

August 29, 2008

**Recovery Report:**  
**Axtel S.A.B. de C.V.'s Recovery  
Rating Profile**

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## Recovery Report:

# Axtel S.A.B. de C.V.'s Recovery Rating Profile

On Aug. 29, 2008, Standard & Poor's Ratings Services affirmed its senior unsecured debt rating and assigned a recovery rating to Axtel S.A.B. de C.V.'s \$250 million senior unsecured notes maturing in 2013 (current outstanding balance \$162.5 million) and \$275 million senior unsecured notes maturing in 2017. The notes are rated 'BB-' (the same as the long-term corporate credit rating) with a recovery rating of '3', indicating that lenders can expect a meaningful (50%-70%) recovery in the event of payment default.

The distinctive characteristics of particular jurisdictions' insolvency regimes have a significant effect on the amounts ultimately recovered, the time to recover such amounts, and the overall predictability of the process. Based on our review, we have assessed Mexico's insolvency regime as a Group B jurisdiction, resulting in the capping of both recovery and issue ratings.

Our classification results in jurisdiction-specific adjustments to our recovery ratings, namely the capping of both recovery ratings and the differential between the issuer credit and issue ratings in countries where we expect debtor-friendly insolvency regimes to affect the recovery process and actual recovery rates negatively. These caps increase the transparency and consistency of our assessments of the effect of countries' insolvency rules--especially countries that are less creditor-friendly--when assigning recovery and issue ratings.

The affirmation of the senior unsecured debt rating and the assignment of the recovery rating follows the introduction of the new recovery methodology that replaces the traditional notching guidelines we have been using for speculative-grade issuers in Mexico. (See Standard & Poor's "Introducing Recovery Ratings In Mexico" and "Debt Recovery For Creditors And The Law Of Insolvency In Mexico," both published Sept. 19, 2007, on RatingsDirect.)

The notes are senior unsecured obligations, ranking equally in right of payment with Axtel's existing and future senior unsecured indebtedness, senior in right of payment to all of its existing and future subordinated indebtedness, and junior to all of its existing and future secured indebtedness and all other indebtedness owed to statutorily preferred creditors. All of Axtel's existing subsidiaries guarantee the notes.

The likelihood of default for Axtel's debt is reflected in the 'BB-' corporate credit rating, which has not changed. (For the complete corporate credit rating rationale on Axtel, see Standard & Poor's research report published May 23, 2008, on RatingsDirect.)

**Table 1**

| Credit Profile                       |               |                 |                       |          |           |
|--------------------------------------|---------------|-----------------|-----------------------|----------|-----------|
| Corporate credit rating              | BB-/Stable/-- |                 |                       |          |           |
| Facility/Issue                       | Issue rating  | Recovery rating | Expected recovery (%) | Maturity | Repayment |
| \$250 million senior unsecured notes | BB-           | 3               | 50-70                 | 2013     | Bullet    |
| \$275 million senior unsecured notes | BB-           | 3               | 50-70                 | 2017     | Bullet    |

## Recovery Analysis

### Simulated default scenario

Our simulated default scenario envisions significant capital expenditures from Axtel because of its appetite for further participation in the consolidation of the Mexican telecommunications industry. Specifically, our default scenario contemplates:

- Geographic expansion to new cities for the next three years;
- Heightened and sustained competitive pressures as Telmex (the incumbent), Maxcom, and new market entrants such as cable operators exert incremental pricing pressures on Axtel, resulting in lower margins and/or loss of market share;
- Axtel not succeeding in new markets and/or attracting new customers in existing markets, leading to weaker-than-expected revenue and EBITDA growth; and
- A weakening of Axtel's top-line performance, rendering it unable to meet its debt service obligations and fund its capital expenditures.

Other components of the default scenario include:

- A default in 2010, when the amortizations on the company's syndicated term loan begin;
- A 200-basis-point (bps) increase in LIBOR during this period; and
- A 200-bps increase in borrowing costs for the senior secured notes from credit deterioration.

### Valuation

In the event of payment default, we believe Axtel would continue to have a viable business model driven by the company's broad portfolio of telecom products, its flexible and advanced network using several access technologies, and the growth potential derived from the eventual implementation of number portability in Mexico. Additionally, our default and recovery analysis has demonstrated that the most likely outcome of an insolvency procedure for Mexican companies is a reorganization. Consequently, we valued Axtel as an ongoing concern.

We applied a 4.3x multiple to the default-level EBITDA of about \$116.2 million, based on our expectations that financially distressed Mexican corporates usually command a multiple of 3.75x to 4.3x, resulting in an estimated enterprise value of \$500 million.

### Results

The result of this analysis provides meaningful (50%-70%) recovery of principal for the senior unsecured notes.

## Transaction Summary

**Table 2**

| Transaction Summary        |                                      |
|----------------------------|--------------------------------------|
| Facility                   | Senior unsecured notes               |
| Borrower                   | Axtel S.A.B. de C.V.                 |
| Guarantors                 | All existing and future subsidiaries |
| Structure                  | No amortization until maturity       |
| Legal jurisdictions/issues | U.S.                                 |

**Table 2**

| <b>Transaction Summary(cont.)</b> |   |
|-----------------------------------|---|
| Key covenants                     | Incur additional indebtedness, pay dividends above certain permitted amount, grant liens, make certain investments and take part in a merger, consolidation and asset sale transactions |

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