follows:

	<u>December 31,</u>	
<u>Current:</u>	<u>2016</u>	<u>2015</u>
Deferred income	<u>\$ 1,022,605</u>	<u>\$ 509,415</u>
Total	<u>\$ 1,022,605</u>	<u>\$ 509,415</u>

The variations in the year of deferred income are as follows:

	<u>2016</u>	<u>2015</u>
Starting balance	\$ 509,415	\$ 729,768
Increases	1,235,772	616,466
Applied to income for the year	<u>(722,582)</u>	<u>(836,819)</u>
Ending balance	<u>\$ 1,022,605</u>	<u>\$ 509,415</u>

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

### **Note 17 - Borrowings:**

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Bancomext	\$ 3,867,268	\$ -
Banco Nacional de México, S. A. (a) (b)	1,500,151	130,000
BBVA Bancomer, S. A. (a) (b) (c)	1,418,643	-
Banco Mercantil del Norte, S. A. (a) (b) (c)	1,418,643	-
JPMorgan Chase Bank, N. A. (c)	1,095,192	-
Banco J. P. Morgan, S. A. (a)	404,959	-
Banco Santander (México), S. A. (a) (c)	1,500,151	-
Bank of America, N. A. (c)	1,239,840	-
ING Bank, N. V. Dublin Branch (c)	1,239,840	-
Export Development Canada (a) (c)	1,176,445	-
The Bank of Tokyo-Mitsubishi UFJ, Ltd. (c)	702,576	-
Bank of Tokyo-Mitsubishi UFJ (México), S. A. (a)	370,549	-
Mizuko, Bank, Ltd. (c)	826,560	-
Comerica Bank (c)	826,560	-
HSBC México, S. A. (a)	1,058,712	-
Scotiabank Inverlat, S. A. (a) (c)	705,808	-
Sabcapital, S. A. de C. V., SOFOM, E. R. (a) (b) (c)	471,318	-
Morgan Stanley senior Funding, Inc. (a)	441,130	-
Banco Monex, S. A. (a) (c)	194,565	-
BBVA Bancomer, S.A. de C. V.	400,000	-
Unsecured notes	-	12,024,160
Financial leasing with Telmex <sup>(1) (3)</sup>	400,137	385,968
Other financial leases <sup>(2) (3)</sup>	303,399	535,423
Accrued interest payable	132,815	545,208
Issuance costs	<u>(180,812)</u>	<u>(93,945)</u>
Total debt	21,514,449	13,526,814
Current portion of debt	<u>(1,028,588)</u>	<u>(1,050,864)</u>
Non-current debt	<u>\$ 20,485,861</u>	<u>\$ 12,475,950</u>

(a) Unsecured syndicated loan Tranche A MXP.

(a) Unsecured syndicated loan Tranche B MXP.

(a) Unsecured syndicated loan Tranche B USD.

<sup>(1)</sup> Indefeasible Right of Use (IRU) lease entered into with Teléfonos de México, S. A. B. de C. V. for an approximate amount of \$708,041 expiring in 2019.

<sup>(2)</sup> Financial leases entered into with banking institutions at approximate rates of 6% for those denominated in U.S. Dollars and the interbank interest rate (TIIE from Spanish) plus 3% and 5.5% for those denominated in pesos, with maturities ranging from 1 to 3 years.

<sup>(3)</sup> Non-bank borrowings.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

At December 31, 2015 and 2007, unsecured notes were comprised as follows:

	<u>2015</u>
Principal of US\$50,400, at an interest rate of 7 5/8 %, maturing in 2017, with interest payable semiannually,	\$ 867,173
Principal of US\$101,700, at an interest rate of 9%, maturing in 2019, with interest payable semiannually.	1,750,417
Principal of US\$544,600, at an initial interest rate of 7% that would increase to 9%, maturing in 2020, with interest payable semiannually.	9,371,572
Principal of US\$22,200 of convertible notes at an interest rate of 7% that would increase to 9%, maturing in 2020, Interest was payable semiannually. (*)	45,856
Discount on the issuance of notes, arising from unsecured notes payable at an initial interest rate of 7% that would increase to 9%, maturing in 2020.	(19,462)
Premium on issuance of debentures, arising from unsecured notes payable, at an interest rate of 9%, maturing in 2019.	<u>8,604</u>
<b>Total</b>	<b><u>\$ 12,024,160</u></b>

(\*) The holders of the convertible bonds could opt to convert the notes in American Depository Shares ("ADSS") or in Certificate of participation (COPs). See Note 2b.

Moreover, the overall unsecured notes were liquidated as part of the redemption mentioned in Note 2.

The terms, conditions and book values of the non-current debt are as follows:

	<u>Country</u>	<u>Currency</u>	<u>Interest rate</u>		<u>Periodicity of maturity</u>	<u>Payment of interest</u>	<u>At December 31,</u>	
			<u>contractual</u>	<u>Effective</u>			<u>2016</u>	<u>2015</u>
Bancomext	México	USD	3.88%	4.43%	01/17/2024	Quarterly	\$ 3,729,852	\$ -
Syndicated loan Tranche A	Mexico	MXP	TIIE + 2%	7.03%	01/15/2019	Biweekly	4,759,800	-
Syndicated loan Tranche B	Mexico	MXP	TIIE + 2.25%	7.26%	01/15/2019	Semiannual	1,499,842	-
Syndicated loan Tranche B	Mexico	USD	EuroDollar rate+ 2.25	3.64%	01/15/2021	Biweekly	10,332,000	-
Unsecured notes	Mexico	MXP/USD	sundry	sundry	sundry	Semiannual	-	12,024,160
Total bank loans							20,321,494	12,024,160
Issuance costs							(180,812)	(93,945)
Financial leases and other							345,179	545,735
<b>Total</b>							<b><u>\$ 20,485,861</u></b>	<b><u>\$ 12,475,950</u></b>

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

At December 31, 2016, the annual maturities of the non-current debt are as follows:

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021 onwards</u>	<u>Total</u>
Bank loans	\$ 137,132	\$ 10,257,788	\$ 5,604,750	\$ 4,141,012	\$ 20,140,682
Financial leases and other	<u>214,910</u>	<u>130,064</u>	<u>205</u>	<u>-</u>	<u>345,179</u>
	<u>\$ 352,042</u>	<u>\$ 10,387,852</u>	<u>\$ 5,604,955</u>	<u>\$ 4,141,012</u>	<u>\$ 20,485,861</u>

At December 31, 2015, the annual maturities of the non-current debt are as follows:

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020 onwards</u>	<u>Total</u>
Stock certificates and bonds	\$ 867,173	\$ -	\$ 1,750,417	\$ 9,312,625	\$ 11,930,215
Financial leases and other	<u>287,680</u>	<u>164,214</u>	<u>93,841</u>	<u>-</u>	<u>545,735</u>
	<u>\$ 1,154,853</u>	<u>\$ 164,214</u>	<u>\$ 1,844,258</u>	<u>\$ 9,312,625</u>	<u>\$ 12,475,950</u>

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

At December 31, 2016 and 2015, the Company had not unused contractual credit facilities.

The fair value of the non-current debt is disclosed in Note 21. Fair values at December 31, 2016 and 2015 are based on a number of different discount rates, which fall within level 2 of the fair value hierarchy.

Liabilities related to financial leases are effectively covered with the rights of the leased asset to be returned to the lessor in the event of default.

