TELEFONOS DE MEXICO S A B DE C V
Form 20-F
June 27, 2008
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As filed with the Securities and Exchange Commission on June 27, 2008.

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007

Commission File Number: 001-32741

Teléfonos de México, S.A.B. de C.V.

(Exact name of registrant as specified in its charter)

Telephones of Mexico

(Translation of registrant s name into English)

United Mexican States

(Jurisdiction of incorporation or organization)

Parque Vía 190, Colonia Cuauhtémoc, 06599 Mexico, D.F., Mexico

(Address of principal executive offices)

Anna Domínguez González

Teléfonos de México, S.A.B. de C.V.

Parque Vía 190

Colonia Cuauhtémoc

06599 Mexico, D.F. Mexico

Tel: (52) 55 52 22 17 74

Fax: (52) 55 55 45 55 50

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing 20 Series L Shares, without par value (L Share ADSs)	**New York Stock Exchange**
Series L Shares, without par value (L Shares)	**New York Stock Exchange (for listing purposes only)**
American Depositary Shares, each representing 20 Series A Shares, without par value (A Share ADSs)	**The NASDAQ Capital Market**
Series A Shares, without par value (A Share ADSs)	**The NASDAQ Capital Market (for listing purposes only)**
8.75% Senior Notes due 2016	**New York Stock Exchange**

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

None.

SECURITIES FOR WHICH THERE IS A REPORTING OBLIGATION PURSUANT TO SECTION 15(d) OF THE ACT:

None

The number of outstanding shares of each class of capital or common stock as of December 31, 2007 was:

8,115 million	AA Shares
430 million	A Shares
10,815 million	L Shares

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

x Yes ¨ No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

¨ Yes x No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

x Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP ¨ IFRS ¨ Other x

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

¨ Item 17 x Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

¨ Yes x No

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PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

SELECTED FINANCIAL DATA

The selected consolidated financial data set forth below have been derived from our audited consolidated financial statements for each of the five years in the period ended December 31, 2007, which have been reported on by Mancera, S.C., a Member Practice of Ernst & Young Global, an independent registered public accounting firm. The selected consolidated financial data should be read in conjunction with, and are qualified in their entirety by reference to, our consolidated financial statements and notes thereto included elsewhere in this Annual Report.

Our consolidated financial statements have been prepared in accordance with Mexican Financial Reporting Standards, or Mexican FRS, which differ in certain respects from generally accepted accounting principles in the United States, or U.S. GAAP. Note 18 to our audited consolidated financial statements provides a description of the principal differences between Mexican FRS and U.S. GAAP, as they relate to us; a reconciliation to U.S. GAAP of net income and total stockholders equity; and condensed financial statements under U.S. GAAP.

Mexican FRS require that our financial statements for periods ending prior to January 1, 2008, recognize the effects of inflation on financial information. Inflation accounting under Mexican FRS has extensive effects on the presentation of our financial statements. See *Item 5. Operating and Financial Review and Prospects Effect of Inflation Accounting*.

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The figures below have been adjusted to give effect for all periods to the two-for-one stock split that occurred in May 2005.

	Year ended December 31,				
	2007	2006	2005	2004	2003
	(in millions of constant pesos as of December 31, 2007, except per share data)				
Income Statement Data:					
Mexican FRS:[1]					
Operating revenues	P. 130,768	P. 129,755	P. 131,449	P. 135,302	P. 135,735
Operating costs and expenses	86,884	83,491	85,210	89,897	92,152
Operating income	43,884	46,264	46,239	45,405	43,583
Income from continuing operations, net of income tax	28,889	27,701	27,263	29,103	24,112
Income from discontinued operations, net of income tax	7,166	2,615	4,926	2,093	2,222
Net income	36,055	30,316	32,189	31,196	26,334
Majority net income per share Basic[2]	1.80	1.41	1.35	1.28	1.06
Majority net income per share from continuing operations Basic[2]	1.46	1.32	1.19	1.22	0.97
Majority net income per share from discontinued operations Basic[2]	0.34	0.09	0.16	0.06	0.09
Majority net income per share Diluted[2]	1.80	1.41	1.35	1.27	1.03
Majority net income per share from continuing operations Diluted[2]	1.46	1.32	1.19	1.21	0.94
Majority net income per share from discontinued operations Diluted[2]	0.34	0.09	0.16	0.06	0.09
Dividends paid per share[2][3]	0.440	0.403	0.370	0.333	0.303
Weighted average number of shares outstanding (millions)					
Basic	19,766	20,948	22,893	23,906	24,908
Diluted	19,766	20,948	22,893	24,404	26,202
U.S. GAAP: [4]					
Operating revenues	P. 196,496	P. 181,586	P. 175,920	P. 156,197	P. 139,223
Operating costs and expenses	144,944	137,374	129,285	113,936	97,931
Operating income	51,552	44,212	46,635	42,261	41,292
Net income	35,375	28,638	29,221	31,497	25,473
Net income per share Basic[2]	1.79	1.37	1.28	1.32	1.02
Net income per share Diluted[2]	1.79	1.37	1.28	1.31	1.00
Dividends paid per share[2][3]	0.440	0.403	0.370	0.333	0.303

(see footnotes on following page)

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	December 31, 2007	2006	2005	2004	2003
	(in millions of constant pesos as of December 31, 2007, except number of shares and ratios of earnings to fixed charges)				
Balance Sheet Data:					
Mexican FRS:(1)					
Plant, property and equipment, net	P. 120,649	P. 124,613	P. 130,088	P. 137,677	P. 141,942
Total assets from continuing operations	172,429	188,182	200,793	214,792	214,719
Total assets from discontinued operations		107,366	93,980	93,259	4,845
Total assets	172,429	295,548	294,773	308,051	219,564
Short-term debt and current portion of long-term debt	12,282	9,041	14,501	5,275	23,777
Long-term debt	79,180	81,376	75,696	79,393	56,816
Total stockholders equity	42,159	121,321	135,879	132,785	93,469
Capital stock	9,403	28,011	29,728	31,238	32,494
Number of outstanding shares (millions)					
Series AA	8,115	8,115	8,115	8,127	8,272
Series A	430	446	479	504	530
Series L	10,815	11,642	13,451	15,034	15,416
U.S. GAAP: (4)					
Plant, property and equipment, net	P. 183,493	P. 175,565	P. 170,984	P. 177,788	P. 148,741
Total assets	294,502	271,160	276,611	291,765	226,892
Short-term debt and current portion of long-term debt	16,987	13,023	15,757	14,719	23,778
Long-term debt	90,035	91,733	82,444	85,729	56,815
Total stockholders equity	117,504	97,335	103,921	100,969	86,114
Capital stock	27,231	28,011	29,728	31,238	32,494
Other Data:					
Mexican FRS:(1)					
Ratio of earnings to fixed charges(5)	7.1	6.7	7.0	8.3	6.5
U.S. GAAP:(4)					
Ratio of earnings to fixed charges(6)	7.1	6.0	6.0	7.4	6.9

(1) Under Mexican FRS, the *Escisión* was deemed effective as of December 26, 2007, and therefore the businesses transferred to Telmex Internacional pursuant to the *Escisión* have been treated as discontinued operations for all periods. See *Item 4. Information on the Company The* Escisión, *Item 5. Operating and Financial Review and Prospect U.S. GAAP Reconciliation* and Note 2 to our audited consolidated financial statements.

(2) We have not presented net income or dividends on a per ADS basis. Each L Share ADS represents 20 L Shares, and each A Share ADS represents 20 A Shares.

(3) Nominal amounts. For information on dividends paid per share converted into U.S. dollars, see *Item 8. Financial Information Dividends.*

(4) Under U.S. GAAP, the Escisión was deemed effective as of June 10, 2008, the date on which the Telmex Internacional share certificates were delivered to our shareholders, and therefore the businesses transferred to Telmex Internacional pursuant to the Escisión were treated as part of our continuing operations as of December 31, 2007. See *Item 4. Information on the Company The* Escisión, *Item 5. Operating and Financial Review and Prospect U.S. GAAP Reconciliation* and Note 18 to our audited consolidated financial statements.

(5) Earnings for this purpose consist of earnings before provision for income tax and equity interest in net income of affiliates, plus fixed charges during the period. Fixed charges for this purpose consist of interest expense during the period. Fixed charges do not take into account gain or loss from monetary position or exchange gain or loss attributable to our indebtedness.

(6) Earnings for this purpose consist of earnings before provision for income tax and equity interest in net income of affiliates, plus fixed charges and depreciation of capitalized interest and minus interest capitalized during the period. Fixed charges for this purpose consist of interest expense plus interest capitalized during the period. Fixed charges do not take into account gain or loss from monetary position or exchange gain or loss attributable to our indebtedness.

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EXCHANGE RATES

The following table sets forth, for the periods indicated, the high, low, average and period-end noon buying rate in New York City for cable transfers in pesos published by the Federal Reserve Bank of New York, expressed in pesos per U.S. dollar. The rates have not been re-expressed in constant currency units.

Period	High	Low	Average(1)	Period End
2003	P. 10.11	P. 11.41	P. 10.79	P. 11.24
2004	10.81	11.64	11.29	11.15
2005	10.41	11.41	10.87	10.63
2006	10.43	11.46	10.90	10.80
2007	10.67	11.27	10.84	10.92
2007:				
December	10.80	10.92	10.85	10.92
2008:				
January	10.82	10.97	10.91	10.82
February	10.67	10.82	10.77	10.73
March	10.63	10.85	10.73	10.63
April	10.44	10.60	10.51	10.51
May	10.31	10.57	10.44	10.33

(1) Average of month-end rates, where applicable.

On June 26, 2008, the noon buying rate was P.10.27 to U.S.$1.00.

We pay cash dividends in pesos, and exchange rate fluctuations affect the U.S. dollar amounts received by holders of our American Depositary Shares, or ADSs, on conversion by the depositary of cash dividends on the shares represented by such ADSs. Fluctuations in the exchange rate between the peso and the U.S. dollar affect the U.S. dollar equivalent of the peso price of our shares on the Mexican Stock Exchange (*Bolsa Mexicana de Valores, S.A. de C.V.*) and, as a result, can also affect the market price of the ADSs.

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RISK FACTORS

Risks Relating to Our Business Generally

Increasing competition in the telecommunications industry could adversely affect our revenues and profitability

We face significant competition which could result in decreases in current and potential customers, revenues and profitability. Governmental authorities in Mexico continue to grant new licenses and concessions to new market entrants, which results in increased competition. In addition, technological developments are increasing cross-competition in certain markets, such as between fixed-line operators and wireless providers and between cable television providers and telephony providers.

Competition in local service, principally from wireless service providers, has been developing in Mexico since 1999. In December 2007, there were approximately 68.2 million cellular lines in service, compared with approximately 19.7 million fixed lines in service (17.8 million of which are part of our network). As of year-end 2007, licenses for local service have been granted to 25 carriers, including Telmex and our subsidiary Teléfonos de Noroeste, S.A. de C.V., or Telnor, mainly in Mexico City, Guadalajara, Monterrey, Puebla and other large and medium-sized cities. All 25 carriers (including Telmex and Telnor) are local fixed-line concessionaires; three carriers (including Telmex) are also local wireless concessionaires in the 3.4 Ghz frequency band.

We also face competition from cable television providers, which have been authorized by the Communications Ministry (*Secretaría de Comunicaciones y Transportes*) to provide voice-transmission services to local fixed-line telecommunications operators and data and broadband Internet access services to the Mexican public. As of December 31, 2007, cable television providers have been granted 59 licenses for the provision of local fixed-line voice-transmission service in various cities in Mexico.

In addition, in April 2006, the Mexican Congress amended the Federal Telecommunications Law (*Ley Federal de Telecomunicaciones*) and the Federal Radio and Television Law (*Ley Federal de Radio y Televisión*) to allow radio and television broadcasting companies to apply for authorizations to provide telecommunications services. Recent regulations adopted by the Communications Ministry would allow, after certain prerequisites have been met, paid audio and television concessionaires to provide fixed-line local telephone services and local telephone service providers like us to provide paid audio and television services. Prior to the adoption of these regulations, four cable television providers, which currently service the majority of the paid television subscribers in Mexico, obtained the necessary amendments to their concessions and have begun competing with us in the market for fixed-line local telephone services. See *Regulation Audio and Television Services.*

The effects of competition on our business are highly uncertain and will depend on a variety of factors, including economic conditions, regulatory developments, the behavior of our customers and competitors and the effectiveness of measures we take in response to the competition we face. Our ability to compete successfully will depend on customer service, marketing and our ability to anticipate and respond to various competitive factors affecting the telecommunications industry, including new services and technologies, changes in consumer preferences, demographic trends, economic conditions and discount pricing strategies by competitors. If we are unable to respond to competition and compensate for declining prices by adding new customers, increasing usage and offering new services, our revenues and profitability could decline.

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Dominant carrier regulations and other regulatory developments could hurt our business by limiting our ability to pursue competitive and profitable strategies

Our business is subject to extensive government regulation, and it can be adversely affected by changes in law, regulation or regulatory policy. The Competition Commission (*Comisión Federal de Competencia*) previously determined that we were a dominant provider of certain telecommunications services, and Mexican law provides for the regulatory authorities to impose additional regulations on a dominant provider. During the past several years, the Competition Commission and the Mexican Federal Telecommunications Commission (*Comisión Federal de Telecomunicaciones*, or Cofetel) adopted resolutions and regulations that apply specifically to us as a dominant carrier. We successfully challenged these resolutions and regulations in Mexican federal court, and in February 2007 the Competition Commission revoked its determination that we are a dominant carrier and closed the case. However, we cannot predict whether the Competition Commission or Cofetel will issue similar resolutions or regulations in the future, and if so, whether our judicial challenges will be successful. We believe that if dominant carrier regulations are imposed on our business, they will reduce our flexibility to adopt competitive market policies.

Between November 2007 and February 2008, the Competition Commission commenced several industry-wide investigations to determine whether any operators, including Telmex and certain of its affiliates, possess substantial market power or engage in relative anti-competitive practices in certain segments of the Mexican telecommunications market. These investigations are at the stage of information collection and analysis, and we cannot predict their outcome. Findings adverse to Telmex may lead to the imposition of restrictions or monetary penalties on us.

Our industry is subject to rapid technological changes, which could adversely affect our ability to compete

The telecommunications industry is in a period of rapid technological change. Our future success depends, in part, on our ability to anticipate and adapt in a timely manner to technological changes. We expect that new products and technologies will emerge and that existing products and technologies will further develop. These new products and technologies may reduce the prices we can charge for our services or they may be superior to, and render obsolete, the products and services we offer and the technologies we use. They may consequently reduce the revenues generated by our products and services or require investment in new technology. As a result, our most significant competitors in the future may be new entrants to our markets that would not be burdened by an installed base of older equipment.

