

Moody's

INVESTORS SERVICE

Credit Opinion: **Axtel, S.A.B. de C.V.**

Global Credit Research - 07 Feb 2013

Monterrey, Mexico

Ratings

Category	Moody's Rating
Outlook	Stable
Corporate Family Rating -Dom Curr	Caa1
Senior Unsecured	Caa2

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Key Indicators

[1][2]Axtel, S.A.B. de C.V.

	9/30/2012(L)	12/31/2011	12/31/2010	12/31/2009	12/31/2008
Scale (USD Billion)	\$0.8	\$0.9	\$0.8	\$0.8	\$1.0
EBITDA Margin	34.1%	38.0%	35.4%	39.8%	40.1%
Debt / EBITDA	3.9x	3.7x	3.5x	2.8x	2.4x
FCF / Debt	5.7%	-7.9%	-4.8%	-0.6%	1.8%
RCF / Debt	23.4%	11.4%	24.4%	29.6%	33.4%
(FFO + Interest Expense) / Interest Expense	3.6x	2.4x	3.9x	4.4x	5.0x
(EBITDA - Capex) / Interest Expense	0.8x	1.0x	0.1x	1.3x	0.4x

[1] All ratios are calculated using Moody's standard accounting adjustments [2] As of 9/30/2012(L); Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

Opinion

Rating Drivers

- Weak liquidity and negative free cash generation
- Weak operating performance and deteriorated credit metrics
- Small operator in an increasingly competitive environment
- Robust network

Corporate Profile

Based in Monterrey, Nuevo León, Mexico, Axtel is a competitive local telephone company providing bundled products including voice, data and Internet services to business and residential users within Mexico. Axtel is the

second largest fixed line telecom in Mexico, with about 5% market share in terms of total fixed lines. During the last twelve months ended in September 30, 2012, the company's revenues reached USD 792 million with a 34.1% adjusted EBITDA margin.

SUMMARY RATING RATIONALE

Axtel's Caa1 corporate family rating reflects uncertainties around litigations on interconnection and termination rates both with Mexican mobile and wireline telcos. If final decisions are adverse to Axtel, these could have a significant impact on its liquidity position. Although the sale of towers, announced in January 2013, contributed to an improved liquidity profile, uncertainties around disputes on telecom tariffs plus the company's need to increase capex in order to grow revenues will continue to place pressure on its liquidity situation.

Axtel's ratings also consider the company's weak operating performance in recent years, given the highly competitive nature of the telecom industry in Mexico; a small revenue size; and the negative free cash flow generation. Somewhat mitigating these credit negatives is Axtel's greater network investments over the last couple of years and the quality of its network.

DETAILED RATING CONSIDERATIONS

NEGATIVE FREE CASH GENERATION AND DETERIORATED CREDIT METRICS

Over the last several years, the following factors have jeopardized Axtel's cash flow generation and credit profile: i) the technology problems faced with Wimax in most of 2008; ii) the economic recession in Mexico in 2009; iii) the need to maintain elevated levels of capex aiming at sustaining revenues in a highly competitive operating environment; and iv) higher financial leverage and refinancing risk due to lower operating margins and cash position.

We believe that continued negative pressure on revenues and margins due to tough competitive environment in all of the company's business segments will keep pressuring revenues, margins, capex and working capital, casting doubts on the sustainability of the company's business model over the long term.

SMALL OPERATOR WITH UNCERTAIN OPERATING PROSPECTS IN A HIGHLY COMPETITIVE MARKET

Axtel's revenue size of only over USD 792 million limits the company's financial flexibility. The company's asset base is modest compared to its peers and provides little flexibility to generate cash from the divestiture of certain operations, if needed.

In addition, the company's focus on residential market and the lack of a triple play offering make it vulnerable to the ongoing wireless substitution; strong competition from incumbent Telmex (A3 stable); and the rising availability of broadband and telecom services by cable TV operators such as Televisa (Baa1 stable).

Thus, uncertainty remains about Axtel's ability to significantly and sustainably reverse its weak operating results. We believe that, in the medium to long term, continued negative pressure on revenues and margins due to tough competitive environment in all of the company's business segments will keep placing pressure on revenues margins, working capital, and capex. For instance, since the end of 2011, the company's performance in long distance segment has been negatively impacted by a decline in international long distance tariffs, a trend that is expected to continue in the future given strong competition from broadband services. Axtel posted adjusted EBITDA margin of 34.1% for the last twelve months ended September 30, 2012, compared to 38% in 2011.

Despite the fact that recent high investments in optic fiber of about USD 80 million in the last couple of years have generated positive results in broadband services since the first half of 2011, it is still not clear if these will be sustainable and sufficient to revert unfavorable operating results especially related to legacy voice services, which represent over 55% of sales.

Furthermore, recent reductions in capex raises some doubts on the company's ability to continue growing its customer base in light of the tough competitive environment. While this strategy alleviates the company's tight liquidity in the short term, over the long term might not be sustainable.