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Financial leasing obligations - minimum payments, gross		
- Less than one year	\$ 358,357	\$ 375,656
- More than a year and less than five years	<u>345,179</u>	<u>545,735</u>
Future financial charges on financial leases	<u>79,805</u>	<u>125,948</u>
Present value of liabilities from financial leases	<u>\$ 783,341</u>	<u>\$ 1,047,339</u>

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### Notes to the Consolidated Financial Statements

December 31, 2016 and 2015

---

The present value of liabilities from financial leases is analyzed as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Less than one year	\$ 408,456	\$ 442,770
More than a year and less than five years	<u>374,885</u>	<u>604,569</u>
	<u>\$ 783,341</u>	<u>\$ 1,047,339</u>

The most restrictive obligations to do and not to do of the debt:

The Company settled its debt in unsecured notes at December 31, 2015 in February 2016, due to which, the restrictions described herein refer to the new debt. On February 16, 2016, the Company drew down on a long-term syndicated loan, in the amounts of US\$500,000 y \$4,787,000. Subsequently, on April 13, an additional draw down was made in the amount of \$1,500,000.

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

The financial ratios to be complied with include the following:

- a. Interest hedge ratio (to be calculated in dollars at the average exchange rate): which is calculated by dividing: the operating profit (loss) before depreciation, amortization and expenses related to "adjustment events" (such as a merger) by the interest expense (excluding interest expenses related to "adjustment events") for the last four quarters of the period under analysis. This factor can not be less than 2.75 times during the first 18 months after the date on which control is exercised and no less than 3.0 times from that point on.
- b. Leverage ratio (calculated in dollars at the average exchange rate for the year, except for the net debt, which is the exchange rate prevailing at year end): which is arrived at by dividing the net consolidated debt (current and non-current debt, net of debt issuance costs, less unrestricted cash and cash equivalents) by the operating profit (loss) before depreciation, amortization and expenses related to "adjustment events" (such as a merger) for each quarter. At December 31, 2016 and up until December 31, 2017, this factor can not exceed 4.25 times. From March 31, 2018 to June 30, 2018, this factor must not exceed 3.75 times; and from September 30, 2018 to the end of the contract, this factor must not exceed 3.5 times.

The obligations to do and not to do contained in the loan agreements establish some obligations, conditions and certain exceptions that require or place restrictions on the Company's ability to:

- Grant lien on assets;
- Conduct operations with affiliates;
- Conduct a merger in which the Company is dissolved, unfavorable sale of assets; and
- Pay dividends

***Axtel, S. A. B. de C. V. and subsidiaries***  
(a subsidiary of Alfa, S. A. B. de C. V.)  
Notes to the Consolidated Financial Statements  
December 31, 2016 and 2015

---

At December 31, 2016 and at the date of issuance of these financial statements, the Company and its subsidiaries had duly complied with the obligations set down in the loan agreements.

**Note 18 - Employee benefits:**

Defined contribution plans:

The Company has a defined contribution plan. According to the structuring of this plans, the cut down on labor liabilities is reflected progressively. The Company has established irrevocable trust funds for payment of the defined contributions plan. Due to the changes made in the 2014 tax reform, the Company interrupted deposits to the trust; however, it has preserved this benefit and recognized labor obligations of \$160,118 at December 31, 2016.

Defined benefit plans:

Valuation of defined benefit plans is mainly based on the number of years of service completed by Company employees, their age and estimated compensation at retirement.

Following is a summary of the main financial information pertaining to said employee benefits:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Obligations in the statement of financial position arising from:		
Pension benefits (1)	\$ 302,399	\$ 28,231
Medical benefits at retirement	<u>4,520</u>	<u>-</u>
Liabilities in the statement of financial position	<u>\$ 306,919</u>	<u>\$ 28,231</u>
Re-measurements from accumulated employee benefit obligations applied to other comprehensive income	<u>\$ 25,167</u>	<u>\$ 1,404</u>

(1) Up until February 15, 2016, the Company recognized seniority premiums.

Pension-related benefits

The Company operates defined benefit pension plans related to pensionable compensation and the duration of the service.

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

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Present value of obligations equal to the liability in the statement of financial position	<u>\$ 302,399</u>	<u>\$ 28,231</u>

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

Movements in the defined benefit obligation are as follows:

	<u>2016</u>	<u>2015</u>
At January 1	\$ 28,231	\$25,128
Present cost of current service	8,066	3,336
Financial cost	8,353	1,665
Remediation:		
Loss from changes in financial assumptions	27,226	1,182
Cost of past services	2,719	(3,079)
Benefits paid	(3,392)	-
Liabilities acquired in merger	116,168	-
Changes to plan (See Note 23) (*)	137,321	-
Reductions	<u>(22,193)</u>	<u>-</u>
At December 31	<u>\$ 302,399</u>	<u>\$28,231</u>

(\*) Effect arising from homogenization of personnel benefits with those offered by ALFA.

The amounts shown in the statement of income are as follows:

	<u>2016</u>	<u>2015</u>
Current cost of service	\$ 8,066	\$ 3,336
Financial cost	8,353	1,665
Cost of past services	2,719	(3,079)
Changes to plan	137,321	-
Effect of reduction	<u>(22,193)</u>	<u>-</u>
Total	<u>\$ 134,266</u>	<u>\$ 1,922</u>

The main ranges of the actuarial assumptions for Mexico were as follows:

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Discount rate	6.75%	6.75%
Future salary increase	5.25%	4.25%
Health care inflation rate	7.50%	-%

The average lifetime of defined benefit obligations is 32.28 and 33.99 years at December 31, 2016 and 2015, respectively.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

The sensitivity analysis of the principal assumptions for defined benefit obligations was as follows:

	<u>Impact on defined benefit obligations</u>		
	<u>Change in assumption</u>	<u>Increase in assumption</u>	<u>Decrease in assumption</u>
Discount rate	1.0%	Decreased by (\$1,150)	Increased by \$885

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

### **Post-employment health care benefits**

The Company operates post-employment health-care benefit plans. The accounting method, the assumptions and frequency of the valuations are similar to those used for defined benefits in pension plans. These plans are not funded.

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

	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Present value of obligations equal to the liability in the statement of financial position	<u>\$4,520</u>	<u>\$ -</u>

The movements of post-employment health-care benefits are as follows:

	<u>2016</u>	<u>2015</u>
At January 1	\$ -	\$ -
Present cost of current service	128	-
Financial cost	409	-
Liabilities acquired in merger	6,094	-
Losses (gains) from changes in financial assumptions	(2,059)	-
Benefits paid	<u>(52)</u>	<u>-</u>
At December 31,	<u>\$ 4,520</u>	<u>\$ -</u>



## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### Notes to the Consolidated Financial Statements

December 31, 2016 and 2015

---

The amounts shown in the statement of income are as follows:

	<u>2016</u>	<u>2015</u>
Current cost of service	\$ 128	\$ -
Financial cost	409	-
Cost of past services	<u>-</u>	<u>-</u>
Total included in personnel costs	<u>\$ 537</u>	<u>\$ -</u>

#### Associated risks

With respect to its defined benefit pension plan and its health-care plan, the Company is exposed to a number of risks, the most significant of which are as follows:

Changes in the discount rate - A decrease in the discount rate would give rise to an increase in obligations under the plans.

Inflation risk - Some of the labor obligations are tied to inflation, higher inflation would give rise to an increase in plan obligations.

Life expectancy - Most of the obligations of the plans will result in benefits to be received by the members thereof; therefore, an increase in the life expectation would result in an increase in plan obligations.