Shifting usage patterns have adversely affected our revenues and will likely continue to do so in the future

Our fixed-line network services face increasing competition due to shifting usage patterns resulting from the adoption of popular new technologies, including wireless devices for voice and other communications, and the subsequent substitution of these technologies for fixed-line telephony. For example, we estimate that an increasing proportion of calls that previously would have been made over our fixed-line network, are now being made on wireless telephones and through Voice over Internet Protocol, or VoIP, services, for which we receive no revenue. This process has adversely affected our traffic volume and the results of our operations and will likely continue to do so in the future.

The Escisión may affect our stock price

On December 21, 2007, our shareholders approved the transfer of our Latin American and yellow pages directory businesses to a new entity, Telmex Internacional S.A.B. de C.V., or Telmex Internacional, by means of a procedure under Mexican corporate law called *escisión*, or split-up. See

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Item 4. Information on the Company The Escisión. As a result of the *Escisión*, substantially all of our operations are conducted in Mexico, which could be perceived to limit the diversification of our businesses and its growth potential, and thus could cause the market price of our shares and ADSs to decline.

Developments in the telecommunications sector have resulted, and in the future may result, in substantial write-downs of the carrying value of certain of our assets

We review on an annual basis, or more frequently where the circumstances require, the value of each of our assets to assess whether those carrying values can be supported by the future cash flows expected to be derived from those assets. Whenever we consider that our goodwill, intangible assets or fixed assets may be impaired due to changes in the economic, regulatory, business or political environment, we consider the necessity of performing certain valuation tests, which may result in impairment charges. The recognition of impairments of tangible, intangible and financial assets could result in a non-cash charge on our income statement, which could adversely affect our results of operations.

A system failure could cause delays or interruptions of service, which could cause us to lose customers and revenues

We will need to continue to provide our users with reliable service over our network. Some of the risks to our network and infrastructure include the following:

- physical damage to our network;
- natural disasters such as hurricanes, earthquakes, floods and storms, among others; and
- disruptions beyond our control.

Disruptions may cause interruptions in service or reduced capacity for customers, either of which could cause us to lose revenues or incur additional expenses.

Risks Relating to Our Controlling Shareholder and Capital Structure

We are controlled by one shareholder

A majority of the voting shares of our company (71.3% as of June 11, 2008) is owned by Carso Global Telecom, S.A.B. de C.V., or Carso Global Telecom. Carso Global Telecom has the effective power to designate a majority of the members of our Board of Directors and to determine the outcome of other actions requiring a vote of the shareholders, except in very limited cases that require a vote of the holders of L Shares. Carso Global Telecom is controlled by Carlos Slim Helú and members of his immediate family, who, taken together, own a majority of the common stock of Carso Global Telecom.

The protections afforded to minority shareholders in Mexico are different from those in the United States

Our bylaws provide that any dispute between us and our shareholders will be governed by Mexican law and that legal actions relating to the execution, interpretation or performance of the bylaws may be brought only in Mexican courts. Under Mexican law, the protections afforded to minority shareholders are different from those in the United States. In particular, the case law concerning fiduciary duties of directors is not well developed, there is no procedure for class actions, there are different procedural requirements for bringing shareholder lawsuits and there are different discovery rules. As a result, it may be more difficult in practice for minority shareholders of Telmex to enforce their rights against us or our directors or controlling shareholder than it would be for shareholders of a U.S. company.

We engage in transactions with related parties that may create the potential for conflicts of interest

We engage in transactions with entities that, like us, are controlled, directly or indirectly, by Carlos Slim Helú and members of his immediate family. These entities include (a) Telmex Internacional and certain of its subsidiaries, (b) Grupo Carso, S.A.B. de C.V., or Grupo Carso, and its subsidiaries, (c) Grupo Financiero Inbursa, S.A.B. de C.V., or Grupo Financiero Inbursa, and its subsidiaries, (d) América Móvil, S.A.B. de C.V., or América Móvil, and its subsidiaries, and (e) Carso Global Telecom. Our transactions with Telmex Internacional include Telmex Internacional s printing and distribution of our directories, Telmex Internacional s access to our customer database and our billing and collection system in connection with its directories business, and completion of international traffic in each other s countries of operation. Transactions with Grupo Carso include the purchase of network construction services and materials, and transactions with Grupo Financiero Inbursa include financial services and insurance. The largest component of our transactions with América Móvil in terms of amounts paid is interconnection between our respective networks in Mexico. We pay fees for consulting and management services to Carso Global Telecom and AT&T International (one of our principal shareholders), and have agreements with AT&T International that provide for the completion of calls in our respective countries of operation.

We also make investments jointly with related parties, sell our investments to related parties and buy investments from related parties. We pursued joint investments with América Móvil to acquire equity interests in Compañía Anónima Nacional Teléfonos de Venezuela in 2006 and Olimpia, an Italian company that owns 18% of the total capital of Telecom Italia in 2007. Neither of these transactions was completed.

Our transactions with related parties may create the potential for conflicts of interest.

Holders of L Shares and L Share ADSs have limited voting rights

Our bylaws provide that holders of L Shares are not permitted to vote except on such limited matters as the transformation or merger of Telmex or the cancellation of registration of the L Shares with the National Securities Registry (*Registro Nacional de Valores*), managed by the Mexican National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*) or any stock exchange on which they are listed. If you hold L Shares or L Share ADSs, you will not be able to vote on most matters, including the declaration of dividends, that are subject to a shareholder vote in accordance with our bylaws.

Holders of ADSs are not entitled to attend shareholders meetings, and they may only vote through the ADS depositary

Under Mexican law, a shareholder is required to deposit its shares with a custodian in order to attend a shareholders meeting. As long as a shareholder holds shares in ADS form, the shareholder will not be able to satisfy this requirement. There can be no assurance that holders of ADSs will receive notice of shareholders meetings from our ADS depositary in sufficient time to enable such holders to return voting instructions to the ADS depositary in a timely manner. In the event that instructions are not received with respect to any shares underlying ADSs, the ADS depositary will, subject to certain limitations, grant a proxy to a person designated by us. In the event that this proxy is not granted, the ADS depositary will vote these shares in the same manner as the majority of the shares of each class for which voting instructions are received.

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You may not be entitled to preemptive rights

Under Mexican law, if we issue new shares for cash as part of a capital increase, we generally must grant our shareholders the right to purchase a sufficient number of shares to maintain their existing ownership percentage in Telmex. Rights to purchase shares in these circumstances are known as preemptive rights. Preemptive rights do not arise upon the sale of newly issued shares in a public offering or the resale of shares of capital stock previously repurchased by us.

We may not legally be permitted to allow holders of ADSs or holders of L Shares or A Shares in the United States to exercise any preemptive rights in any future capital increase unless we file a registration statement with the U.S. Securities and Exchange Commission, or SEC, with respect to that future issuance of shares. At the time of any future capital increase, we will evaluate the costs and potential liabilities associated with filing a registration statement with the SEC and any other factors that we consider important to determine whether we will file such a registration statement. We cannot assure you that we will file a registration statement with the SEC to allow holders of ADSs or U.S. holders of L Shares or A Shares to participate in a preemptive rights offering. As a result, the equity interest of such holders in Telmex may be diluted proportionately. In addition, under current Mexican law, it is not practicable for the ADS depositary to sell preemptive rights and distribute the proceeds from such sales to ADS holders.

Our bylaws restrict the acquisition of shares in some circumstances

Our bylaws provide that any acquisition of more than 10% of our capital stock by any person or group of persons acting together requires the approval of our Board of Directors. If you wish to acquire more than 10% of our capital stock, you will not be able to do so without the approval of our Board of Directors.

Our bylaws restrict the ability of non-Mexican shareholders to invoke the protection of their governments with respect to their rights as shareholders

As required by Mexican law, our bylaws provide that non-Mexican shareholders shall be considered as Mexicans in respect of their ownership interests in Telmex and shall be deemed to have agreed not to invoke the protection of their governments in certain circumstances. Under this provision, a non-Mexican shareholder is deemed to have agreed not to invoke the protection of his own government by asking such government to interpose a diplomatic claim against the Mexican government with respect to the shareholder s rights as a shareholder, but is not deemed to have waived any other rights he may have, including any rights under the U.S. securities laws, with respect to his investment in Telmex. If you invoke such governmental protection in violation of this agreement, your shares could be forfeited to the Mexican government.

It may be difficult to enforce civil liabilities against us or our directors, officers and controlling persons

Telmex is organized under the laws of Mexico, and most of our directors, officers and controlling persons reside outside the United States. In addition, substantially all of our assets and their assets are located in Mexico. As a result, it may be difficult for investors to effect service of process within the United States on such persons or to enforce judgments against them, including in any action based on civil liabilities under the U.S. federal securities laws. There is doubt as to the enforceability against such persons in Mexico, whether in original actions or in actions to enforce judgments of U.S. courts, of liabilities based solely on the U.S. federal securities laws.

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Risks Relating to Developments in Mexico

Economic and political developments may adversely affect our business

Substantially all of our business operations and assets are located in Mexico. As a result, our business may be significantly affected by the general condition of the Mexican economy, by devaluation of the peso against the U.S. dollar, by inflation and high interest rates in Mexico and by political developments in Mexico.

Mexico has experienced adverse economic conditions in the past

In the past, Mexico has experienced both prolonged periods of weak economic conditions and deterioration in economic conditions that have had a negative impact on our company. If the Mexican economy falls into a recession or if inflation and interest rates increase significantly, our business, financial condition and results of operations could suffer material adverse consequences because, among other things, demand for telecommunications services may decrease and consumers may find it difficult to pay for the services we offer.

Our financial condition and results of operations are affected by exchange rate variations

We report exchange gains or losses on our U.S. dollar-denominated indebtedness and accounts payable. Changes in the value of the Mexican peso against the U.S. dollar affect our debt and therefore our financial condition and results of operations. We use derivative instruments to manage our exposure to the risk associated with exchange rate variations. At December 31, 2007, our U.S. dollar-denominated indebtedness amounted to P.91,462 million. The peso depreciated against the U.S. dollar by 0.3% in 2007 and by 1.5% in 2006. We had a net foreign exchange loss in both periods (P.643 million in 2007 and P.1,159 million in 2006), including losses on derivatives we had entered into to minimize our exposure to the U.S. dollar.

Major devaluation or depreciation of the peso may also result in disruption of the international foreign exchange markets and may limit our ability to transfer or to convert pesos into U.S. dollars and other currencies for the purpose of making timely payments of interest and principal on our indebtedness. While the Mexican government does not currently restrict, and for many years has not restricted, the right or ability of Mexican or foreign persons or entities to convert pesos into U.S. dollars or to transfer other currencies out of Mexico, the government could institute restrictive exchange rate policies in the future.

High levels of inflation and high interest rates in Mexico could adversely affect our financial condition and results of operations

Mexico has experienced high levels of inflation and high domestic interest rates. High levels of inflation can adversely affect our profitability and, more generally, can result in lower demand or lower growth in demand for telecommunications services.

Developments in the U.S. economy may adversely affect our business

Economic conditions in Mexico are heavily influenced by the condition of the U.S. economy due to various factors, including trade, investment and emigration from Mexico to the United States. Events and conditions affecting the U.S. economy may adversely affect our business, results of operations, prospects and financial condition.

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FORWARD-LOOKING STATEMENTS

This Annual Report contains forward-looking statements. We may from time to time make forward-looking statements in our periodic reports to the SEC on Form 6-K, in our annual report to shareholders, in offering circulars and prospectuses, in press releases and other written materials and in oral statements made by our officers, directors or employees to analysts, investors, representatives of the media and others. Examples of such forward-looking statements include:

- projections of operating revenues, net income, net income per share, capital expenditures, dividends, capital structure or other financial items or ratios;
- statements of our acquisition or divestiture plans;
- statements about the impact of our acquisition of businesses;
- statements of our plans, objectives or goals relating to competition, regulation and rates;
- statements about competition in the business sectors in which we operate;
- statements about our future financial performance or the economic performance of Mexico or other countries;
- statements about currency exchange rates;
- statements about the future impact of regulations; and
- statements of assumptions underlying such statements.

Words such as believe, anticipate, plan, expect, intend, target, estimate, project, predict, forecast, guideline, should and intended to identify forward-looking statements but are not the exclusive means of identifying them.

Forward-looking statements involve inherent risks and uncertainties. We caution you that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements. These factors, some of which are discussed under *Risk Factors* beginning on page 5, include technological improvements, customer demand, competition, economic and political conditions, government policies, inflation rates, exchange rates and regulatory developments. We caution you that the foregoing list of factors is not exclusive and that other risks and uncertainties may cause actual results to differ materially from those in forward-looking statements.

Forward-looking statements speak only as of the date they are made. We do not undertake to update such statements in light of new information or new developments.

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Item 4. Information on the Company

GENERAL

Overview

We own and operate a fixed-line telecommunications system in Mexico, where we are the only nationwide provider of fixed-line telephony services. We also provide other telecommunications and telecommunications-related services such as corporate networks, Internet access services, information network management, telephone and computer equipment sales, and interconnection services to other carriers.

We have developed a multi-service network in which more than 90% of the lines have the capacity to provide simultaneous transmission of voice and data through a broadband connection. Our network capability allowed us to increase the number of customers of Infinitum, our broadband Internet access service, by 60.5% in 2007 to over 2.9 million. At the same time, we are extending our voice and Internet access services to remote areas. Through e-Mexico II and III, we are participating in a government-sponsored program that extends high-speed Internet access to over 4,800 digital community centers in over 4,000 towns. In 2006, we were granted an authorization to participate in the Social Coverage Fund II (*Fondo de Cobertura Social II*), which will allow us to provide voice, data and Internet access services to more than 8.7 million people in over 11,000 communities, through 254 thousand rural lines. We currently provide such services to 5.1 million people in over 6,000 communities through our participation in the Social Coverage Fund II.

In 2007, we continued our efforts to grow voice and data service revenues by offering multiple-service products. In addition, we have made investments to increase our service offerings and to update the telecommunications platform in rural areas where we are the sole telecommunications carrier. We plan to continue expanding our multiple-service offerings in the future and to take advantage of technological advances with the objective of providing our customers with packages that combine voice, data and video.