Moody's believes that this tough competitive environment will persist for the long term given that the large diversified media company, Televisa, started strengthening its telecom offerings in mid 2011 by adding mobile telephony to its portfolio of DTH, cable TV, broadband access and fixed telephony services. This stiff competitive environment diminishes industry pricing power and increases operating expenses, thus impacting margins.

HIGH CONTINGENT LIABILITIES INCREASE LIQUIDITY RISK

Mobile operators claim that Axtel owe a total of about MXN 2 billion in interconnection fees, whose rates were reduced by the regulator for years 2008-2011. A recent decision by the supreme court giving the regulator the final word on this matter increases the chance that Axtel will be requested to pay this amount, given Cofetel's previous pronouncements on this case. A final resolution should be achieved before mid 2013.

Axtel also claims that from 2006 to 2008 it overpaid a total of MXN 794.3 million to mobile operators in interconnection services, which the company expects to receive back eventually.

In addition, Axtel has a similar dispute with Telmex for an amount of MXN 1.24 billion in long distance termination services for the period from March 2009 to June 2010. The case is now in the hands of the federal court. This situation has caused service interruptions in the past that have jeopardized Axtel's services especially to commercial business.

Axtel has limited reserves in the event it loses the above disputes.

Structural Considerations

The 2017 and 2019 notes are rated one notch below Axtel's Caa1 Corporate Family Rating because they are effectively subordinated to the secured exchanged notes, which comprise 50% of the company's total debt outstanding.

Liquidity Profile

Axtel has a weak liquidity position. The low level of cash on hand as of September 30, 2012 at MXN 667 million casts doubt on the company's ability to face upcoming cash outflows, consisting mainly of working capital needs and interest payments. While earnings and cash flow have been impacted by declining revenues from long distance services, working capital needs have been above trend mostly due to slow collection of receivables from certain government entities. Axtel expected these accounts receivable to be fully paid during the fourth quarter of 2012.

Axtel's debt maturity profile is comfortable as almost all of the company debt matures in 2017 or thereafter. In its assessment of Axtel's liquidity risk, Moody's assumed that Axtel will hedge foreign exchange exposure related at least to interest payments on the USD debt outstanding.

Rating Outlook

The stable ratings outlook is based on Moody's belief that, over the next 12 to 18 months, there will be no material change in Axtel's operating performance.

What Could Change the Rating - Up

A strengthened liquidity position could support a positive rating action. Specifically, if the disputes on telecom rates result in a favorable decision for Axtel, its ratings could be upgraded. However, for any positive rating action to occur it is necessary that Axtel's core operations improve, with prospects for consistent positive free cash flow generation.

What Could Change the Rating - Down

Should Axtel's liquidity position weaken further from unfavorable legal decisions on telecom rates, modest operating results and continued negative free cash flow generation, its ratings could experience downward pressure. An underperformance of Axtel's business that does not allow for an improvement in interest coverage from current low levels or that drive adjusted debt/EBITDA above 4 times for an extended period of time would also pressure the ratings.

Other Considerations

GRID IMPLIED RATING

We use the Global Telecommunications Industry Methodology to assist in the assessment of Axtel's credit quality. The Methodology suggested rating outcome for Axtel is based on the company's last twelve months results as of September 2012. All financial metrics incorporate our standard adjustments. Application of this Methodology

indicates a global rating of B1 for Axtel. The difference between Axtel's Methodology-indicated rating and its actual rating is driven primarily by a tight liquidity profile and the competitive nature of the Mexican telecommunications industry.

Rating Factors

Axtel, S.A.B. de C.V.

Global Telecommunications Industry [1][2]	Current LTM 9/30/2012		Moody's 12-18 month Forward View	
	Measure	Score	Measure	Score
Factor 1: Scale And Business Model, Comp Environment And Tech Positioning (27%)				
a) Scale (USD Billion)	\$0.8	B	\$0.8	B
b) Business Model, Competitive Environment and Tech Positioning	x	B	x	B
Factor 2: Operation Environment (16%)				
a) Regulatory and Political	x	Ba	x	Ba
b) Market Share	x	Caa	x	Caa
Factor 3: Financial Policy (5%)				
a) Financial Policy	x	B	x	B
Factor 4: Operating Performance (5%)				
a) EBITDA Margin	34.1%	Baa	34.5%	Baa
Factor 5: Financial Strength (47%)				
a) Debt / EBITDA	3.9x	B	3.9x	B
b) FCF / Debt	5.7%	B	-15.2%	Caa
c) RCF / Debt	23.4%	Ba	2.8%	Caa
d) (FFO + Interest Expense) / Interest Expense	3.6x	Ba	1.4x	Caa
e) (EBITDA - Capex) / Interest Expense	0.8x	Caa	1.0x	Caa
Rating:				
a) Indicated Rating from Grid	B1	B1	B3	B3
b) Actual Rating Assigned	Caa1	Caa1	Caa1	Caa1

[1] All ratios are calculated using Moody's standard accounting adjustments [2] As of 9/30/2012(L); Source: Moody's Financial Metrics

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