#### **Note 19 - Deferred taxes:**

Following is an analysis of the deferred tax asset and liability, on a net basis:

	<u>At December 31,</u>	
	<u>2016</u>	<u>2015</u>
Deferred tax asset:		
To be recovered at more than 12 months	\$ 3,037,830	\$ 1,808,845
To be recovered within 12 months	<u>1,018,943</u>	<u>426,624</u>
	<u>4,056,773</u>	<u>2,235,469</u>
Deferred tax liability:		
To be covered at more than 12 months	(10,318)	-
To be covered within 12 months	<u>-</u>	<u>-</u>
	<u>(10,318)</u>	<u>-</u>
Deferred tax asset net	<u>\$ 4,046,455</u>	<u>\$ 2,235,469</u>

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

Gross movements in the deferred tax on income account are as follows:

	<u>2016</u>	<u>2015</u>
At January 1 (Note 3)	\$ 2,235,469	\$ 1,806,710
Credit to statement of income	1,556,866	428,537
Merger	242,203	-
Taxes receivable related to other components of comprehensive income	<u>11,917</u>	<u>222</u>
At December 31	<u>\$ 4,046,455</u>	<u>\$ 2,235,469</u>

Movements in the deferred income tax asset during the year are as follows:

	<u>Assets (liabilities)</u>	
	<u>At December 31,</u>	
	<u>2016</u>	<u>2015</u>
Unamortized tax losses	\$ 2,797,686	\$ 1,682,858
Allowance for doubtful accounts	591,444	469,257
Property, plant and equipment	1,012,748	295,775
Provisions and other	481,128	387,443
Intangible assets and other	<u>153,908</u>	<u>-</u>
Deferred tax asset	<u>\$ 5,036,914</u>	<u>\$ 2,835,333</u>
Property, plant and equipment	(\$ 54,416)	\$ -
Telephone concession rights	(15,905)	(28,554)
Long-term debts	(549,342)	(549,342)
Intangible assets and other	(370,796)	(21,968)
Deferred tax liability	<u>(990,459)</u>	<u>(599,864)</u>
Deferred tax asset, net	<u>\$ 4,046,455</u>	<u>\$ 2,235,469</u>

The movements in temporary differences during the year are as follows:

	<u>Balance at December 31, 2015</u>	<u>Applied to income</u>	<u>Increase from merger</u>	<u>Applied to other comprehensive income</u>	<u>Balance at December 31, 2016</u>
Unamortized tax losses	\$ 1,682,858	\$ 1,111,685	\$ 3,143	\$ -	\$ 2,797,686
Allowance for doubtful accounts	469,257	15,367	106,820	-	591,444
Property, plant and equipment	295,775	716,973	-	-	1,012,748
Intangible assets and other	-	(9,417)	163,325	-	153,908
Provisions and other	<u>387,443</u>	<u>(22,249)</u>	<u>104,017</u>	<u>11,917</u>	<u>481,128</u>
	<u>2,835,333</u>	<u>1,812,359</u>	<u>377,305</u>	<u>11,917</u>	<u>5,036,914</u>
Telephone concession fees	28,554	(12,649)	-	-	15,905
Long-term debts	549,342	-	-	-	549,342
Property, plant and equipment	-	(80,686)	135,102	-	54,416
Fair value of derivative financial instruments	11,257	(11,257)	-	-	-
Intangible assets and other	<u>10,711</u>	<u>360,085</u>	-	-	<u>370,796</u>
	<u>599,864</u>	<u>255,493</u>	<u>135,102</u>	<u>-</u>	<u>990,459</u>
Deferred tax asset	<u>\$ 2,235,469</u>	<u>\$ 1,556,866</u>	<u>\$ 242,203</u>	<u>\$ 11,917</u>	<u>\$ 4,046,455</u>

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### Notes to the Consolidated Financial Statements

December 31, 2016 and 2015

	Balance at December 31, 2014	Applied to income	Increase from merger	Applied to other comprehensive income	Balance at December 31, 2015
Unamortized tax losses	\$ 1,257,927	\$ 424,931	\$ -	\$ -	\$ 1,682,858
Allowance for doubtful accounts	498,990	(29,733)	-	-	469,257
Property, plant and equipment	312,239	(16,464)	-	-	295,775
Provisions and other	<u>366,192</u>	<u>21,029</u>		<u>222</u>	<u>387,443</u>
	<u>2,435,348</u>	<u>399,763</u>	-	<u>222</u>	<u>2,835,333</u>
Telephone concession fees	40,466	(11,912)	-	-	28,554
Long-term debts	549,342	-	-	-	549,342
Fair value of derivative financial instruments	28,123	(16,866)	-	-	11,257
Intangible assets and other	<u>10,707</u>	<u>4</u>	-	-	<u>10,711</u>
	<u>628,638</u>	<u>(28,774)</u>	-	-	<u>599,864</u>
Deferred tax liability	<u>\$ 1,806,710</u>	<u>\$ 428,537</u>	<u>\$ -</u>	<u>\$ 222</u>	<u>\$ 2,235,469</u>

The deferred income tax asset arising from unamortized tax losses is recognized when the existence of future tax profits is probable and realization of the related tax benefit is permitted. The Company recognized a deferred tax asset of \$4,046,455 for 2016 and \$2,235,469 for 2015, of which the asset from tax losses arising from a remaining and incurred amount of \$2,797,686 for 2016 and \$1,682,858 for 2015, which can be amortized against future tax profits.

Tax losses at December 31, 2016 expire in the following years:

<u>Year of expiration</u>	<u>Amount</u>
2017	
2018	\$ 381,363
2019	-
2020	18,715
2021	1,693,985
2022 and later	<u>9,184,996</u>
	<u>\$11,279,059</u>

#### **Note 20 - Shareholders' equity:**

At December 31, 2016, the Company's capital stock was \$10,233,841 and was comprised of 19,229'939,531 Class "I", Series "B" common nominative shares, with no par value, entirely subscribed and paid in. At that date, all series "B" shares issued by the Company were placed in a trust (CPO Trust).

As a result of the merger mentioned in Note 2.1., the following, among other matters, were approved: a) issuance of 97,750,656 Class "I", Series "A" shares and 9,571,214,832 Class "I", Series "B" shares worth \$3,464,252, which were subscribed by ALFA, to be subscribed by the Onexa, S. A. de C. V. shareholders, according to their shareholding interest in said company, as part of the price for the merger, when the merger went into effect, and b) issuance of 4,279,126 Class "I" Series A shares and 1,015,008,824 Class "I", Series "B" shares, to held in the Company's treasury, free of preferred subscription rights, as these

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

shares were issued as part of the price of the merger, to be delivered to ALFA. If it becomes necessary, as per the adjustment that is the object of the transaction's Confirmatory Agreement, without the need to make additional contributions, and will be considered paid as per the terms of said agreement. The shares held in the Company's treasury can not be represented or voted at shareholders' meetings, and will confer no corporate or economic rights.

Following is an analysis of the effect of the merger on the company's shareholders' equity:

	<u>Capital stock</u>	<u>Fusion reserve</u>	<u>Total</u>
Issuance of shares (see Note 2)	\$ 3,464,252	\$ 3,385,870	\$ 6,850,122 (*)
Difference between the fair value and shareholders' equity of Onexa		(3,482,023)	(3,482,023)
Transfer to the reserve	(128,491)	128,491	-
Indemnification (see Note 2)		(983,747)	(983,747)
Financial liability (see Note 2)		(246,396)	(246,396)
	<u>\$ 3,335,761</u>	<u>(\$ 1,197,805)</u>	<u>\$ 2,137,956</u>

(\*) Corresponds to the fair value of shares issued for merger mentioned in Note 2a., taking into account the estimated unit price thereof at the date of the merger, which totaled \$6,850,122.

During 2016, the \$90,000 reserve set up for the repurchase of shares was canceled. Moreover, during 2016 and 2015, conversion options were exercised totaling \$36,094, equivalent to 104,833,887 shares and \$133,644 equivalent to 388,180,282 shares, respectively.