As a result of the *Escisión*, substantially all of our operations are now conducted in Mexico. Our strategy is to increase the value of our lines by capitalizing on our extensive and modern infrastructure and our technical capabilities to provide high-quality services to our customers across Mexico, pursuing growth in the broadband and data businesses, introducing and promoting packaged service offerings combining broadband with voice services at attractive prices, and maintaining our focus on customer service. In Mexico s major population centers, data is a source of growth, and we are well positioned to deliver Internet access and meet the demands of the growing data market. We plan to pursue growth in the sales of computer equipment at our Telmex stores and contribute to raising the Internet penetration rate in Mexico. In addition, when the prescribed regulatory framework has been put in place and we are granted the necessary authorization, we intend to begin providing paid audio and television services and to expand our multiple service products to include triple play packages.

We are a Mexican corporation headquartered in Mexico City, D.F., Mexico. Our legal name is Teléfonos de México, S.A.B. de C.V., and we frequently refer to ourselves commercially as Telmex. Our principal executive offices are located at Parque Vía 190, Colonia Cuauhtémoc, 06599 Mexico, D.F., Mexico. Our telephone number at this location is (52) 55 5703-3990. Our website can be accessed at www.telmex.com.

In this Annual Report, we, us or our refers to Teléfonos de México, S.A.B. de C.V. and, where the context requires, its consolidated subsidiaries.

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History

We were formed in 1947 under private foreign ownership to acquire the Mexican telephone business of a wholly owned subsidiary of the LM Ericsson group of Sweden. In 1950, we acquired the Mexican telephone business of a wholly owned subsidiary of the International Telephone and Telegraph Company, which operated the only other national telephone network in Mexico at that time. In 1972, the Mexican federal government acquired the majority of our capital stock. In December 1990, the Mexican government sold shares representing voting control of our company. The Mexican government sold the balance of its shares in a series of transactions beginning in May 1991. In September 2000, we transferred our Mexican wireless business and our foreign operations at the time to América Móvil, S.A.B. de C.V., or América Móvil, in an *escisión*, or split-up. Beginning in 2004, we expanded our operations outside Mexico through a series of acquisitions in Brazil, Argentina, Chile, Colombia, Peru, Ecuador and the United States. On December 26, 2007, we transferred our Latin American and yellow pages directory businesses into a new entity, Telmex Internacional, in the *Escisión*. See *The* Escisión.

Significant Subsidiaries and Investees

The following table sets forth our significant subsidiaries and investees accounted for using the equity method at December 31, 2007:

Name of Company	Jurisdiction of establishment	Percentage of ownership and voting interest	Description
Subsidiaries			
Integración de Servicios TMX, S.A. de C.V.	Mexico	100.0%	Intermediate holding company
Alquiladora de Casas, S.A. de C.V.	Mexico	100.0%	Real estate company owning our facilities
Compañía de Teléfonos y Bienes Raíces, S.A. de C.V.	Mexico	100.0%	Real estate company owning our facilities
Consorcio Red Uno, S.A. de C.V.	Mexico	100.0%	Supplier of telecommunications network integration services and information systems
Teléfonos del Noroeste, S.A. de C.V.	Mexico	100.0%	Fixed-line public network concessionaire for the state of Baja California Norte and the San Luis Rio Colorado region of the state of Sonora
Uninet, S.A. de C.V.	Mexico	100.0%	Provider of corporate networks and Internet access services to Telmex and corporate customers
Telmex USA, L.L.C.	Delaware	100.0%	Authorized long distance service re-seller, telephone card sales, receipt of payments for lines in Mexico (installation expenses and monthly rental) and authorized by the FCC to provide facility-based long distance services in the United States
Affiliated companies			
Grupo Telvista S.A. de C.V.	Mexico	45.0%	Provider of telemarketing services in the United States and Mexico
2Wire, Inc.	California	13.0%	Broadband network equipment and service provider for residential and small-business customers

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OPERATIONS

At March 31, 2008, we had 17.8 million local fixed lines in service in Mexico, down 2.7% from March 31, 2007. In long distance services, we estimate that at the end of December 2007, our share of traffic in cities open to competition was 80.5% for domestic long distance and 81.4% for international long distance calls originating in Mexico.

Of our revenues in 2007, 41.6% was attributable to local service, 20.7% to long distance service, 17.3% to interconnection, 8.7% to corporate networks, and 8.4% to Internet access services. Other services, including principally sales of computers, telephones and accessories at Telmex stores and billing and collection services to third parties, accounted for 3.3% of revenues.

Overview

The following table gives selected data on the size and usage of our network:

	December 31,				
	2007	2006	2005	2004	2003
Lines in service (thousands)	17,800	18,251	18,375	17,172	15,683
Internet access accounts (thousands)	3,320	2,660	2,116	1,741	1,452
Billed line equivalents for data transmission (thousands)	2,715	2,330	2,011	1,517	1,139
Lines in service per employee	401.8	402.0	399.6	371.2	331.4
Domestic long distance call minutes for the year (millions)	18,275	18,108	17,853	16,700	15,376
International long distance call minutes for the year (millions)[1]	9,531	8,997	7,131	6,297	4,513
Total local calls (millions)	24,892	26,575	26,680	26,782	26,625
Prepaid telephone service cards sold (millions)	187	230	258	273	279

(1) Includes incoming and outgoing traffic.

Local Service

We are a nationwide provider of local telephone service in Mexico. We provide local telephone service to approximately 23 thousand communities throughout Mexico. Of all lines in service, 38.2% are in the Mexico City, Monterrey and Guadalajara areas, and 27.8% are in the Mexico City area alone. We provide service to approximately 21 thousand communities with fewer than five thousand inhabitants, exceeding our obligations to extend services to rural areas.

Local traffic in 2007 decreased by 6.3% compared to 2006, for a total of 24,892 million calls. The decrease in billed traffic in 2007 was attributable primarily to the competition of cellular service and fixed-line local service provided by other carriers, the reduction of lines in service, as well as the migration of switched traffic to corporate networks, virtual private networks, VoIP and other alternative service offerings, including the migration from dial-up to broadband Internet services. We expect that the increase in penetration of alternative service offerings and increasing competition will continue to curb measured service growth.

Our charges for fixed-line local telephone service include (a) installation charges, (b) monthly line rental charges, (c) monthly measured service charges, (d) digital services and (e) charges for other services, such as the transfer of a line to another address and reconnection. Residential customers pay a fixed charge per local call in excess of a monthly allowance of 100 local calls, and commercial customers pay for every local call at the same fixed rate per call. The concession we hold to operate a public network for basic telephone services, or the Concession, permits but does not require us to base our charges on the duration of each call, with a monthly allowance of free calls or call minutes for residential customers. We currently do not charge by duration of invoiced calls in any region, except in the case of prepaid services.

With the goal of promoting our local service offering among our customers, since 2005, we have introduced local service packages known as Business Line (*Línea Negocio*), which includes up to 1,000 local calls per month, Telmex SRI Digital Trunk Options (*Opciones Telmex SRI para troncales digitales*), which includes up to 24,000 local calls per month and, since 2006, Home Line (*Línea Hogar*), which includes up to 400 local calls per month.

In 2007, we did not increase rates for local telephone service. We have had lower rates in real terms for every year since March 2001.

Domestic Long Distance Service

Our nationwide domestic long distance transmission network consists of more than 30 thousand kilometers of optical fiber connecting Mexico s major cities, and includes secondary branches and additional transmission rings throughout Mexico designed to avoid network congestion.

Domestic long distance traffic increased by 0.9% in 2007 for a total of 18,275 million minutes at the end of 2007 and by 1.4% in 2006. The slow growth in domestic long distance traffic for a second consecutive year was primarily due to a decrease in traffic delivered by other long distance carriers to Telmex for completion, which was more than offset by the increase in traffic as a result of the introduction of the calling party pays system for domestic and international long distance service in November 2006. Our charges for domestic long distance service are based on call duration and the type of service (direct-dial or operator-assisted).

We offer a variety of domestic long distance discount plans that reduce the effective rates paid by our customers based on volume, time of use or other factors. High volume corporate clients pay P.1.00 per minute, which represents a discount of up to 55.9% from our nominal rate, while other customers that maintain service with us receive discounts of up to 39%, as well as a 50% discount on calls made between 8:00 p.m. and 7:59 a.m. from Monday to Saturday and all day Sunday. Our Lada 100 Nacional plan offers a monthly package of 200 domestic long distance minutes for P.115 (including value-added tax).

In 2007, we did not increase rates for domestic long distance service. We have had lower rates in real terms for every year since March 1999.

International Long Distance Service

We are a nationwide provider of international long distance telecommunications services in Mexico. International long distance traffic with the United States, Canada, Central America and other countries is carried by a combination of fiber optic network, microwave transmission, satellite systems and submarine cable.

In 2007, incoming international long distance traffic increased by 6.6%, or by 469 million minutes, while outgoing international long distance traffic increased by 3.4%, or by 64 million minutes.

Charges for international long distance calls are based on call duration, type of service (direct-dial or operator-assisted) and the call destination. Customers receive a 33.3% discount on calls made to the United States and Canada between 7:00 p.m. and 6:59 a.m. from Monday to Friday, all day Saturday, and

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between 12:00 a.m. and 4:59 p.m. on Sunday. Our Lada Favorito and Destinos Estratégicos Lada plans offer discounts on calls to certain cities in the United States and other countries that are pre-selected by customers, while the Lada 100 International plan offers 100 minutes per month to the United States and Canada for P.230 (including value-added tax).

In 2007, we did not increase rates for international long distance service. We have had lower rates in real terms for every year since March 1999.

Bilateral agreements with foreign carriers govern the rates of our payment to foreign carriers for completing international calls from Mexico and by foreign carriers to us for completing international calls to Mexico. The rates of payment under such agreements are negotiated with each foreign carrier. Settlements among carriers are made on a net basis. Settlement amounts payable to us in respect of calls from the United States to Mexico generally exceed amounts payable by us in respect of calls from Mexico to the United States. As a result, we receive net settlement payments from U.S. carriers. We make net settlement payments to other international carriers taken as a whole.

The international settlement rates that U.S. carriers pay to foreign carriers have been subject to intense downward pressure due to competition and regulatory factors, including initiatives by the U.S. government. Since 1999, there has been a cumulative reduction of 84% in our settlement rates with U.S. carriers. We negotiate settlement rates with U.S. carriers on an annual basis. We are in the process of negotiating new settlement rates with most of the U.S. carriers for the period beginning January 1, 2008. In 2007, we paid U.S.$0.030 per minute for northbound (Mexico to the United States) calls (compared to U.S.$ 0.033 per minute in 2006) and received an average rate of U.S.$0.038 per minute for completing international calls originated in the United States (compared to U.S.$0.0430 per minute in 2006).

Our international long distance revenues are affected by the use of VoIP technology, which transmits ordinary telephone calls over the Internet. For long distance calls made through VoIP services, we do not receive the international long distance service revenues that we would otherwise receive, such as revenues generated from billed minutes and termination fees.

Interconnection

We provide interconnection service pursuant to which (a) long distance, local and cellular carriers operating in Mexico establish points of interconnection between their networks and our network and (b) we carry calls between the points of interconnection and our customers. When a customer of another carrier calls a local service customer of ours, we complete the call by carrying the call from the point of interconnection to the particular customer, and when a local service customer of ours who has preselected a competing long distance carrier makes a long distance call, we carry the call from the customer to the point of interconnection with the relevant carrier s network. Excluding the calling party pays system, we have only one rate for interconnecting all categories of carriers and all types of calls.

We believe that our interconnection revenues have been affected by a practice we call local bypass, in which incoming international calls are routed from domestic long distance carriers to local lines other than ours and then connected to our local network for termination. As a result of Mexico s bill and keep system, under which local carriers do not pay interconnection fees to other local carriers, we do not receive an interconnection fee from these calls. Without local bypass, we would receive a domestic termination fee for completing these incoming calls. Although we, together with most local and long distance carriers, have requested regulatory intervention to eliminate local bypass, we believe our interconnection revenues will continue to be adversely affected by this practice.

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Corporate Networks

Corporate networks consist of the transmission of voice, video and data between two or more end points using private circuits. During 2007, the number of 64 Kbps line equivalents provided by means of corporate networks increased by 16.5%, to 2,715 thousand. Our principal product offerings for corporate networks are Ladalinks (*Ladaenlaces*), Frame Relay and Internet through Internet Protocol / Multi-Protocol Label Switching, or IP/MPLS. Using equipment installed on-site, Ladalinks customers have dedicated digital network links that transmit information at speeds ranging from 64 Kbps to 10 Gbps. IP/MPLS is a multi-service platform that allows us to provide integrated voice, data and video services at speeds ranging from 64 kbps to 155 Mbps. Frame Relay is a protocol for transmission of data, voice and video over a shared digital network. The speed of Frame Relay transmission ranges from 64 Kbps to 2,048 Kbps. All of these services offer extensive technical assistance and customer support. In addition, we provide network outsourcing, including network maintenance and support, to major institutions and private companies. We also provide hosting and co-location products, as well as telecommunications network integration services and information systems.

Internet Access Services

Internet access services connect both business and residential customers to the Internet through either a dial-up or a broadband connection. In 2007, the number of our Internet customers increased to approximately 3.3 million at year-end, an increase of 24.8% compared with 2006. We estimate that our Internet access market share was 54.7% of dial-up connections and 71.2% of broadband connections at December 31, 2007, measured on the basis of the total number of Internet access accounts in Mexico.

Our broadband service, Infinitum, allows our customers to use our high-capacity connectivity services with applications such as video-conferencing, file transfer, terminals and e-mail. Infinitum operates over Asymmetric Digital Subscriber Line, or ADSL, technology. In 2007, as a result of an aggressive market strategy aimed at migrating our customers from dial-up to broadband services, combined with improved ADSL service packages and a price reduction that took effect in April 2007, we increased our ADSL customer base by approximately 1.1 million accounts. At year-end 2007, we had over 2.9 million ADSL customers, an increase of 60.5% over 2006. Prodigy Mobile (*Prodigy Móvil*), our high-speed wireless service for residential and business customers, connects users at speeds of up to 2 Mbps within a range of up to 100 meters. At December 31, 2007, we maintained over 1,000 public hot spots in over 70 cities in Mexico, providing wireless Internet access to our customers.

Consistent with our strategy of retaining our current customers and maximizing the value of residential and business Internet accounts, in 2007 we continued to offer flexible plans permitting Infinitum customers to create their own individualized packages of additional voice services including a combination of local, long distance or fixed-to-cellular calls.