In light of the above, through agreements adopted at the July 21, 2016 extraordinary general shareholders' meeting, the following matters among others, were approved: (i) the pertinent changes in capital stock arising from the conversions exercised or, if applicable, not exercised by the holders of the obligations convertible to shares; (ii) cancellation of 182'307,349 Class "I", Series "B" shares, not subscribed or paid in, which had been deposited in the Company's treasury to backup conversion of convertible debentures, the holders of which exercised no conversion rights in this regard, or consequently, the authorized capital stock reduction; and (iii) consolidation in a single series of all shares currently comprising the capital stock, through conversion of the Series "A" shares to Series "B" shares, with the same characteristics as those current outstanding.

At December 31, 2015, the Company's capital stock was \$6,861,986 and was comprised of 9,456,140,156 shares, entirely subscribed and paid in. The Company's shares were divided into two classes: Class "I", representing the minimum fixed portion of the capital stock, and Class "II" representing the variable portion of the capital stock. The shares pertaining to the two classes, "I" and "II", offer their holders the same economic and corporate rights (the only different being those rights that can be conferred as per the applicable law, to the holders of shares that form part of the variable portion of a Variable Capital Publicly Traded Stock Company. Each of the classes had two series: Series "A" and "B", both indistinct and providing their holders the same corporate and economic rights. The shares had no par value. Of the total number of shares, 97,750,656 were Class "I" Series A and 9,358,389,500 were Class Series B. At December 31, 2015, the Company had issued no Class "II" shares (either series "A" or series "B"). At December 31, 2015, all series "B" shares issued by the Company were placed in a trust (CPO Trust).

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

During the years ended Saturday, December 31, 2016 and 2015, the Company suffered net losses of \$3,599,262 and \$1,732,267, respectively. At December 31, 2016 and 2015, the Company showed an accumulated deficit of \$8,486,561 and \$111,074,524, respectively, and short-term liabilities in excess of current assets of \$1,532,511 in 2016. At December 31, 2016, the Company had lost more than two thirds of its capital stock, a legal cause for dissolution, which any interested party may request be declared by the courts. However, the principal shareholders have expressed their intention to support the Company so as to allow it to continue in existence as a going-concern.

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

Dividends are not subject to income tax if paid from the after-tax earnings account (CUFIN from Spanish). Dividends in excess of the CUFIN are subject to 42.86% tax, when paid out. The tax incurred is payable by the Company and may be credited against income tax for the current year or for the following two years. Dividends paid from previously taxed profits are not subject to tax withholding or additional payments. At December 31, 2016, the tax value of the CUFIN and the value of the Capital Contributions Account (CUCA from Spanish) totaled \$1,235,485 and \$21,964,841, respectively.

In October 2013, the Senate and House of Representatives approved the issuance of a new Income Tax Law that went into effect on January 1, 2014. Among other aspects, this law establishes a 10% tax on earnings generated as from 2014, on dividends paid to residents in Mexico and abroad, and establishes that for the periods from 2001 to 2013, the net tax profit will be determined in the terms of the current Income Tax Law in the tax period in question. During November 2015, a temporary-validity article was issued, granting a tax incentive for individuals resident in Mexico subject to an additional 10% payment on distributed dividends or earnings. The incentives is applicable, provided said dividends or earnings were generated in 2014, 2015 and 2016, and were reinvested in the entity that generated said earnings, and consists of a tax credit equivalent to the amount arrived at by applying the percentage corresponding to the year of the distribution, to the dividend or earnings distributed, as shown below:

Year of distribution of the dividend or profit	Percentage of application to the dividend or distributed profit.
2017	1%
2018	2%
2019 onward	5%

The tax credit determined is only creditable against the additional 10% income tax that the entity is required to withhold and pay.

The following requirements must be met to apply the tax credit:

- The entity must identify, in its books of account, the records corresponding to the earnings or dividends generated in 2014, 2015 and 2016, as well as the respective distributions.
- In entity must disclose, in the notes to the financial statements, analytical information for the period in which the earnings were generated, or the dividends were reverted or distributed.
- Entities whose shares are not traded in the Mexican Stock Market and who apply this incentive must opt for having their financial statements audited for tax purposes in the terms of Article 32-A of the Federal Tax Code.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

Entities distributing dividends or profits on shares placed among the general investing public must advise stock brokerage firms, credit institutions, investment operators, the parties distributing the shares of investment entities or any other securities market intermediaries of the period corresponding to the profits on which dividends are being paid, so that said intermediaries can withhold the respective tax.

According to the procedures established in the Income Tax Law, in the event of a capital reduction, any excess of shareholders' equity over the capital contributions account is accorded the same tax treatment as dividends.

### **Note 21 - Financial instruments:**

#### **a. Financial instruments per category**

The book values of the financial instruments per category are comprised as follows:

	<u>At December 31, 2016</u>		
	Accounts receivable and payable at amortized <u>cost</u>	Financial assets and liabilities at fair value with changes in <u>income</u>	<u>Total categories</u>
Financial assets:			
Cash and cash equivalents	\$ 1,447,118	\$ -	\$1,447,118
Restricted cash	153,040		153,040
Trade receivables and other accounts receivable, net	3,207,349		3,207,349
Financial instruments (zero strike call)	-	152,978	152,978
Non-current account receivable	<u>8,642</u>	<u></u>	<u>8,642</u>
Total financial assets	<u>\$ 4,816,149</u>	<u>\$ 152,978</u>	<u>\$ 4,969,127</u>
Financial liabilities:			
Current debt	\$ 1,028,588		\$ 1,028,588
Suppliers, related parties and sundry creditors	4,286,158	246,396	4,532,554
Non-current debt	20,485,861		20,485,861
Other non-current accounts payable	<u>985,975</u>	<u></u>	<u>985,975</u>
Total financial assets	<u>\$ 26,786,582</u>	<u>\$ 246,396</u>	<u>\$ 27,032,978</u>

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

	<u>At December 31, 2015</u>		
	Accounts receivable and payable at amortized <u>cost</u>	Financial assets and liabilities at fair value with changes in <u>income</u>	<u>Total categories</u>
Financial assets:			
Cash and cash equivalents	\$ 2,575,222	\$ -	\$ 2,575,222
Trade receivables and other accounts receivable, net	2,358,355		2,358,355
Financial instruments (zero strike call)		378,099	378,099
Non-current account receivable	127,798		127,798
Total financial assets	<u>\$ 5,061,375</u>	<u>\$ 378,099</u>	<u>\$ 5,439,474</u>
Financial liabilities:			
Current debt	\$ 1,050,864		\$ 1,050,864
Suppliers, related parties and sundry creditors	2,676,819	2,676,819	
Non-current debt	12,475,950		12,475,950
Derivative instruments (convertible debt)	-	65,222	65,222
Other non-current accounts payable	<u>112,340</u>		<u>112,340</u>
Total financial assets	<u>\$ 16,315,973</u>	<u>\$ 65,222</u>	<u>\$ 16,381,195</u>

### **b. Fair value of financial assets and liabilities**

The amounts shown for cash and cash equivalents, trade receivables and other accounts receivable, other current assets, trade payables and other accounts payable, current debt, current provisions and other current liabilities approximate their fair value given the short span of their terms. The net book value of these accounts represents the expected cash flow.

Following are the book and value and estimated fair value of financial assets and liabilities valued at their amortized cost:

	<u>At December 31, 2016</u>		<u>At December 31, 2015</u>	
	<u>Book value</u>	<u>Fair value</u>	<u>Book value</u>	<u>Fair value</u>
Financial assets:				
Non-current receivable	\$ 8,642	\$ 8,310	\$ 128,613	\$ 122,489
Financial liabilities:				
Bank loans	20,458,910	19,525,014		
Unsecured notes			11,989,865	11,989,134
Other liabilities	703,536	658,793	921,391	945,706
Indemnification (*)	983,747	983,747	-	-

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

Estimated fair values were determined on a discounted cash flow basis, and these fair values are considered Level 2. These fair values do not consider the current portion of financial assets and liabilities, as the current portion closely resembles its fair value.

(\*) The fair value of the indemnification closely resembles its book value due to the term and interest-rate terms. See Note 27.

#### **c. Financial instruments and derivative financial instruments**

##### **Financial instruments**

At December 31, 2016 and 2015, the Company has entered into Over the Counter (OTC) transaction agreements with Bank of America Merrill Lynch (BAML) and Corporativo GBM, S.A.B. de C.V. (GBM) denominated "Zero Strike Call" or options, at a price closely resembling zero. The asset underlying these instruments is the market value of Axtel's CPOs. The contracts signed prior to October 2016 can only be settled in cash. As from that date, the term of the contracts yet to be settled was extended and as a result of this negotiation, the settlement method can be in cash or in shares, as opted by the Company's. The original term of these contracts is 6 months and can be extended by mutual agreement between the parties; however, as this is an American type option, the Company can exercise it at any given time prior to the date of maturity.

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

##### **Where:**

Number of options = determined in the contract

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

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

Exercise price = 0.000001 pesos

The company determined the classification and measurement of these contracts as financial assets at fair value with changes in income.



## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

At December 31, 2016 and 2015, the lending position of the options represents the maximum amount of their credit exposure, as shown below:

<u>Counterparty</u>	<u>Notional amount</u>	<u>Contract start date</u>	<u>Type of underlying asset</u>	<u>Fair value</u>	
				<u>2016</u>	<u>2015</u>
Bank of America Merrill Lynch	30,384,700	2010 y 2009	CPO's Axtel	\$ 106,954	\$ 264,348
Corporativo GBM, S. A. B. de C. V.	13,074,982	2015 y 2014	CPO's Axtel	<u>46,024</u>	<u>113,751</u>
				<u>\$ 152,978</u>	<u>\$ 378,099</u>

For the year ended December 31, 2016, the changes in fair value of the Zero Strike Calls gave rise to an unrealized loss of 225,121 (unrealized profit of 221,182 at December 31, 2015), recognized in comprehensive financing income, in the Changes in fair value of financial instruments line item, net. During 2015, the Company paid a premium of \$34,918.

Following is a summary of the fair value hierarchy by which financial instruments and derivative financial instruments:

<u>At December 31, 2016</u>				
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Financial assets:				
Zero strike calls	<u>\$ 152,978</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 152,978</u>
Financial liabilities:				
Financial liabilities arising from the merger (see Note 2)	<u>\$ -</u>	<u>\$ 246,396</u>	<u>\$ -</u>	<u>\$ 246,396</u>
<u>At December 31, 2015</u>				
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Financial assets:				
Zero strike calls	<u>\$ 378,099</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 378,099</u>
Financial liabilities:				
Convertible bonds	<u>\$ -</u>	<u>\$ 65,222</u>	<u>\$ -</u>	<u>\$ 65,222</u>

d. Hierarchy of fair value

The Company has adopted the standard that establishes a three-level hierarchy to be used upon measuring and disclosing the fair value. Classification of an instrument within the fair value hierarchy is based on the lowest level of the significant data used in valuation thereof. Following is a description of the three levels of the hierarchy:

- Level 1 - Price quoted for identical instruments in an active market.

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

The fair value of financial instruments negotiated in active markets is based on market price quoted at the closing date of the balance sheet. A market is considered active if the quotes are clear and regularly available through a stock exchange, trader, broker, industry group, price setting services, or regulatory agency and those prices currently and regularly reflect the market transactions in conditions of independence.

- Level 2 - Prices quoted for similar instruments in active markets; prices quoted for identical or similar instruments in inactive markets; and valuations through models where all significant data are observable in active markets.

The fair value of financial instruments that are not traded in an active market is determined using valuation techniques. These valuation techniques maximize the use of information observable in the market when it is available and is based as little as possible on specific Company estimates. If all of the significant data entered and required to measure an instrument at fair value are observable, the instrument is classified at Level 2.

- Level 3 - Valuations conducted through techniques where one or more of the related significant data are not observable.

This hierarchy requires the use of observable market data when available. In its valuations of fair value, the Company considers relevant and observable market information, to the extent possible.

If one or more of the significant data is not based on observable market information, the instrument is included in Level 3.

#### **Note 22 - Expenses according to their nature:**

The cost of sales and selling and administration costs classified according to their nature are comprised as follows:

	<u>Year ended</u> <u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Cost of service <sup>(1)</sup>	\$ 2,747,613	\$ 1,765,628
Employee benefit expenses (Note 26)	2,958,216	1,939,545
Maintenance	1,667,790	1,123,856
Depreciation and amortization	3,829,589	2,618,567
Advertising expenses	169,736	182,978
Energy and fuel consumption	273,001	198,325
Travel expenses	69,199	42,765
Operating leases	1,107,916	904,230
Technical assistance, professional fees and administrative services	126,934	48,922
Other	<u>358,977</u>	<u>299,018</u>
Total	<u>\$ 13,308,971</u>	<u>\$ 9,123,834</u>

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

(1) The cost of services consists mainly of interconnection costs and costs related to implementation of IT solutions, including:

- Charges related to leased lines, normally paid on a per-circuit basis per month to Telmex and to other suppliers of last-mile access.
- Cost of interconnection, including charges for local access and resale, paid on a per-minute basis mainly to Telmex.
- International payments to foreign operators on a per-minute basis to complete international calls originating in Mexico.

### **Note 23 - Other (expenses) income, Net:**

Other income and expenses for the period at December 31, 2016 and 2015 is comprised as follows:

	Year ended December 31,	
	2016	2015
Merger-related expenses (1)	(\$ 835,200)	\$ -
Disposals of property, plant and equipment due to damage and obsolescence	(52,795)	-
(Loss) profit on sale of property, plant and equipment	(4,483)	113,734
Other income (expenses), net	<u>54,749</u>	<u>(551,055)</u>
Total other expenses, net	<u>\$ 837,729</u>	<u>\$ 437,321</u>

(1) Corresponds mainly to \$514,630 of staff compensation, \$137,300 to adoption of the retirement benefit plan and \$183,270 to other merger-related expenses (mainly fees for professional services). See Note 2.a.