We also offer (a) Prodigy Home at a reduced monthly fee, which provides customers with unlimited Internet access between 4:00 p.m. and 8:00 a.m. from Monday to Friday plus the entire weekend and access for P.0.13 per minute at all other times, (b) a Multifon Card function which allows customers who do not otherwise have Internet access to access the Internet with their Multifon Card for P.0.13 per minute, and (c) Prodigy Roaming, a service that provides traveling customers with a connection anywhere in Mexico and in over 785 cities in the United States at the rate for local call.

Multiple Service Packages

In August 2007, we introduced a multiple service package for our residential customers called All Mexico without Limits (*Todo México sin Limites*). At a price of P.999 per month (including value-added tax), this plan includes monthly line rental charges, broadband Internet access, unlimited local and

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domestic long distance calls, five digital services, virtual storage space, 35 text messages and the Lada America rates for North, Central and South America. In March 2008, we introduced two similar packages that offer a more limited range and volume of services at lower monthly prices.

Other Products and Services

We provide various other telecommunications and telecommunications-related products and services, including sales of computer and telecommunications equipment and accessories, public phones, Internet portals, and billing and collection services to third parties.

Telmex Stores

We use our network of 380 Telmex stores (*Tiendas Telmex*) to offer our products and services throughout Mexico. In addition to their function as customer service centers, the Telmex stores offer a wide range of computer and telecommunications equipment and accessories, along with financing plans for their purchase. The network of Telmex stores serves not only as a focal point for interaction with our current and prospective customers but also as a growing revenue source.

Billing and Customer Service

For corporate customers, we offer SI@NA, an Internet service that permits customers to view their telecommunications spending. Residential customers may also access billing information over the Internet using the Telmex on-line (*Telmex en Línea*) service available on our website (www.telmex.com). We provide our customers with a bill format that details their usage of local, long distance and other services.

We provide customer service through a network of customer service centers and call centers and through our website. Our customer service centers have evolved from their traditional purpose as places for payment to become Telmex stores that offer telecommunications products and services. Large corporate customers also receive customer service from dedicated customer service personnel. Through our Integrated Solutions (*Solución Integral*) service, we assist corporate customers in meeting their telecommunications needs by providing them with integrated telecommunications solutions consisting of a broad range of services. We offer service level agreements to corporate customers that set service standards and guarantee continuity of service.

We have developed our website (www.telmex.com) to serve as a customer service platform, where users can easily find information about the company and its service offerings, execute online transactions in the My Telmex (*Mi Telmex*) section and find answers to their questions in the Assistance and Support (*Asistencia y Soporte*) section.

Public Telephony and Prepaid Phone Cards

We have several programs to meet the need for different kinds of public telephone service in different areas. We had more than 724 thousand fixed-line public telephones in operation at December 31, 2007. In the increasingly competitive market to provide telecommunications services, independent operators have installed public telephones for which we provide access. There were more than 73 thousand independently operated public telephones at December 31, 2007, an increase of 9.9% compared with 2006.

In 2007, we sold 150.3 million prepaid cards under the brand name Ladatel for use in public phones, a decrease of 19.7% from 2006, and 36.7 million prepaid cards under the brand name Multifon for use in public and residential telephones, a decrease of 13.4% from 2006. This represents an average

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of almost 1.8 cards per Mexican resident. We have installed Internet kiosks in public places so that our customers can access Internet products and services using Ladatel cards. Multifon Home offers prepaid local and long distance service on home telephones. In the case of our Multifon products, customers do not pay monthly fees, and prepaid fixed-line service is charged on a per-minute basis like public telephony services. At December 31, 2007, Multifon lines totaled 1.0 million, a decrease of 15.5% compared to December 31, 2006, primarily due to the cancellation of lines that were not in use. Revenues from sales of prepaid cards accounted for 4.1% of our consolidated revenues in 2007. In 2007, our revenues from public telephony decreased by 20.5% as a result of intense competition from wireless carriers.

Operations in the United States

Our U.S. subsidiary, Telmex USA LLC, or Telmex USA, holds a facilities-based authorization by the U.S. Federal Communications Commission permitting Telmex USA to install and operate telecommunications facilities in the United States. Telmex USA is also authorized to resell long distance services and sell prepaid telephone cards in the United States, and to collect installation and monthly rent payments for telephone lines in Mexico.

In December 2005, we agreed with Alcatel and AT&T International (one of our principal shareholders) to jointly invest in an aggregate 51% interest in 2Wire, Inc., or 2Wire, a broadband network equipment and service provider for homes and small offices in the United States. In January 2006, we acquired an 18.5% equity interest in 2Wire and in December 2006, we sold a 5.5% interest in 2Wire to AT&T International. Our current interest in 2Wire is 13.0%.

Network

Our local and long distance fiber optic network, the largest in Mexico, consists of more than 102 thousand kilometers, reaches approximately 90% of Mexico s population and has connections via submarine cables with 39 other countries while also connecting most major cities throughout Mexico. Our network included 17.8 million local fixed lines in service at December 31, 2007, a decrease of 2.5% compared to December 31, 2006, reflecting 1.0 million new lines and 1.4 million disconnections in 2007.

Our network is 100% digital. During 2007, customers made increasing use of digital services, such as caller ID, call waiting, three-way calling, call forwarding and voicemail. The number of lines with digital services in use at year-end 2007 was 8.2 million (46% of the total number of lines in service), representing an increase of 1.6% from 2006.

Our network has two principal components: the Access Network, which includes our external copper, fiber optic and wireless networks, and the Core Network, which consists of transport, processing and IP sectors under an integrated network and service management structure and uses advanced technologies to provide voice and broadband services and advanced applications.

Access Network

Our external copper network is capable of supporting conventional telephone services, as well as modern broadband services using different digital technologies such as Asymmetric Digital Subscriber Line 2+, or ADSL2+, which allows us to use existing telephone lines for Internet access at speeds that exceed 4 Mbps.

Access via our fiber optic network is available to all of our corporate customers through the multiple broadband services we offer them. Our fiber optic network is becoming increasingly accessible to our residential customers as well; in 2007, we added 2,700 kilometers to the network as part of a strategic plan to decrease reliance on the external copper network and increase the bandwith available for new applications.

Our wireless network is principally used to provide voice, data and Internet access services, based on terrestrial or satellite platforms, to customers who are geographically far from our fiber optic infrastructure.

Core Network

A part of our core network operates under a Next Generation Network architecture with the following features: convergence of multimedia services, devices and network infrastructure based on centralized control designed to rapidly deliver new services to our customers; and an integrated service management structure focused on our customers needs. The connectivity part of our core network is based on broadband packet transport technologies that allow us to provide voice, data and video services with differentiated levels of service quality in an environment where the functions of control and creation of services are centralized and independent from the type of connection (fixed-line, cellular or other).

Our transport network is fully redundant and is supported by optic rings and equipment using Synchronous Digital Hierarchy, or SDH, and Next Generation SDH technologies, which allow the network to be restored within 50 milliseconds and minimize the risk of signal interruption in the event of a system failure. The Next Generation SDH technology also permits a scalable increase in the required bandwidth and allows us to transport packet-based traffic.

In order to increase transmission capacities, we use Dense Wavelength Division Multiplexing, or DWDM, technology which divides the optic fiber signals into multiple wavelengths and allows us to operate our network at speeds of up to 160 Gbps over one optic fiber pair, equivalent to managing almost two million simultaneous telephone conversations.

We have introduced optical cross-connect technology equipment, which enables the interconnection of signals transported optically, the differential provision of service recovery mechanisms and the protection of optical links with various recovery schemes to enhance network efficiency.

Our digital microwave network serves as a backup to the fiber optic network and as a primary means of transmission in rural areas and small towns where fiber optic infrastructure is not available.

Voice processing in our network is controlled by digital local and long distance telephone exchanges employing high levels of redundancy and load sharing to enhance network availability and service quality. We also use an Advanced Intelligent Network platform, which at present manages over 70 applications and value-added services with high reliability levels. Further, this platform is capable of implementing new services and applications throughout our network in a short amount of time.

We continuously control and monitor our network s performance and traffic levels and manage the routing of traffic and other network functions through a centralized network management platform that operates 24 hours a day, 365 days a year. This centralized management facilitates geographical expansion of the network, permits faster implementation of network systems and enables us to warrant compliance with the Service Level Agreements demanded by our business customers.

IP Network

All of our IP-based services are offered through a multiservice IP/MPLS platform. IP/MPLS is a high-capacity, high-performance network platform based on service convergence and is designed to complement our transport network, a feature that allows us to expand our backbone network with routes of up to 10 Gbps, maintain redundant routes and offer national coverage of our IP-based services.

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The IP technology used in our network gives us the flexibility necessary to offer our customers access to IP services at speeds ranging from 64 kbps to 155 Mbps, as well as broadband and satellite access.

The technological capacity of our IP network permits the differentiation of distinct classes of service through which integrated voice, data and video services can be provided. This feature allows us to offer in an efficient manner a wide variety of services such as Internet access for residential and corporate customers, corporate networks, VoIP, wireless access and multimedia application support.

In 2007, we increased our Internet connection capacity by more than 60 Gbps, reaching 150 Gbps.

Competition

The Mexican market for fixed-line domestic and international long distance services was opened to competition beginning in 1996. Fourty-four carriers have been granted licenses to provide long distance service in Mexico, and 11 are in operation (including Telmex and Telnor). Among our competitors, Alestra S. de R.L. de C.V. and Axtel S.A.B. de C.V., or Axtel, have made the most substantial investments in infrastructure and marketing.

The Communications Ministry (*Secretaría de Comunicaciones y Transportes*) has established rules for the determination of interconnection rates between our competitors and us. If we are unable to agree with our competitors on interconnection rates, the Mexican Federal Telecommunications Commission (*Comisión Federal de Telecomunicaciones*, or Cofetel) imposes the rates. During the last seven years, however, we have agreed on these rates with our long distance competitors. We agreed with our long distance competitors to maintain the same interconnection rates for 2007 and 2008 that have applied since 2002.

Customers are free to choose a competing carrier at any time. An independent organization confirms all requests to change long distance carriers. In general, our competitors have focused their attention on obtaining market share in Mexico s most profitable markets, such as the major cities and high-volume users of international and domestic long distance service.

Competition in the Mexican market for fixed-line local services began in 1999 (although this market had been open for competition since 1990). As of December 31, 2007, 25 carriers (including Telmex and Telnor) have licenses to provide local fixed-line telephony (three of which, including Telmex, also have licenses to provide local wireless telephony), and 10 carriers hold 18 licenses for cellular and mobile telephony. All 10 cellular and mobile licensees are owned by only three companies: Radiomóvil Dipsa, S.A. de C.V., or Telcel, Telefónica Móviles México, S.A. de C.V., or Telefónica Móviles, and Grupo Iusacell, S.A. de C.V. At the end of 2007, there were nine fixed-line and wireless local carriers in operation (in addition to Telmex and Telnor), primarily competing in regional markets, mainly in Mexico City, Guadalajara, Monterrey and other large cities. Axtel and Maxcom are our principal fixed-line local competitors.

The competitive environment in the Mexican telecommunications market has been the subject of controversy and of attention from Mexican regulators and from abroad. See *Regulation Competition*. The effects of competition on us depend, in part, on the business strategies of competitors, regulatory developments, exchange rates and the general economic and business climate in Mexico, including demand growth, interest rates and inflation. The effects could include loss of market share and pressure to reduce rates for our services.

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At December 31, 2007, we estimate that our market share in Mexico was 80.5% in domestic long distance service and 81.4% in international long distance service measured on the basis of total number of billed minutes generated by our local customers making domestic and international long distance calls in cities in which we face competition. At December 31, 2007, our market share in Internet access services was 54.7% of dial-up connections and 71.2% of broadband connections, measured on the basis of the total number of Internet access accounts in Mexico. Compared to the approximately 17.8 million fixed lines in service in our network, at December 31, 2007 our local fixed-line competitors had approximately 1.9 million lines in service, which represented an increase in the number of our competitors lines of service of 20.7% in 2007 and 41.6% in 2006.

In local service and public telephony, we also face competition from cellular carriers, which we estimate had a combined total of 68.2 million cellular lines in service at year-end 2007. We anticipate continued intense competition as mobile carriers promote mobile-to-mobile calls and messages as cheaper alternatives to fixed-to-mobile calls. We also face increasing competition in international and domestic long distance and local services from VoIP, a technology that transmits ordinary telephone calls over the Internet. More recently, we have begun to face competition in voice services and, to a more significant extent, Internet access services from cable television operators.

Regulation

Our business is subject to comprehensive regulation and oversight by the Communications Ministry and Cofetel. The Communications Ministry is part of the executive branch of the Mexican federal government, and Cofetel is an agency of the Communications Ministry. Regulation and oversight are governed by the Law of General Means of Communication (*Ley de Vias Generales de Comunicación*, or the General Communications Law), the Federal Telecommunications Law (*Ley Federal de Telecomunicaciones*) and the related Telecommunications Regulations adopted by the Communications Ministry and Cofetel, the Concession and other concessions and licenses granted by the Communications Ministry. We are also subject to oversight by the Agency for Consumer Protection (*Procuraduría Federal del Consumidor*) and the Competition Commission (*Comisión Federal de Competencia*).

Set forth below is a summary of certain provisions of the General Communications Law, the Federal Telecommunications Law, the Telecommunications Regulations and our concessions.

General

The General Communications Law, the Federal Telecommunications Law and the Telecommunications Regulations provide the general legal framework for the regulation of telecommunications services in Mexico. The Federal Telecommunications Law replaced most of the provisions of the General Communications Law relating to telephone communications, but those provisions of the General Communications Law not specifically addressed in the Federal Telecommunications Law remain in effect. The Telecommunications Regulations implement particular provisions of the Federal Telecommunications Law, and regulations implementing other provisions of the law are pending. The objectives of the Federal Telecommunications Law are to promote the efficient development of the telecommunications industry, to encourage fair competition in the provision of quality, low-priced services and to assure satisfactory breadth of coverage of the Mexican population.

Regulatory Oversight

The Communications Ministry is the Mexican government agency principally responsible for regulating telecommunications services. The Communications Ministry s approval is required for any change in our bylaws. It also has broad powers to monitor our compliance with the Concession, and it may revoke our Concession or temporarily seize or expropriate our assets. The Communications Ministry may require us to supply it with such technical, administrative and financial information as it may request.