### **Note 24 - Financial income or loss, Net:**

Financing income and costs for the years ended December 31, 2016 and 2015 is comprised as follows:

	Year ended December 31,	
	2016	2015
Financial income:		
Interest income on short-term bank deposits	\$ 19,738	\$ 30,192
Financial assets at fair value applied to income	-	221,182
Other financial income	<u>4,643</u>	<u>6,737</u>
Financial income, excluding exchange gains	24,381	258,111
Exchange gains	<u>210,124</u>	<u>438,658</u>
Total financial income	<u>\$ 234,505</u>	<u>\$ 696,769</u>

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

	<u>Year ended December 31,</u>	
	<u>2016</u>	<u>2015</u>
Financial expenses:		
Interest expense on bank loans	(\$ 775,668)	(\$ 42,474)
Expense related to prize for early cancellation (Note 2b)	(758,064)	-
Financial assets at fair value applied to income	(225,121)	
Interest expense on unsecured notes	(221,944)	(1,165,094)
Expenses related to other interest and commissions	(2,472)	-
Financial expenses related to employee benefits	(6,492)	-
Embedded derivative instrument	(71,318)	(57,475)
Other financial expenses	<u>(41,021)</u>	<u>(28,741)</u>
Total financial expenses, excluding exchange loss	(2,102,100)	(1,293,784)
Exchange loss	<u>(2,988,804)</u>	<u>(2,097,724)</u>
Total financial expenses	<u>(5,090,904)</u>	<u>(3,391,508)</u>
Financial profit or loss, net	<u>(\$ 4,856,399)</u>	<u>(\$ 2,694,739)</u>

### **Note 25 - Employee benefit expenses:**

	<u>Year ended December 31,</u>	
	<u>2016</u>	<u>2015</u>
Wages, salaries and benefits	\$2,448,479	\$ 1,599,088
Social security dues	421,205	285,554
Employee benefits (Note 19)	8,914	5,800
Other dues	<u>79,618</u>	<u>49,103</u>
Total	<u>\$2,958,216</u>	<u>\$ 1,939,545</u>

### **Note 26 - Income taxes for the year:**

	<u>Year ended December 31,</u>	
	<u>2016</u>	<u>2015</u>
Currently-payable tax:		
Tax incurred on income for the period	(\$ 97,048)	(\$ 61,305)
Deferred tax	1,556,866	434,499
Adjustment with respect to prior years	<u>11,888</u>	<u>-</u>
Income tax charge to income	<u>\$1,471,706</u>	<u>\$ 373,194</u>

***Axtel, S. A. B. de C. V. and subsidiaries***  
(a subsidiary of Alfa, S. A. B. de C. V.)  
Notes to the Consolidated Financial Statements  
December 31, 2016 and 2015

The reconciliation between the statutory and the effective income tax rates is as follows:

	<u>2016</u>	<u>2015</u>
Pretax loss	(\$ 5,070,968)	(\$ 2,105,461)
Equity in earnings of associated companies recognized by the equity method	<u>5,189</u>	<u>5</u>
Loss before equity in associated companies	(5,065,779)	(2,105,456)
Statutory rate	<u>30%</u>	<u>30%</u>
Tax at statutory rate	1,519,734	631,637
(Plus) less the effect of taxes on:		
Tax effect of inflation	105,895	4,023
Non-deductible items	(249,064)	(192,040)
Other differences, net	<u>95,141</u>	<u>(70,426)</u>
Total reserve for taxes on income applied to income	<u>\$ 1,471,706</u>	<u>\$ 373,194</u>
Effective rate	<u>29%</u>	<u>18%</u>

The charge / credit of tax related to the components of other comprehensive income is as follows:

	<u>2016</u>			<u>2015</u>		
	<u>Pretax</u>	<u>Tax charged/(credited)</u>	<u>After taxes</u>	<u>Pretax</u>	<u>Tax charged/(credited)</u>	<u>After taxes</u>
Effect of translation of foreign entities	\$ 14,556	(\$ 4,367)	\$ 10,189	\$	\$	\$
Remediation of employee benefit obligations	<u>(25,167)</u>	<u>7,550</u>	<u>(17,617)</u>	<u>(1,404)</u>	<u>222</u>	<u>(1,182)</u>
Deferred tax	<u>(\$ 10,611)</u>	<u>\$ 3,183</u>	<u>(\$ 7,428)</u>	<u>(\$ 1,404)</u>	<u>\$ 222</u>	<u>(\$ 1,182)</u>

**Note 27 - Transactions with related parties:**

The transactions with related parties for the year ended December 31, 2016 conducted at market values were as follows:

<u>December 31, 2016</u>							
<u>Loans received from related parties</u>							
	<u>Accounts receivable</u>	<u>Accounts payable</u>	<u>Monte</u>	<u>Interest</u>	<u>Currency</u>	<u>Date of expiration DD/MM/YY</u>	<u>Interest rate</u>
Holding company <sup>(2)</sup>	\$	\$ 246,396			MXN	07/14/17	N/A
Holding company			\$ 413,280	\$ 12,605	USD	07/15/17	3%
Holding company <sup>(1)</sup>		287,300			MXN	02/28/18	TIE +2.25%
Holding company <sup>(1)</sup>		287,300			MXN	02/28/19	TIE +2.25%
Holding company <sup>(1)</sup>		204,574			USD	02/28/18	TIE +2.25%
Holding company <sup>(1)</sup>		204,574			USD	02/28/19	TIE +2.25%
Affiliates	<u>20,949</u>	<u>8,034</u>	<u>2,228</u>	<u>229</u>	USD		Libor 3M+2,75%
Total	<u>\$ 20,949</u>	<u>\$ 1,238,178</u>	<u>\$ 415,508</u>	<u>\$ 12,834</u>			

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

(1) Indemnification (see Note 2).

(2) Merger-related financial liabilities (see Note 2).

### **Income from sales and other to related parties**

	<u>Year ended December 31, 2016</u>			
	<u>Services</u>	<u>Interest</u>	<u>Dividends</u>	<u>Other</u>
Holding company	\$	\$	\$	\$
Affiliates	131,060			
Associated companies				
Total	<u>\$ 131,060</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>

### **Cost of sales and other expenses with related parties.**

	<u>Years ended December 31</u>			
	<u>Interest</u>	<u>Administrative services</u>	<u>Other costs and expenses</u>	<u>Dividends paid</u>
Holding company	\$ 10,093	\$ 2,317	\$	\$
Affiliated companies	1,458		31,287	
Associated companies				
Total	<u>\$ 11,551</u>	<u>\$ 2,317</u>	<u>\$ 31,287</u>	<u>\$</u>

Additionally, as mentioned in note 2a., during 2016, \$809,793 was paid corresponding to obligations to do and not to do.

For the year ended December 31, 2016, compensation and benefits paid to the Company's main officers totaled \$245,506 (\$259,368 in 2015), comprised of base salary and benefits required by law, complemented by a program of variable compensation basically based on the Company's results and by the market value of ALFA shares.

The principal transactions with related parties for the years ended on December 31, 2015 are as follows:

Rent expense	\$ 34,860
Installation service expenses	18,020
Other	<u>2,705</u>

Salaries payable to related parties at December 31, 2015 included in the Accounts payable line item are as follows:

Short-term accounts payable	
GEN Industrial, S. A. de C. V. *	\$ 131
Neoris de México, S. A. de C. V. *	<u>598</u>
Total	<u>\$ 729</u>

\* Main administrative services.

***Axtel, S. A. B. de C. V. and subsidiaries***  
(a subsidiary of Alfa, S. A. B. de C. V.)  
Notes to the Consolidated Financial Statements  
December 31, 2016 and 2015

---

**Note 28 - Contingencies and commitments:**

At December 31, 2016, the commitments and contingencies pertaining to Axtel and its subsidiaries were as follows:

**I. Contingencies**

Disagreements related to Interconnection with other mobile operators.

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

i. The Company (Axtel and Avantel) signed transaction agreements with Telcel in 2015 that covered the period from January 1, 2005 to April 4, 2014, under which the parties agreed to terminate their disputes related to mobile interconnection rates generated during that period.

ii. Rates corresponding to mobile interconnection services provided by Telcel to the Company as from April 5, 2014 to date are subject to gratuitousness conditions stipulated in article 131 of the LFTR. Telcel contested said condition; however, no ruling has yet been handed down by the Supreme Court of Justice of Mexico.

Therefore, at December 31, 2016 and 2015, the Company and its advisors consider that the gratuitousness conditions will prevail as per the favorable resolutions obtained, as a result of which, the Company has recognized the cost based on said rates and there are no reserves related to this contingency.