Cofetel is an independent agency within the Communications Ministry, with five commissioners appointed by the Communications Ministry on behalf of the President of Mexico, one of whom is appointed as chairman. Many of the powers and obligations of the Communications Ministry under the Federal Telecommunications Law and the Telecommunications Regulations have been delegated to Cofetel. We regularly provide reports to Cofetel on our operations, financial performance and other matters. We are also required to publish our annual network expansion program, and we must advise Cofetel of the progress of our expansion program on an annual basis.

Mexican law gives certain rights to the Mexican government in its relations with concessionaires and provides that when the Concession expires we may not sell or transfer any of our assets unless we give the Mexican government a right of first refusal. If the Mexican government declines to exercise its right, our unions also have a right of first refusal. In addition, Mexican law permits the Mexican government to expropriate our assets in certain circumstances.

Concessions

Under the Federal Telecommunications Law and the Telecommunications Regulations, a provider of public telecommunications services must operate under a concession granted by the Communications Ministry. Such a concession may not be transferred or assigned without the approval of the Communications Ministry. A concession to provide public fixed-line local and long distance services generally has a term of up to 30 years and may be extended for additional 30-year terms. Our Concession was granted in 1976 and amended in August 1990, and will expire in 2026. Our subsidiary Teléfonos del Noroeste, S.A. de C.V., or Telnor, holds a separate concession in two states in northwestern Mexico, which will also expire in 2026. The material terms of the Telnor concession are essentially the same as the terms of the Concession.

Operators of private networks that do not use electro-magnetic frequencies are not required to obtain a concession to provide private telecommunications services but are required to obtain approval from the Communications Ministry.

In addition to the Concession, we currently hold concessions for the use of frequencies to provide wireless local access and point-to-point and point-to-multipoint transmission, which we obtained from Cofetel through a competitive bidding process. These concessions are granted for a term of up to 20 years and may be extended for additional 20-year terms.

Audio and Television Services

The regulatory framework governing the provision of audio and television services by telecommunications companies and of telecommunications services by audio and television providers has been the subject of an ongoing amendment process since 2006. The outcome of this process and the resulting changes in the regulatory framework may affect our business.

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In April 2006, the Mexican Congress approved an amendment to the Federal Telecommunications Law and the Federal Radio and Television Law (*Ley Federal de Radio y Televisión*). The amendment allows radio and television broadcasters to provide telecommunications services after complying with certain conditions and makes Cofetel responsible for overseeing all telecommunications services, including those related to broadcasting. Subsequently, approximately one-third of the Mexican Senate objected to the validity of the amendment in a proceeding before the Mexican Supreme Court (*Suprema Corte de Justicia de la Nación*). In June 2007, the Supreme Court declared invalid various provisions of the law, including those that would allow radio and television broadcasters to provide telecommunications services without seeking more than a simple authorization and to use their frequencies free of charge, and concluded that such broadcasters would be required to participate in public bidding processes in order to obtain frequencies for use in providing such services.

In October 2006, the Communications Ministry adopted regulations that would permit paid audio and television concessionaires to provide fixed-line local telephone services and local telephone service providers like us to provide paid audio and television services. This would facilitate the convergence of voice, data and video services into one integrated product that could be delivered over a broadband network. The regulations provide for the amendment of existing concessions to allow their holders, including Telmex, to provide these new services, subject to certain regulatory steps to be taken by Cofetel and the satisfaction by Telmex of certain conditions, including the implementation of network interoperability, telephone number portability and verification of compliance with existing concession obligations, as well as the adoption of an interconnection framework. Once the prescribed regulatory steps have been taken and we have satisfied all conditions, we intend to begin providing paid audio and television services in accordance with the terms of these regulations.

Prior to the adoption of these regulations, four cable television providers, which currently service the majority of the paid television subscribers in Mexico, obtained the necessary amendments to their concessions and have begun competing with us in the market for fixed-line local telephone services.

As part of the regulatory process described above, in April 2008, Cofetel presented for public comment a preliminary draft of a Fundamental Technical Plan for Interconnection and Interoperability (*Plan Técnico Fundamental de Interconexión e Interoperabilidad*). We submitted a comment letter to Cofetel, in which we outlined our position with respect to the terms of the proposed plan.

We cannot predict the outcome and the effect of the regulatory processes described above, but they could result in the entry of new competitors to our business and could have an adverse effect on our competitive position and results of operations.

Termination of the Concession

The Concession provides that it will remain in force until 2026 and that we may renew it for an additional 15-year term, subject to additional requirements the Communications Ministry may impose. Thereafter, it may be renewed for successive 30-year terms as provided under the Federal Telecommunications Law.

The General Communications Law provides that upon the expiration of the Concession the Mexican government is entitled to purchase our telecommunications assets at a price determined on the basis of an appraisal by a public official, and the Telecommunications Regulations provide that upon expiration of the Concession the Mexican government has a right of first refusal to acquire our telecommunications assets. However, the General Communications Law also provides that in certain cases, upon expiration of the Concession our telecommunications assets will revert to the Mexican government free of charge. There is substantial doubt as to how these provisions of the General Communications Law and the Telecommunications Regulations would be applied, and accordingly there can be no assurance that upon expiration of the Concession our telecommunications assets would not revert to the Mexican government free of charge.

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The General Communications Law, the Federal Telecommunications Law and the Concession include various provisions under which the Concession may be terminated before its scheduled expiration date. Under the General Communications Law and the Federal Telecommunications Law, the Communications Ministry may cause early termination of the Concession in certain cases, including:

- Failure to comply with the terms of the Concession;
- Interruption of all or a material part of the services provided by us;
- Transfer or assignment without Communications Ministry approval of the Concession, the rights provided under the Concession or any asset used to provide telephone service;
- Violation of the prohibition against ownership of our shares by foreign states;
- Violation of the prohibition against any material modification of the nature of our services without prior Communications Ministry approval; and
- Breach of certain other obligations under the General Communications Law and the Federal Telecommunications Law.

In addition, the Concession provides for early termination by the Communications Ministry following administrative proceedings in the event of:

- Material and continuing violation of any of the conditions set forth in the Concession;
- Material failure to meet any of the service expansion requirements under the Concession;
- Material failure to meet any of the requirements under the Concession for improvement in the quality of service;
- Engagement in any telecommunications business not authorized under the Concession and requiring prior approval of the Communications Ministry;
- Following notice and a cure period, failure without just cause to allow other concessionaires to interconnect their telephone networks to our telephone network; or
- Our bankruptcy.

Under the Federal Telecommunications Law, our concessions could be terminated if: (a) the term of any concession expires; (b) we resign our rights under any concession; (c) the Mexican government through the Communications Ministry expropriates any of the concessions; (d) we are liquidated or become bankrupt; or (e) the Communications Ministry revokes any of the concessions.

The General Communications Law provides that in the event of early termination of the Concession for certain specified causes, including violation of the prohibition on ownership of our shares by foreign states, we would forfeit all of our telecommunications assets to the Mexican government. In the event of early termination of the Concession for any other causes, the General Communications Law provides that a portion of our telecommunications assets would revert to the Mexican government free of charge, and that we may be required to dismantle the remaining portion. There is substantial doubt as to

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whether the provisions of the Concession and the Telecommunications Regulations regarding the consequences of expiration of the Concession would apply to mitigate the provisions of the General Communications Law in the event of early termination.

Our assets and rights under the concessions may also be temporarily seized by the Communications Ministry.

Dominant Carrier Regulations

The Federal Telecommunications Law provides that if a company is determined to be dominant in a relevant market, the Communications Ministry has the power to adopt specific regulations on rates, quality of service and information provided by the dominant company. In February 1998, the Competition Commission issued a resolution confirming its determination that we were a dominant carrier in the following markets: (a) local telephone service, (b) access service, (c) inter-urban transport, (d) domestic long distance service and (e) international long distance service.

In September 2000, Cofetel adopted dominant carrier regulations, specifically applicable to us as a dominant carrier. It is difficult to assess the impact these regulations would have had on rates or competition, in part because neither the methodologies nor the procedures for their implementation were fully specified. We believe, however, that if similar regulations were to be implemented in the future, they would reduce our flexibility to adopt competitive market policies.

After the Competition Commission issued the February 1998 resolution, we commenced proceedings in the Mexican federal courts challenging the constitutionality of the resolution and the validity of the dominant carrier regulations. In challenging this and all subsequent resolutions of the Competition Commission, we asserted that they constituted a unilateral amendment of the terms of our Concession, which we believe is not permitted under the Mexican constitution or the terms of the Concession itself. We also asserted that the determination that we are a dominant carrier, on which Cofetel s power to issue these regulations was predicated, was flawed because the Competition Commission made its determinations in 1997 in reliance on earlier findings that were out of date, and because its determinations did not extend to all the markets covered by the dominant carrier regulations. Finally, we objected to the specific rate rules imposed by the dominant carrier regulations on a variety of grounds, including that they gave Cofetel excessive discretion, that they would unfairly burden competition and that they did not adequately permit us to recover our investments in infrastructure.

Following several appeals, the February 1998 resolution of the Competition Commission was held unconstitutional in May 2001. In May 2002, several resolutions issued by the Competition Commission and Cofetel were nullified, including the September 2000 Cofetel resolution adopting the dominant carrier regulations.

In May 2001, the Competition Commission issued a new resolution with practically the same terms in which it concluded that we are a dominant carrier in the same five markets. In April 2004, a Mexican federal court decided in favor of our constitutional challenge to the resolution and declared the resolution invalid. In September 2004, the Competition Commission issued additional resolutions in which it again concluded that we are a dominant carrier, and in October 2004, we again commenced constitutional proceedings in the Mexican federal courts challenging the validity of the new resolutions. Following several judicial decisions and appeals, the Competition Commission issued a resolution in February 2007, approved by the unanimous vote of all its members, revoking all of its prior resolutions and definitively closing the case. However, we cannot predict whether the Competition Commission or Cofetel will issue similar resolutions or regulations in the future, and if so, whether our judicial challenges will be successful.

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Between November 2007 and February 2008, the Competition Commission commenced several industry-wide investigations to determine whether any operators, including Telmex and certain of its affiliates, possess substantial market power in each of the following segments of the telecommunications market: (a) the calling party pays system for local and long distance services, (b) completion of switched public traffic, (c) origination of switched public traffic, (d) local transmission services, and (e) line and circuit leasing. These investigations are at the stage of information collection and analysis, and we cannot predict their outcome. Findings adverse to Telmex may result in a conclusion that we have substantial market power with respect to these telecommunications services and, subject to further proceedings before Cofetel, may lead to the imposition of dominant carrier regulations on our business, which we believe will reduce our flexibility to adopt competitive market policies.

Competition

The Telecommunications Regulations and the Concession contain various provisions designed to introduce competition in the provision of telecommunications services. In general, the Communications Ministry is authorized to grant concessions to other parties for the provision of any of the services provided by us under the Concession. There are currently 11 competing long distance carriers operating in Mexico (including Telmex and Telnor) and concessions have been granted to a total of 44 long distance companies, all of which also have concessions for international long distance services. As of December 31, 2007, there were 25 local fixed-line licensees (including Telmex and Telnor), of which three also hold local wireless licenses (including Telmex), primarily in Mexico City, Guadalajara, Monterrey, Puebla and other large and medium-sized cities. See *Operations Competition*. Concessions are not required to operate certain private local telecommunications networks or to provide value-added services, although other authorizations may be required.

Some operators are offering VoIP services, although the application of current regulations to these services is unclear. With respect to international long distance services, Cofetel rules cover matters such as the termination of international calls and mechanisms for routing calls into and out of Mexico. Currently, international traffic must be carried by Mexican concessionaires and through authorized international gateways consistent with Cofetel s international long distance rules.

In 2003, the Communications Ministry expanded the concessions granted to cable television operators to permit them to provide bidirectional transmission of data. In addition, in 2004, the Communications Ministry began to permit cable operators to provide signal-transmission services to local fixed-line operators and data and broadband Internet access services to the Mexican public. Our Concession permits us to distribute, with prior authorization, television signals through our network to companies authorized to provide television services to the public, but we are not allowed to hold a concession to provide television signals to end users. Recent regulations adopted by the Communications Ministry would allow, after certain prerequisites have been met, paid audio and television concessionaires to provide fixed-line local telephone services and local telephone service providers like us to provide paid audio and television services. Prior to the adoption of these regulations, four cable television providers, which currently service the majority of the paid television subscribers in Mexico, obtained the necessary amendments to their concessions and have begun competing with us in the market for fixed-line local telephone services. See *Regulation Audio and Television Services.*

The competitive environment in the Mexican telecommunications market has been the subject of controversy and of attention from Mexican regulators and from abroad. In particular, in now-revoked resolutions, the Competition Commission determined that we were a dominant provider of certain telecommunications services, and Cofetel adopted specific regulations applicable to us as a dominant carrier, which regulations were later nullified by Mexican federal courts. See *Regulation Dominant Carrier Regulations*. The Competition Commission also has repeatedly ruled that we have engaged in relative anti-competitive practices, which are less significant violations than absolute anti- competitive practices and carry lower fines. Most of these rulings have been declared null and void by federal courts or withdrawn by the Competition Commission.

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Between November 2007 and February 2008, the Competition Commission commenced three industry-wide investigations of relative anti-competitive practices in the following markets: (a) residential broadband Internet access services, (b) fixed-line interconnection services, and (c) transmission services for switched long distance traffic. These investigations are at the stage of information collection and analysis, and we cannot predict their outcome. Findings adverse to Telmex may result in the imposition of monetary penalties on us.

The Mexican Antitrust Law (*Ley Federal de Competencia Económica*) was amended in 2006, and new regulations pursuant to the amended Antitrust Law are expected to be published in the near term. The amendment strengthens the authority of the Competition Commission by, among other things, providing the Competition Commission with the ability to issue opinions that are binding on other governmental entities. The amendment also expands the definition of anti-competitive practices, provides a more rigorous approval process for business combinations and establishes more stringent penalties, including substantially higher fines and, in certain circumstances, the divestiture of assets. As a result of this amendment, it is likely that there will be more investigations and proceedings pursuant to the Antitrust Law, which could result in the imposition of restrictions on our operations and an increase in competition.

The competitive environment in the Mexican telecommunications market has also been influenced by external factors. For example, as a result of a WTO dispute settlement, in August 2005 Mexico adopted regulations authorizing resale of outgoing international and domestic long distance service, adding the downward pressure on the prices we charge our customers for our long distance services.

Rates

The General Communications Law, the Federal Telecommunications Law and the Telecommunications Regulations provide that the basis for setting the rates charged by a telecommunications concessionaire is set forth in its concession.