**b. Telefónica Group**

i. The Company (Axtel and Avantel) signed transaction agreements with Telefónica Group covering the period from 2005 to 2011, under which the parties agreed to terminate their disputes related to mobile interconnection rates generated during that period.

ii. For 2012, 2013, 2014 and 2015, the Federal Telecommunications Institute (IFT from Spanish) resolved interconnection disagreements with the Company, reducing the interconnection rates for termination services involving mobile service users. Given the results of other litigation procedures regarding interconnection rates in the mobile network, in February 2016, the Company and Telefónica Group signed the agreements for termination of disputes related to interconnection rates.

Alestra entered into settlement agreements with Telefónica Group for the period from January 1 2007 to July 31, 2016, with the period from August 1 to December 31, 2016 yet to be determined by the courts. The rates used for payment of compensation for said period are those resolved by the IFT in other cases, and based on the results of the litigation process, no changes are expected.

Therefore, at December 31, 2016 and 2015, the Company and its advisors consider that the rates will prevail as per the favorable resolutions obtained, as a result of which, the Company has recognized the cost based on said rates and there are no reserves related to this contingency.

**c. Iusacell Group (now AT&T)**

i. For 2012, 2013, 2014 and 2015, the IFT resolved interconnection disagreements with the Company, reducing the interconnection rates for termination services involving mobile service users.

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

- ii. In 2015, the Company (Axtel) signed transaction agreements for the aforementioned periods, except for 2012 and 2013, because the IFT's resolution that set the rates is under litigation at the specialized courts. For said years, the company obtained a favorable sentence in July 2016, as a result of which, the Second Specialized Collegiate Court confirmed the rates set by the IFT.
- iii. Iusacell Group contested the IFT's resolution for 2015 and in July 2016, the Company (Axtel) obtained a favorable first instance sentence confirming the rates. At present, no ruling has yet been handed down by the Specialized Collegiate Court with respect to the new motion for review filed by Iusacell.
- iv. Alestra has on-going litigation at the specialized courts regarding interconnection rates with Iusacell for 2012, 2013, 2014 and 2015 and with ATT for 2015 and 2016, for which no ruling has yet been handed down.

Therefore, at December 31, 2016 and 2015, the Company and its advisors consider that the rates pertaining to the IFT resolutions will prevail, as a result of which, the Company has recognized the cost based on said rates and there are no reserves related to this contingency.

**d. Disagreements on interconnection with Telmex & Telnor.**

- i. For the periods from 2009 to 2014, the Company (Axtel) obtained favorable definitive sentences confirming that rates for termination of long-distance calls from the Company to Telmex set by the Federal Telecommunications Commission ("Cofetel"). For 2009, 2012, 2013 and 2014, Telmex filed legal actions contesting the rates set by Cofetel.
- ii. Additionally, there is a disagreement between Telmex and Avantel regarding the rates for terminating long-distance calls that the Cofetel resolved in favor of Avantel for 2009, approving a rate reduction. Telmex contested this resolution at the courts, and the related sentence is expected to be handed down shortly.
- iii. In May 2011, Cofetel also approved a reduction in the rates for termination of long-distance calls for 2011. Telmex contested this resolution before the SCT; however, the appeal was dismissed. Telmex filed a new appeal with the Federal Court of Justice for Administrative Matters, sentence pending.
- iv. In August 2015, the IFT set the interconnection rates to be paid by Telmex to the Company for local origination. Telmex obtained a first-instance sentence protected by the Eightieth Transitory article of the Federal Telecommunications and Radio Broadcasting Law (LFTR) (for the two different rates per period). Telmex filed an appeal which was sent to the Supreme Court of Justice to determine the constitutionality of said transitory article.
- v. For 2015, the IFT set the interconnection rates to be paid by Telmex to the Company for fixed termination. Telmex contested said resolution and the gratuitousness imposed by article 131 of the LFTR regarding termination in its network. No ruling has yet been handed down by the Supreme Court in this regard.
- vi. Alestra is a party in litigation with Telmex for interconnection rates applicable from 2008 to 2013, except 2009, as Telmex contested the reduction of rates set by the Cofetel. There is a trust with BBVA Bancomer (as trustee) to guarantee payment of fixed interconnection services in the dispute



## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

applicable to 2008. This trust agreement was amended to include the amounts in dispute from 2009 to 2010. In April 2013, Alestra obtained a favorable sentence for 2009, and was awarded a refund of the amount deposited in the trust for that year, plus interest, for a total \$290.6 million pesos, for a resulting balance at December 31, 2016 of \$153.0 million. (See Note 8).

- vii. As from April 2012, Alestra and Telmex resumed negotiations and given the most recent and reliable information and the market conditions, the resale interconnection rates have changed prospectively based on Alestra Management's analysis and judgment. Alestra continues its negotiations with Telmex and the parties are expected to reach an agreement in the near future.
- viii. In April 2015, the IFT set the interconnection rates for termination of long-distance calls in the Telmex network to be applied by Alestra from 2013 to 2015. Telmex contested the injunction trial Alestra obtained a favorable sentence for 2015 and the trials pertaining to the other years are soon to be resolved.
- ix. Under the LFTR, as from August 13, 2014 and during the time they remain as preponderant agents in the telecommunications sector, Telmex and Telcel are forbidden to charge the interconnection rates for termination of calls that end in their network. During 2016, IFT began a process for review of the measures of preponderance imposed on América Móvil as holding company for Telmex and Telcel. A number of different scenarios can arise from this review, such as: i) that the measures imposed on Telmex and Telcel be either entirely or partially eliminated; ii) that the existing measures be modified; or iii) that they are confirmed. If the asymmetric regulation imposed on Telmex and Telcel is softened and/or eliminated, this could have a material adverse effect on the Company's business. At December 31, 2016, the preponderant agent status of Telmex, Telnor and Telcel remained unchanged.

At the date of issuance of the financial statements, the Company and its advisors consider that the rates pertaining to the IFT and Cofetel resolutions will prevail as per the favorable resolutions obtained, as a result of which, the Company has recognized the cost based on said rates and there are no reserves in the books of account related to this contingency. Likewise, the process for review of the preponderance measures is still ongoing.

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

- i. The Company (Axtel) and Solution Ware participated in seven projects with the Government of Nuevo León, the Department of Labor And Social Welfare, The Department of Social Development, The National Population Registry, the National Forest Commission, Seguros Monterrey and the Government of the State of Tamaulipas. To date, Solution Ware has filed a number of ordinary commercial lawsuits against the Company, for payment of a number of purchase orders for administrative services, as well as interest, damages and lost profits, as well as legal costs. At the date of these financial statements, Solution Ware has demanded, via commercial notary public, payment of \$91,776 and \$US12,701.

At the date of issuance of the financial statements, the Company and its advisors consider there is no real probability that these lawsuits will prosper and therefore, no reserves were set up in this regard.

While the results of the disputes can not be predicted, at December 31, 2016, the Company does not believe there are any actions to be applied, or threats, claims or legal procedures against the Company, which, if determined adversely for the Company, would significantly damage, whether individually or in the aggregate, its financial position and/or operating results.

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

## **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

### **Other contingencies**

The Company is a party to a number of lawsuits and claims arising from the normal course of its operations, which Management does not expect will have a significant adverse effect on its financial position or results of future operations. Reserves were set up in connection with these contingencies.

### **II. Commitments**

The Company has commitments related to lease agreements, mainly in connection with office space, that qualify as operating leases.

The minimum future payments added, corresponding to non-cancellable operating leases are as follows:

Within 1 year	\$ 762,194
After 1 year but not exceeding five years	2,451,428
After 5 years	5,110,650

### **Note 29 - Foreign currency position:**

At February 21, 2017, date of issuance of the audited financial statements, the rate of exchange was 20.41 nominal pesos to the US dollar.

At December 31, 2016 and 2015, the Company has the following foreign currency assets and liabilities:

	<u>At December 31, 2016</u>		<u>At December 31, 2015</u>	
	<u>Dollar (US)</u>	<u>Mexican pesos</u>	<u>Dollar (US)</u>	<u>Mexican pesos</u>
Monetary assets	\$ 62,311	\$ 1,287,601	\$ 124,523	\$ 2,141,796
Liabilities:				
Current	(84,604)	(1,748,248)	(127,022)	(2,184,778)
Non-current	<u>(502,189)</u>	<u>(10,377,242)</u>	<u>(710,481)</u>	<u>(12,220,273)</u>
Foreign currency position	<u>(\$ 524,482)</u>	<u>(\$ 10,837,889)</u>	<u>(\$ 712,980)</u>	<u>(\$ 12,263,255)</u>

### **Note 30 - Segment reporting:**

Up until 2015, the Company considered itself to operate in a single business segment. Management formerly evaluated the business by dividing the information into two types of revenue (mass market and business); however, in 2016 and 2015, it was not possible to attribute individual costs to each of them, either directly or indirectly.

During 2016, as a result of the merger mentioned in Note 2 a., the information provided to the Chief Operating Decision Maker (CODM), two additional segments were incorporated: Consumption and Government, to the segment in place in 2015. The information per segment for 2015 was reformulated for comparative purposes.

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

At present, the information used in strategic decision making is reported to the CODM based on three operating segments. The approach of the tree operating segments is as follows:

The Massive operating segment offers the consumer and small-business markets communication products and services.

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

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

Aside from the three operating segments focusing on customers, the Company's remaining operations are included in the "Unallocated expenses" category to be applied to the Company's consolidated income. The "Unallocated expenses" category includes expenses related to the group's centralized functions, including acquisitions, chain of supply and the entity's management.

These operating segments are managed separately, as the products and services offered and the markets where they are located are different. Resources are allocated to the operating segments considering the strategies defined by the Company's Management. Operations between operating segments are conducted at market values.

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

The Company determines the adjusted EBITDA as the result of adding depreciation and amortization; and impairment of merger assets and expenses, to the operating (loss) profit. This is considered a useful measurement of the business's operating performance, as it provides a significant analysis of the commercial performance, by excluding specific items reported separately due to the nature or incidence. Interest income or expenses are not allocated to the reporting segments, as this activity is handled globally by the group's central treasury.

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

# ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

Notes to the Consolidated Financial Statements

December 31, 2016 and 2015

Following is the consolidated financial information pertaining to the information segments:

## **I. Analytical information per segment**

	<u>2016</u>			<u>2015</u>				
	<u>Mass</u>	<u>Business</u>	<u>Government</u>	<u>Total</u>	<u>Mass</u>	<u>Business</u>	<u>Government</u>	<u>Total</u>
Sales per segment	\$ 3,129,580	\$ 8,783,843	\$ 2,023,897	\$13,937,320	\$ 3,316,104	\$ 4,242,215	\$ 2,592,119	\$ 10,150,438
Cost of service	(436,820)	(1,579,947)	(730,846)	(2,747,613)	(448,381)	(1,032,026)	(819,461)	(2,299,868)
Expenses	<u>(1,098,137)</u>	<u>(905,408)</u>	<u>(242,768)</u>	<u>(2,246,313)</u>	<u>(1,103,005)</u>	<u>(292,033)</u>	<u>(137,390)</u>	<u>(1,532,428)</u>
Business Unit								
Contribution (BUC)	<u>\$ 1,594,623</u>	<u>\$ 6,298,488</u>	<u>\$ 1,050,283</u>	<u>\$ 8,943,394</u>	<u>\$ 1,764,718</u>	<u>\$ 2,918,156</u>	<u>\$ 1,635,268</u>	<u>\$ 6,318,142</u>
	51%	72%	52%	64%	53%	69%	63%	62%
Unallocated expenses				<u>(4,435,190)</u>				<u>(3,110,292)</u>
Adjusted EBITDA				4,508,204				3,207,850
Impairment of non-current assets				(52,795)				-
Merger-related expenses				(835,200)				-
Depreciation and amortization				(3,829,589)				(2,618,567)
Operating (loss) profit				(209,380)				589,283
Financial gain (loss), net				(4,856,399)				(2,694,739)
Equity in the results of associated company				(5,189)				(5)
Income taxes				1,471,706				373,194
Net consolidated loss				<u>(3,599,262)</u>				<u>(1,732,267)</u>

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

#### **II. General information**

##### **a. Sales of service**

	<u>2016</u>	<u>2015</u>
Voice	\$ 4,236,979	\$ 3,844,266
RA (Networks under Administration)	3,046,351	2,976,006
DI (Internet data)	4,209,462	1,901,650
Video	499,726	375,122
Administrative Applications	215,042	265,573
Hosting	586,149	269,899
Systems Integration	573,475	197,428
Security	322,680	226,854
Cloud Services	125,474	7,086
Other services	<u>121,982</u>	<u>86,554</u>
Total	<u>\$ 13,937,320</u>	<u>\$ 10,150,438</u>

##### **b. Per geographic segment**

###### **Sales per geographic zone**

	<u>2016</u>	<u>2015</u>
Mexico	\$ 13,865,436	\$ 9,859,514
Outside Mexico	<u>71,884</u>	<u>290,924</u>
Total	<u>\$ 13,937,320</u>	<u>\$ 10,150,438</u>

#### **Note 31 -Subsequent events:**

In preparing the financial statements, the Company has evaluated events and transactions for subsequent recognition or disclosure thereof at December 31, 2016 and up to February 21, 2017 (date of issuance of the financial statements), and has concluded there are no subsequent events that would affect said statements, except for the following relevant subsequent event that has no effect on the records in the financial statements at December 31, 2016:

On November 17, 2016, the consortium ALTAN Redes, S. A. P. I. de C.V. ("ALTAN"), won the international request for tenders put out by the Ministry of Communications and Transportation, for construction and operation of the Shares Network.

The Company will hold a 4% shareholding interest in ALTAN, representing an investment of US\$30,000, of which US\$1,000 was payable in cash in January 2017 and the remainder through a service provision plan.

## ***Axtel, S. A. B. de C. V. and subsidiaries***

(a subsidiary of Alfa, S. A. B. de C. V.)

### **Notes to the Consolidated Financial Statements**

**December 31, 2016 and 2015**

---

In this regard, Axtel will not only be a shareholder, but will also provide telecommunications and IT services to ALTAN. However, because it is a telecommunications service licensee, the Company will have no significant influence on the ALTAN operation. In light of the above, its interest will be effected through the acquisition of a special series of shares with no voting rights, mostly contributing services and capabilities.

With respect to ALTAN, on January 17, 2017, through its Agency for Promotion of Investments in Telecommunications (PROMTEL), the Ministry of Communications and Transportation and the IFT granted ALTAN a concession title for commercial use as a wholesale shared network, for a 20-year term as from the date of the award.

At present, the Company is working with ALTAN to subscribe the agreement requiring that Axtel provide services for up to a minimum of US\$29,000. We trust that by month end, said agreement was subscribed by both parties.



Dr. Sergio Rolando Zubirán Shetler  
Chief Executive Officer



Lic. Adrián de los Santos Escobedo  
Chief Financial Officer



Ing. Manuel Ramírez López  
Corporate Controller