Under the Concession, our rates in any period for basic telephone services, including installation, monthly rent, measured local service and long distance service, are subject to a ceiling on the price of a basket of such services weighted to reflect the volume of each service provided by us during the preceding period. There is also a price floor based on our average long-run incremental cost. Within this aggregate price range, we are free to determine the structure of our own rates. We must register our rates with Cofetel before they may take effect.

The price cap varies directly with the Mexican National Consumer Price Index, permitting us to raise nominal rates to keep pace with inflation, subject to consultation with the Communications Ministry. We have not raised our nominal rates since March 2001 for local service and since March 1999 for long distance service. Under the Concession, the price cap is also adjusted downward periodically to pass on the benefits of our increased productivity to our customers. The Communications Ministry sets a new periodic adjustment for every four-year period to permit us to maintain an internal rate of return equal to our weighted average cost of capital. The Communications Ministry fixed the adjustment per quarter in nominal terms at 0.74% for 2003-2006 and 0.84% for 2007-2010. For services extending beyond basic telephone service, the Federal Telecommunications Law and the Concession permit us, under certain conditions and subject to registration with Cofetel, to set our prices free of rate regulation. These services include data transmission, directory services and services based on digital technology, such as caller ID, call waiting, speed dialing, automatic redialing, three-way conference and call transfer.

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Interconnection

We are required under the Federal Telecommunications Law to permit any other long distance concessionaire to connect to our network in a manner that enables customers to choose the network by which their long distance calls are carried. Cofetel rules governing the interconnection rights and obligations of local service concessionaires require local service concessionaires to provide interconnection on a nondiscriminatory basis to any other concessionaire. For recent developments that may affect the interconnection regime in Mexico, see *Audio and Television Services*.

The Concession provides that other terms of interconnection, including fees, are to be negotiated between us and each other long distance carrier, and that, in the event the parties are unable to agree, the Communications Ministry imposes the terms. Since 2002, we have agreed with competing long distance carriers to an interconnection rate of U.S.$0.00975 per minute and per interconnection point. This rate will apply through December 31, 2008.

In Mexico, under the calling party pays system, our fixed-line customers pay us an interconnection charge when they call a mobile telephone, and we pay 72.4% of that amount to the mobile carrier that completes the call. Historically, this interconnection charge applied only to local calls. In November 2006, however, Cofetel extended the calling party pays charge to domestic and international long distance calls, while concurrently eliminating the fee that cellular carriers charge their customers for receiving long distance calls from fixed-line and mobile callers. In December 2006, we entered into an agreement with all cellular carriers to terminate all existing disputes with respect to international and long distance calling party pays rates. The agreement established declining calling party pays rates for local, domestic long distance and international long distance calls through 2010.

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CAPITAL EXPENDITURES

The following table sets forth, in constant pesos as of December 31, 2007, our capital expenditures, before retirements, for each year in the three-year period ended December 31, 2007. Like other financial information in this Annual Report, the amounts shown below for capital expenditures reflect only our continuing operations.

	Year ended December 31,		
	2007	2006	2005
	(in millions of constant pesos as of December 31, 2007)		
Data, connectivity and transmission network	P. 7,787	P. 6,104	P. 5,485
Internal plant	1,444	1,294	1,955
Outside plant	1,329	3,194	4,428
Systems	748	801	769
Other	2,132	2,344	2,488
Total capital expenditures	P. 13,440	P. 13,737	P. 15,125

Our total capital expenditures decreased by 2.2% in 2007, although we made larger investments in our data, connectivity and transmission networks to support our businesses. In 2007, our consolidated capital expenditures totaled P.13.4 billion (U.S.$1.2 billion). The investments in our data, connectivity and transmission networks represented 57.9% of our consolidated capital expenditures (P.7.8 billion or U.S.$717 million).

We have budgeted capital expenditures in an amount equivalent to approximately P.6.3 billion (U.S.$550 million) for the year 2008, of which 63.4% (P.4.0 billion or U.S. $348.7 million) are budgeted for investments in our data, connectivity and transmission network. Budgeted capital expenditures for 2008 exclude any other investments we may make to acquire other companies. For subsequent years, our capital expenditures will depend on economic and market conditions. Our budgeted capital expenditures are financed through operating cash flows and limited borrowing.

THE *ESCISIÓN*

On December 26, 2007, we transferred our Latin American and yellow pages directory businesses to a new, separate entity, Telmex Internacional, S.A.B. de C.V., or Telmex Internacional, using a procedure under Mexican corporate law called *escisión*, or split-up. In an *escisión*, an existing company is divided, creating a new company to which specified assets and liabilities are allocated. The shares of the new company are issued to the shareholders of the existing company, pro rata to their share ownership in the existing company. This procedure differs from the procedure by which a spin-off is typically conducted in the United States, where a parent company distributes to its shareholders shares of a subsidiary.

The *Escisión* was approved on December 21, 2007, by a single action of our shareholders at an extraordinary meeting. The establishment of Telmex Internacional became effective on December 26, 2007, following certain corporate and administrative procedures relating to the shareholders resolution from the extraordinary meeting, including its registration with a Mexican notary public and in the Mexican Public Registry of Commerce as well as its publication in the *Diario Oficial* (Official Gazette). The primary purposes of the *Escisión* were:

- to allow each company to operate more efficiently and at the right scale, in Mexico and abroad, in order to allow each of them to operate autonomously for administrative, commercial and financial purposes;

- to improve the competitive position of each company; and

- to tailor further the operations of Telmex in the Mexican telecommunications market, distinguishing its operations in the middle- and high-revenue markets, in which there is competition, from the low-revenue and rural markets, in which there is no competition.

In the *Escisión*, we contributed the shares of an intermediate holding company called Controladora de Servicios de Telecomunicaciones , S.A. de C.V., or Consertel, to Telmex Internacional. Telmex Internacional itself did not receive any material assets other than the shares of Consertel, and did not receive any liabilities. Consertel is the company through which we previously held the shares of all our subsidiaries, and it underwent a separate *escisión* shortly before the Telmex *Escisión*, that left Consertel owning generally (a) the shares of Telmex s subsidiaries operating outside of Mexico (directly or through intermediate holding companies), (b) the shares of the Telmex subsidiaries engaged in the Mexican yellow pages business (directly or through the related intermediate holding companies) and (c) liquid assets with a total value of approximately U.S.$2 billion (directly or through subsidiaries). All of Consertel s other assets and liabilities were conveyed to a new Telmex subsidiary. These consisted primarily of shares of subsidiaries and affiliate investees that were not transferred to Telmex Internacional, and certain related liabilities.

Mexican law provides a mechanism for a judicial challenge to an *escisión*, but such a challenge must be brought within the period of 45 days following the registration of the new company created in the *escisión*. That period has now passed for both the Telmex *Escisión* and the earlier *escisión* of Consertel.

Mexican law also provides that if an obligation is assumed by the new company in an *escisión*, and the new company fails to perform, a claimant may make a claim against the old company for up to three years unless the claimant expressly consented to the *escisión*. Telmex Internacional received assets but no liabilities in the *Escisión*, so Telmex Internacional does not have any obligations to which these provisions are applicable. Consertel, which is a subsidiary of Telmex Internacional, will be subject to the possibility that a claimant against the new Telmex subsidiary created in the Consertel *escisión* might seek to assert its claim against Consertel if that new Telmex subsidiary defaults. We have agreed to indemnify Telmex Internacional against any such claim, but we consider the risk of such a claim to be remote.

The *Escisión* might have constituted or led to a default under some agreements of Telmex and certain subsidiaries that were transferred to Telmex Internacional in the *Escisión*. Telmex and such subsidiaries obtained waivers or consents under all such agreements. The *Escisión* also required Telmex to obtain authorizations or approvals from, or otherwise to make submissions to, regulatory authorities in Mexico. All such proceedings have been completed.

Following the *Escisión*, there are and will continue to be a variety of contractual relationships between Telmex and Telmex Internacional, both to accomplish the separation of the *Escisión* and to provide for ongoing commercial relationships. These include:

- agreements relating to the implementation of the *Escisión*;

- certain transitional arrangements that will continue while Telmex Internacional develops independent capabilities; and

- completion of international traffic, printing and distribution of telephone directories and access to Telmex s customer database, and use of each other s services, generally on terms similar to those on which each company does business with third parties.

See *Item 7. Related Party Transactions* for more information on the contractual relationships between us and Telmex Internacional after the *Escisión*.

Telmex Internacional Shares and ADSs

As of the effective date of the *Escisión*, the capital stock of Telmex Internacional was issued and outstanding. Each holder of Telmex shares became the owner of an equal number of Telmex Internacional shares of the corresponding class, and each Telmex ADS represented an equal number of Telmex and Telmex Internacional shares. On June 10, 2008, shortly following the effectiveness of Telmex Internacional s registration statement on Form 20-F, each outstanding instrument representing shares of Telmex was exchanged for separate instruments representing shares of Telmex and shares of Telmex Internacional, respectively. JPMorgan Chase Bank, N.A., the depositary for the Telmex and the Telmex Internacional ADSs, delivered Telmex and Telmex Internacional ADSs to each record holder of Telmex ADSs.

Adjustments Related to the *Escisión*

Since the *Escisión*, we have carried out repurchases of our shares. Until our shares and those of Telmex Internacional began trading separately, the repurchased Telmex shares included the shares of Telmex Internacional. On June 10, 2008, Telmex Internacional transferred to us P.3,572 million in consideration for the repurchase of shares of Telmex Internacional.

As approved by our shareholders at the December 21, 2007 meeting approving the *Escisión*, our Board of Directors was authorized to adjust the stockholders equity and cash and cash equivalents of Telmex and Telmex Internacional to account for post-*Escisión* stock repurchases by us. In May 2008, our Board of Directors approved the adjustment of cash and cash equivalents transferred to Telmex Internacional, and on June 10, 2008, we transferred P.3,572 million to Telmex Internacional to effect this adjustment.

OTHER MATTERS

Investments

We occasionally make investments and enter into joint ventures in telecommunications-related businesses within and outside Mexico. We also invest in publicly traded equity securities of companies in technology and communications businesses. Our marketable securities are carried at market value, and gains and losses are recognized in our statement of income.

Portugal Telecom

In 2006, we acquired 20.7 million common shares in Portugal Telecom, SGPS S.A., or Portugal Telecom, for P.2,956.8 million (U.S.$252.3 million). We sold 15.7 million shares during 2006 and 2007 and the remaining 5.0 million shares in January 2008 for P.3,086.9 million (U.S.$282.2 million) in the aggregate. We recognized a gain of P.129.7 million as a result of the sale of these shares.

MCI, Inc.

Through May 2005, we owned approximately 25.6 million shares of common stock of MCI, which represented approximately 8.1% of MCI s outstanding common stock. Other parties that may have been deemed to be under common control with us held an additional interest of approximately 5.7% of MCI s outstanding common stock. In April 2005, we and certain parties related to us entered into an agreement with Verizon and certain of its subsidiaries to sell to Verizon and certain of its subsidiaries our

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entire interest in common shares of MCI for a cash purchase price of U.S.$25.72 per share. We received approximately U.S.$660 million (P.8,450 million) for our 25.6 million MCI shares in May 2005. We recognized a gain of P.541 million as a result of the sale of these shares.

Plant, Property and Equipment

We have transmission facilities, exchanges, outside plant and commercial and administrative offices throughout Mexico. We own most of the locations of our exchanges and offices and lease other locations. We hold a small number of operating properties under financial leases, but the aggregate amount of such financing is not material to our operations as a whole. We carry casualty insurance against loss or damage to buildings, equipment contained in buildings and outside plant, including our fiber optic network.

We have purchased equipment from a variety of suppliers, and there are sufficient alternative sources of equipment so that interruption of any source would be unlikely to cause a significant disruption to our operations or our investment plan.

The Telmex Foundation

The Telmex Foundation (*Fundación Telmex, A.C.*), established in 1996, is a not-for-profit entity active in the areas of education, health, nutrition, justice, culture, sports and natural disaster relief. We do not consolidate the Telmex Foundation in our financial statements.

Item 4A. Unresolved Staff Comments

None.

Item 5. Operating and Financial Review and Prospects

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in this Annual Report. Our consolidated financial statements have been adjusted to treat as discontinued operations the businesses we transferred to Telmex Internacional in the *Escisión*. Accordingly, they differ from the financial statements we have previously published. Except where we specify otherwise, the discussion below concerns only our continuing operations and not those we transferred to Telmex Internacional in the *Escisión*.

Our consolidated financial statements have been prepared in accordance with Mexican Financial Reporting Standards, or Mexican FRS, which differ in certain respects from generally accepted accounting principles in the United States, or U.S. GAAP. Note 18 to our audited consolidated financial statements provides a description of the principal differences between Mexican FRS and U.S. GAAP, as they relate to us; a reconciliation to U.S. GAAP of net income and total stockholders equity; and condensed financial statements under U.S. GAAP.

Effect of Inflation Accounting

Through the end of 2007, Mexican FRS required us to recognize certain effects of inflation in our financial statements. They also required us to re-express financial statements from prior periods in constant pesos as of the end of the most recent period presented. As discussed below, we do not expect that inflation accounting will be applicable in 2008.

Recognition of effects of inflation

All our financial statements and other financial information included in this registration statement recognize effects of inflation in accordance with Mexican FRS. The main inflation adjustments are as follows:

In general, nonmonetary assets are adjusted for inflation based on the consumer price index of the country in which the assets are located. This includes plant, property and equipment, inventories, and licenses and trademarks. The carrying value of our nonmonetary assets in Mexico is adjusted at the end of each period to reflect Mexican inflation in that period, as measured by the Mexican National Consumer Price Index.

A special rule applies to plant, property and equipment that was imported. Such assets are adjusted for inflation based on the consumer price index of the country of origin, and then converted into pesos using the exchange rate at the balance sheet date. For example, the carrying value of switching equipment purchased in the United States and used in our Mexican operations is adjusted at the end of each period to reflect U.S. inflation in that period and the appreciation or depreciation of the Mexican peso against the U.S. dollar.

Gains and losses in purchasing power that result from holding monetary assets and liabilities are recognized in income.

Capital stock, other capital contributions and retained earnings are adjusted for inflation based on the Mexican consumer price index.

Re-expression in constant pesos

Financial statements for all periods have been re-expressed in constant pesos as of December 31, 2007. The re-expression in constant pesos uses a factor that is determined using the Mexican National Consumer Price Index. The re-expression factor is 1.0376 for the financial statements of 2006 and 1.0796 for the financial statements of 2005. This re-expression factor differs from the factor we used in prior years financial statements and in the Information Statement that described the *Escisión*, which was filed with the SEC on a Form 6-K on December 7, 2007. See *Pro Forma Financial Information* below.

The value of the re-expression factor has a significant impact on the comparison between our results of operations for 2007 and for prior years. To illustrate the effects of the re-expression in constant pesos, if we provided a particular service for 100 nominal pesos of revenue in 2006 and again in 2007, the re-expression in constant pesos would result in a 3.7% decrease in revenue, from 103.8 constant pesos in 2006 to 100 constant pesos in 2007.

Cessation of inflation accounting under Mexican FRS

Mexican FRS have changed for periods beginning in 2008, and the inflation accounting methods summarized above will no longer apply, except if the economic environment in which we operate qualifies as inflationary for purposes of Mexican FRS. An environment is inflationary if the cumulative inflation rate equals or exceeds an aggregate of 26% over three consecutive years (equivalent to an average of 8% in each year). Based on current forecasts, we do not expect the Mexican economic environment to qualify as inflationary in 2008 or 2009, but that could change depending on actual economic performance.

As a result, we expect to present financial statements without inflation accounting beginning in 2008. We will not re-express financial statements for prior periods to give retrospective effect to the

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cessation of inflation accounting. In this respect, our financial statements for 2008 will not be comparable to those for prior periods. In comparing our results for 2008 to results for prior periods, we expect that the most important effects of the cessation of inflation accounting, and of related changes in other accounting standards, will be as follows:

- We will no longer recognize a monetary gain and loss attributable to the effects of inflation on our monetary assets and liabilities. We expect our financing costs to be less volatile as a result.

- We will cease to adjust the carrying values of nonmonetary assets for inflation. We expect that this will make our depreciation charges less volatile.

- We will cease to re-express results of prior periods. Financial information for dates and periods prior to 2008 will continue to be expressed in constant pesos as of December 31, 2007.

- We will cease to use inflation-adjusted assumptions in determining our employee benefit obligations and instead use nominal discount rates and other assumptions. We do not expect this change to have a significant effect on our financial results in the short term, but it is difficult to predict.

Effects of inflation accounting on U.S. GAAP reconciliation

U.S. GAAP does not ordinarily contemplate the recognition of effects of inflation or the re-expression of prior-period financial statements. However, in reconciling our net income and stockholders equity to U.S. GAAP, we have generally not reversed the effect of inflation accounting under Mexican FRS, pursuant to a long-established practice under which Mexican FRS inflation accounting is acceptable in financial statements filed with the SEC, with one exception with respect to the special rule applicable to plant, property and equipment manufactured in a country other than the country in which they are located. Our reconciliation does reverse the effects of that special rule. See Note 18 to our audited consolidated financial statements.

Changes in Mexican FRS

Note 1(II)(w) to our audited consolidated financial statements discusses new accounting pronouncements under Mexican FRS that came into force in 2007. Some of these pronouncements have already been fully implemented in the financial statements included in this registration statement. Others will require us to change our financial presentation in 2008 in ways that we expect to have a material effect on our results of operations and our balance sheet. In particular, the cessation of inflation accounting, as described above, will also entail changes in accounting for employee benefit obligations.

Pro Forma Financial Information

In the Information Statement that described the *Escisión*, which was filed with the SEC on a Form 6-K on December 7, 2007, we presented pro forma financial information of Telmex as of and for the years ended December 31, 2005 and 2006 which was re-expressed in constant pesos using a re-expression factor based on (1) the inflation rate in each country in which we had operations, (2) the exchange rate between the Mexican peso and the currency of each country in which we had operations, and (3) the contribution to our consolidated revenues from each country in which we had operations before the *Escisión*. With respect to the financial information contained in the Information Statement, our Mexican operations represented more than 70% of the weight in the factor and Brazilian operations represented approximately 25%. After the *Escisión*, Mexican operations represented more than 99% of

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the operations, assets and liabilities of Telmex. For that reason, in this Annual Report, the financial information for our continuing operations has been re-expressed using a re-expression factor based on the Mexican National Consumer Price Index, while the financial information for our discontinued operations has been re-expressed using a re-expression factor based on the three components described above. As a result, the financial information presented in this Annual Report differs from and is not directly comparable to the financial information presented in prior years financial statements and in the Information Statement.

Overview

Total revenues increased by 0.8% in 2007, primarily due to the increase in revenues from interconnection service by 25.1%, other services by 25.9% and Internet access services by 7.7%. In contrast, local, domestic long distance and international long distance service revenues decreased by 6.6%, 5.3% and 8.1%, respectively, in 2007 primarily due to lower average real rates and a decline in the number of lines in service by 2.5%. In response to competitive market pressures, we have not raised our nominal rates since 2001, and we have given discounts for some domestic long distance and connectivity services, including a 25.5% reduction in the rates we charge for broadband services that took effect in April 2007. Average revenue per line has also declined, partly because we have added new customers who have less disposable income and make less use of their lines.

Competition and changing technologies have had extensive effects on our financial performance, and it is difficult to predict their future impact. We expect continued pressure on prices for basic telephone services. In local service, the rapid growth in mobile telecommunications has made them the principal competitor for local networks. In addition, local and long distance services face competition from other means of communication such as private circuits and the Internet, including VoIP, a technology that transmits ordinary telephone calls over the Internet. The number of our broadband subscribers (Infinitum ADSL) grew by 60.5% in 2007, and we expect that it will continue to grow and to affect usage of other services. Revenues from voice services (including local, long distance and interconnection) represented 79.6% of our total revenues in 2007 (81.1% in 2006), while revenues from corporate networks and Internet access services represented 17.0% of our total revenues in 2007 (16.2% in 2006).

In 2007, operating income decreased by 5.1%. Our operating margin was 33.6% in 2007 and 35.7% in 2006. Our operating margin decreased in 2007 as the mix of our revenues changed, with a lower proportion of revenues from voice services and a higher proportion of interconnection revenues.

We expect that the percentage of our revenues attributable to local and long distance services will continue to decline as a result of continued pressure on prices and continued migration of customers to mobile and alternative products, while our revenues from corporate networks and Internet access services will continue to grow as a percentage of our total revenues as demand for integrated telecommunications solutions among corporate customers and Internet penetration rates among residential customers continue to rise. We expect that the decline in revenues from voice services will be partly offset by an increase in interconnection revenues, as other telecommunications providers make use of our network to complete their customers calls.

Our future results may be affected significantly by the general economic and financial conditions in Mexico and the United States, including the level of economic growth, exchange rate and interest rate fluctuations and inflation. Our performance may also be affected by acquisitions and other investments we may make. Exchange rate variations on our U.S. dollar-denominated indebtedness and the effect of inflation on our net monetary liabilities contribute to the volatility of our comprehensive financing cost, which we manage through the use of hedging instruments.

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Summary of Operating Income and Net Income

In the table below we set forth our operating revenues, operating costs and expenses and operating income (each expressed as a percentage of total operating revenues), as well as our comprehensive financing cost, income tax, income from continuing operations, income from discontinued operations, net income and non-controlling interest for each of the years in the three-year period ended December 31, 2007.

	Year ended December 31,					
	2007		2006		2005	
	(millions of pesos)	(percentage of operating revenues)	(millions of pesos)	(percentage of operating revenues)	(millions of pesos)	(percentage of operating revenues)
Operating revenues:						
Local service	P. 54,398	41.6%	P. 58,251	44.9%	P. 60,244	45.8%
Domestic long distance service	17,349	13.3	18,324	14.1	18,907	14.4
International long distance service	9,678	7.4	10,532	8.1	10,593	8.1
Interconnection service	22,604	17.3	18,071	13.9	18,895	14.4
Corporate networks	11,340	8.7	10,877	8.4	11,183	8.5
Internet access services	10,940	8.4	10,158	7.8	8,800	6.7
Other	4,459	3.3	3,542	2.8	2,827	2.1
Total operating revenues	130,768	100.0	129,755	100.0	131,449	100.0
Operating costs and expenses:						
Cost of sales and services	32,364	24.7	32,059	24.7	32,435	24.7
Commercial, administrative and general	19,553	15.0	19,383	15.0	19,111	14.5
Transport and interconnection	16,542	12.6	13,338	10.2	13,350	10.2
Depreciation and amortization	18,425	14.1	18,711	14.4	20,314	15.4
Total operating costs and expenses	86,884	66.4	83,491	64.3	85,210	64.8
Operating income	43,884	33.6%	46,264	35.7%	46,239	35.2%
Employee profit sharing	2,867		3,059		3,039	
Other income, net	(2,823)		(446)		(987)	
Comprehensive financing cost:						
Interest income	(1,396)		(1,495)		(2,036)	
Interest expense	6,615		6,952		6,409	
Exchange loss, net	643		1,159		3,554	
Monetary gain, net	(2,513)		(2,846)		(2,228)	
	3,349		3,770		5,699	
Equity interest in net income (loss) of affiliates	17		9		(20)	
Income before income tax	40,508		39,890		38,468	
Income tax	11,619		12,189		11,205	
Income from continuing operations	28,889		27,701		27,263	
Income from discontinued operations, net of income tax	7,166		2,615		4,926	
Net income	P. 36,055		P. 30,316		P. 32,189	

	Year ended December 31, 2007 (millions of pesos)	2007 (percentage of operating revenues)	2006 (millions of pesos)	2006 (percentage of operating revenues)	2005 (millions of pesos)	2005 (percentage of operating revenues)
Distribution of net income:						
Majority interest	P. 35,485		P. 29,640		P. 30,957	
Non-controlling interest	570		676		1,232	
Majority net income per share from continuing operations	P. 1.46		P. 1.32		P. 1.19	
Majority net income per share from discontinued operations	P. 0.34		P. 0.09		P. 0.16	
Majority net income per share[1]	P. 1.80		P. 1.41		P. 1.35	

(1) Includes majority net income per share from discontinued operations.

Revenues

Total revenues in 2007 were P.130,768 million, an increase of 0.8% over 2006, due primarily to an increase in revenues generated by the calling party pays system and an increase in other revenues (mainly attributable to sales in Telmex stores and Internet access services), partly offset by the decline of revenues from local and long distance services. The percentage of our revenues attributable to voice services (including local, long distance and interconnection services) declined from 81.1% in 2006 to 79.6% in 2007, while revenues from corporate networks and Internet access services grew to 17.0% of our revenues in 2007 compared to 16.2% in 2006.

Local Service Revenues

Operating revenues from local service include installation charges for new lines, monthly line rental charges, monthly fees for digital services and monthly measured service charges based on the number of calls. These revenues depend on the number of lines in service, the number of new lines installed and the volume of calls. Measured service charges are due from residential customers only for the number of local calls exceeding a specified monthly allotment. Accordingly, revenues from local service for residential customers do not depend solely on usage volume.

Revenues from local service decreased by 6.6% in 2007 and by 3.3% in 2006. The decrease in 2007 was due to a decrease of lines in service, lower average revenue per local billed call in real terms, a decrease in local and public telephony traffic due to competition from both wireless and other fixed-line service providers, and the migration of customers from dial-up to broadband Internet access services.

The decrease in local service revenues in 2006 was caused by lower average revenue per billed call in real terms and a decrease in local and public telephony traffic, reflecting the effects of competition from both wireless and other fixed-line service providers. These effects were partly offset by a higher penetration of digital services.

Domestic Long Distance Revenues

Operating revenues from domestic long distance service consist of (a) amounts earned from our customers and (b) amounts earned from other telecommunications operators for terminating their domestic long distance calls made to our customers. The amount of operating revenues from domestic long distance service depends on rates and traffic volume.

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Domestic long distance revenues decreased by 5.3% in 2007 and by 3.1% in 2006. The decrease in 2007 was primarily due to lower average revenue per minute in real terms, partly offset by higher billed traffic generated by the calling party pays system for domestic long distance service. The decrease in 2006 was due to a decrease in the average revenue per minute in real terms and a slower growth in domestic long distance traffic due to competition from wireless and other telecommunications providers.

International Long Distance Revenues

Operating revenues from international long distance service consist of (a) amounts earned from our customers and (b) amounts earned from foreign telecommunications carriers for terminating international calls made to our customers. The amount of operating revenues from international long distance service depends on the volume of traffic, the rates charged to our customers, the rates charged by each party under agreements with foreign carriers, principally in the United States, and the effects of competition. We report international long distance revenues gross of the settlement amounts payable to foreign carriers, which are recorded in cost of sales and services. In 2007, settlement payments from foreign carriers represented 2.7% of our consolidated revenues and 36.1% of our international long distance revenues. Settlement payments under service agreements with foreign carriers are generally denominated in U.S. dollars.

International long distance revenues decreased by 8.1% in 2007 and by 0.6% in 2006. The decrease in 2007 was primarily due to lower average revenue per minute in real terms, partly offset by higher billed traffic generated by the calling party pays system for international long distance service. Outgoing billed minutes grew by 3.4% and incoming billed minutes grew by 6.6%.

The decrease in 2006 was primarily caused by lower average revenue per minute in real terms, partly offset by an increase in revenues from international settlement payments in connection with higher traffic. Outgoing billed minutes grew by 4.8% and incoming billed minutes grew by 33.3%.

Revenues from Interconnection Service

Revenues from interconnection service represent fees for connection with our network of fixed-to-mobile, mobile-to-fixed and long distance calls. Calls between fixed and mobile telephones are subject to the calling party pays system, which Cofetel extended in November 2006 to cover long distance calls as well as local calls. In the case of local and domestic long distance service, under the calling party pays system, our fixed-line customers pay us an interconnection charge when they call a mobile telephone, and we pay 72.4% of that amount to the mobile carrier that completes the call. In the case of international long distance service, we pay 100% of the interconnection fee received from the international carrier that originates the call to the mobile carrier that completes the call. We recognize the amount paid to us under interconnection revenue, and we recognize the amount we pay under interconnection cost.

Revenues from interconnection service increased by 25.1% in 2007 and decreased by 4.4% in 2006. The increase in 2007 was primarily due to a full year of revenues generated by the calling party pays system for domestic and international long distance services (compared with only two months in 2006), partly offset by an 8.9% decrease of the calling party pays rates for local and long distance services. In 2007, revenues from fixed-to-mobile calls represented 89.8% of interconnection revenues (86.6% in 2006), revenues from local and long distance operators represented 7.2% (10.2% in 2006) and the balance of interconnection revenues represented payments from cellular carriers for mobile-to-fixed calls. Pursuant to an agreement with all cellular operators in Mexico concluded in 2006, the calling party pays rate for local, domestic long distance and international long distance services will gradually decline through 2010.

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The decrease in 2006 was primarily due to a 9.1% decrease in calling party pays revenues, caused by a 9.8% decrease of the calling party pays rate for local service in 2006, partly offset by an increase in traffic and additional revenues generated by the introduction of the calling party pays system for domestic and international long distance services in November 2006.

Revenues from Corporate Networks

Revenues from corporate networks include primarily revenues from the installation and leasing of dedicated private lines and revenues from virtual private network services. Revenues from corporate networks increased by 4.3% in 2007 and decreased by 2.7% in 2006. The increase in 2007 was caused by a 16.5% increase in billed line equivalents and higher sales of value added services, partly offset by a decline in average revenue per billed line equivalent due to increased competition.

The decrease in 2006 was principally due to the decrease in average revenue per billed line equivalent resulting from increased competition, partly offset by a 15.9% increase in billed line equivalents.

Revenues from Internet Access Service

Revenues from Internet access service include service fees for dial-up and broadband Internet access. Revenues from Internet access services increased by 7.7% in 2007 and by 15.4% in 2006. The increase in 2007 was due to a 60.5% increase in the number of our broadband (ADSL) customers, which reached 2,925 thousand at the end of 2007, partly offset by a 25.5% reduction in the rates we charge for broadband services that took effect in April 2007.

The increase in 2006 was caused by a 76.4% increase in the number of our broadband (ADSL) customers, which reached 1,823 thousand at the end of 2006. The migration of customers from dial-up to broadband services contributed in part to the increase in our customer base in both 2007 and 2006.

Other Revenues

The largest components of other revenues are sales of computers, telephones and accessories at Telmex stores and billing and collection services offered to third parties. Other revenues increased by 25.9% in 2007 and by 25.3% in 2006. The increase in 2007 was attributable to higher sales of computers, telephones and accessories at Telmex stores.

The increase in 2006 was attributable to higher sales of computers, telephones and accessories at Telmex stores and an increase in the volume of billing and collection services offered to third parties.

Operating Costs and Expenses

Cost of Sales and Services

Cost of sales and services increased by 1.0% in 2007 and decreased by 1.2% in 2006. The increase in 2007 was due to costs of goods sold attributable to higher sales of computers and telecommunications equipment, partly offset by a reduction in maintenance costs and optimization of resource use.

The decrease in 2006 was due to tighter expense control, a reduction in maintenance costs and optimization of resource use, partly offset by an increase in the costs of computer equipment caused by higher sales of computers in conjunction with Internet access service.

Commercial, Administrative and General Expenses

Commercial, administrative and general expenses increased by 0.9% in 2007 and by 1.4% in 2006. The increase in 2007 was principally due to a higher charge for doubtful accounts related to the disconnection of customers with payment problems, partly offset by lower advertising expenses and lower production costs of prepaid cards.

The increase in 2006 was principally due to a higher charge for doubtful accounts (reflecting the effect in 2005 of a reversal of P.209 million pursuant to an agreement with a data operator) and higher advertising expenses.

Transport and Interconnection Costs

Transport and interconnection costs include payments we make to cellular carriers under the calling party pays system. Transport and interconnection costs increased by 24.0% in 2007 and decreased by 0.1% in 2006. The increase in 2007 was due to a full year of costs generated by the calling party pays system for domestic and international long distance services (compared with only two months in 2006), partly offset by a 13.0% decline in the costs generated by the calling party pays system for local and long distance services.

The decrease in 2006 was due to a 9.9% decline in the costs generated by the calling party pays system for local service, partly offset by the introduction of the calling party pays system for domestic and international long distance services in November 2006.

Depreciation and Amortization

Depreciation and amortization decreased by 1.5% in 2007 and by 7.9% in 2006. Under Mexican FRS, we adjust imported fixed assets based on the rate of inflation in the respective country of origin and the prevailing exchange rate at the balance sheet date. As a result, changes in exchange rates and inflation rates affect the value of fixed assets and thus the amount of depreciation. The decrease in both periods resulted from lower adjustment of the value of our imported fixed assets, a decrease in the amount of our depreciable assets and technological improvements reflected in a decline in equipment prices.

Operating Income

In 2007, operating income decreased by 5.1%, reflecting a 0.8% increase in revenues and a 4.1% increase in operating costs and expenses. Operating margin decreased to 33.6% in 2007 from 35.7% in 2006, as the mix of our revenues changed, with a lower proportion of revenues from voice services and a higher proportion of interconnection revenues.

In 2006, operating income increased by 0.1%, reflecting a 1.3% decrease in revenues and a 2.0% decrease in operating costs and expenses. Operating margin increased to 35.7% in 2006 from 35.2% in 2005, due to decreased costs and lower depreciation.

Employee Profit Sharing

Like other Mexican companies, we are required by law to pay to our employees, in addition to their agreed compensation and benefits, profit sharing in an aggregate amount equal to 10% of our taxable income (calculated without reference to inflation adjustments).

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Other Income, Net

Other income, net, amounted to P.2,823 million in 2007 and P.446 million in 2006. Other revenues in 2007 mainly comprised a gain of P.1,653 million as a result of the favorable resolution regarding the deductibility of employee profit sharing amounts paid in 2004 and 2005. In 2006, the Supreme Court declared that the provision in the Mexican income tax law establishing the non-deductibility of employee profit sharing amounts was unconstitutional. As a result, in 2007 we obtained a ruling providing that we may deduct the employee profit sharing amounts paid in 2004 and 2005. Beginning in 2006, we have treated employee profit sharing payments as deductible for income tax purposes. Other income, net, in 2007 also included a gain of P.372 million from the sale of marketable securities and a gain of P.188 million from recoveries under our insurance policies, principally in connection with damages caused by hurricanes. Other income and expenses, net, in 2006 mainly comprised a gain of P.173 million from the sale of marketable securities and a gain of P.65 million from recoveries under our insurance policies, principally in connection with damages caused by hurricanes.

Comprehensive Financing Cost

Under Mexican FRS, comprehensive financing cost reflects interest income, interest expense, foreign exchange gain or loss and the gain or loss attributable to the effects of inflation on monetary liabilities and assets. A substantial proportion of our indebtedness (80.1% at December 31, 2007) is denominated in U.S. dollars, so variation in the value of the peso against the U.S. dollar affects our foreign exchange gain or loss and interest expense. Approximately 16.6% of our assets were denominated in foreign currencies at the end of 2007. In 2007, comprehensive financing cost was P.3,349 million compared with P.3,770 million in 2006. The changes in each component were as follows:

- Interest income decreased by 6.6% in 2007 and by 26.6% in 2006. The decrease in both 2007 and 2006 was due to a lower average level of interest-bearing assets.

- Interest expense decreased by 4.8% in 2007 and increased by 8.5% in 2006. The decrease in 2007 was primarily due to much lower losses on interest rate swaps (P.176 million compared to P.1,142 million in 2006) and a decrease in the average interest rates, partly offset by a higher average level of debt. The increase in 2006 was primarily due to the high level of losses on interest rate swaps (P.1,142 million compared to P.211 million in 2005), partly offset by the decrease in the average interest rates and the decline in the amount paid for debt repurchases (zero in 2006 compared to P.194 million in 2005).

- We recorded a net exchange loss of P.643 million in 2007 and of P.1,159 million in 2006. In 2007, the net exchange loss was due to a net loss of P.621 million on currency hedging instruments and a loss of P.22 million due to the depreciation of the peso against the U.S. dollar during 2007 by approximately 0.2%. In 2006, the net exchange loss was due to an exchange loss of P.1,132 million caused by the depreciation of the peso against the U.S. dollar by approximately 1.5% and a net loss of P.27 million on currency hedging instruments.

- Because average monetary liabilities exceeded average monetary assets, we recognized a net gain from monetary position. The net gain in monetary position decreased by 11.7% in 2007 and increased by 27.7% in 2006. The decrease in 2007 was due to a lower net monetary liability position and a lower inflation rate compared to 2006. The increase in 2006 was due to a greater net monetary liability position and a higher inflation rate compared to 2005.

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Income Tax

The statutory rate of the Mexican corporate income tax was 28% in 2007, 29% in 2006 and 30% in 2005. The Mexican Income Tax Law was amended in 2004 to decrease gradually the corporate income tax rate to 28.0% in 2007 and thereafter. Our effective rate of corporate income tax as a percentage of pre-tax profit was 28.7% in 2007, 30.5% in 2006 and 29.1% in 2005. The effective tax rate was lower in 2007 than in 2006 due to the lower statutory corporate income tax rate, partly offset by a decrease in depreciation and comprehensive financing cost for tax purposes. The effective tax rate was higher in 2006 than in 2005 due to the deduction in 2005 of the net loss related to the sale of our 50% equity interest of Technology & Internet LLC to Grupo Condumex, partly offset in 2006 by higher depreciation for tax purposes and the lower statutory income tax rate.

Income from Continuing Operations

Income from continuing operations increased by 4.3% in 2007 and by 1.6% in 2006. In 2007, the increase was mainly due to the recognition of a gain of P.1,653 million as a result of the favorable resolution regarding the deductibility of employee profit sharing amounts paid in 2004 and 2005, a decrease in the statutory corporate income tax rate and a decrease in comprehensive financing cost. In 2006, the increase was due to a decrease in the comprehensive financing cost, partly offset by our higher effective rate of corporate income tax.

Liquidity and Capital Resources

Our principal capital requirements are for capital expenditures, dividend payments and acquisitions. We have generally met our capital requirements primarily from operating cash flows and limited borrowing. We also use our operating cash flows to finance our share repurchase program. Resources provided by operating activities were P.51,239 million in 2007 and P.47,666 million in 2006. Our resources provided by operating activities increased in 2007 due to the decreased application of resources to marketable securities and accounts receivable, partly offset by the decreased application of resources to accounts payable, accrued liabilities and taxes payable. We had a working capital deficit from continuing operations (an excess of current liabilities over current assets) of P.1,909 million at December 31, 2007 and a surplus of P.6,111 million at December 31, 2006. The deficit in 2007 resulted from the transfer of approximately U.S.$2 billion to Telmex Internacional in the *Escisión*. See *Item 4. Information on the Company The* Escisión. We intend to provide the additional working capital needed through our operating cash flows and limited borrowing, and we expect to have a working capital surplus in 2008.

Our capital expenditures were P.13,440 million in 2007 and P.13,737 million in 2006. In 2007, we used 74.4% of our capital expenditures for growth projects in the voice, data and transport infrastructure, 24.0% for operational support projects and operating needs, and 1.6% for rural and public telephony. We expect that our capital expenditures in 2008 will be approximately P.6.3 billion (U.S.$550 million), excluding expenditures for any acquisitions we may decide to make.

The amount we spent on share repurchases was P.15,783 million in 2007, P.24,684 million in 2006 and P.18,927 million in 2005. The amount spent on share repurchases is determined from time to time by the executive committee of the Board of Directors taking into account factors including the price of our shares and our capital resources. Our shareholders have given renewed authorization to our officers to make share repurchases, most recently on April 27, 2007. There is no obligation to spend any of the authorized amounts. See *Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers.*

The amount spent on share repurchases from the *Escisión* through June 10, 2008, when our shares and those of Telmex Internacional began trading separately, was P.8,306 million. The Telmex shares repurchased in that period included the shares of Telmex Internacional. See *Item 4. Information on the Company The* Escisión *Adjustments Related to the* Escisión.

Dividends paid totaled P.8,820 million in 2007, P.8,846 million in 2006 and P.9,237 million in 2005. Our shareholders have approved dividends of P. 0.40 per share to be paid in four installments out of 2007 income. We expect to pay an aggregate of approximately P.7.6 billion in dividends from June 2008 through March 2009 (based on the number of outstanding shares at March 31, 2008).

In the table below we set forth certain contractual obligations as of December 31, 2007, consisting of debt (including financial leases) and purchase obligations, and the period in which the contractual obligations come due. The amount of our long-term debt reported in the table excludes interest and fee payments, which are primarily variable amounts, and does not reflect derivative instruments, which provide for payment flows that vary depending on exchange rates. Purchase obligations include capital commitments primarily for long-term equipment supply contracts. The table below does not include pension liabilities, deferred taxes or current accounts payable.

	Payments Due by Period (as of December 31, 2007)				
	Total	**2008**	**2009-2010**	**2011-2012**	**2013 and beyond**
	(in millions of pesos)				
Contractual obligations:					
Total debt[(1)]	P. 91,462	P. 12,282	P. 32,228	P. 22,289	P. 24,663
Purchase obligations	7,539	4,848	2,691		
Total	P. 99,001	P. 17,130	P. 34,919	P. 22,289	P. 24,663

(1) Excludes interest payments, fees and the effect of derivative instruments.

At December 31, 2007, we had total indebtedness of P.91,462 million (approximately U.S.$8,417 million) compared to total indebtedness of P.90,417 million (approximately U.S.$8,013 million) at December 31, 2006. We incurred additional U.S. dollar and peso-denominated debt in 2007. The increase in 2007 was primarily due to the issuance in Mexico of P.9,500 million of peso-denominated senior notes, a new loan of U.S.$300 million and a new medium-term loan of P.1,500 million, all of which were partly offset by the amortization of our indebtedness.

The major categories of indebtedness are as follows:

U.S. dollar-denominated bank loans. These include two syndicated loan facilities, loans with support from export credit agencies and other loans. Most of our bank facilities bear interest at specified spreads over LIBOR. The weighted average interest rate at December 31, 2007 was approximately 5.0%. We had U.S.$3,988 million (P.43,331 million) in bank loans outstanding at December 31, 2007. The largest component is the U.S.$3,000 million facility that we obtained in August 2006 to refinance the syndicated U.S.$2,500 million bank loan we obtained in 2005. This loan has three tranches: U.S.$1,300 million maturing in 2009, U.S.$1,000 million maturing in 2011, and U.S.$700 million maturing in 2013. In addition, in June 2006, we obtained a U.S.$500 million syndicated loan facility divided into two equal tranches maturing in 2010 and 2012, and in March 2007, we obtained a U.S.$300 million loan facility to be repaid in semi-annual installments through final maturity in 2016.

Certain of our bank loans contain financial and operating covenants. The most restrictive covenants require us to maintain a consolidated ratio of EBITDA to interest expense of no

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less than 3.00 to 1.00 and a consolidated ratio of total debt to EBITDA of no more than 3.75 to 1.00 (using terms defined in the credit agreements). Compliance with these covenants has not been a significant constraint on our ability to obtain financing.

Senior notes issued outside Mexico. We had U.S.$2,750 million (P.29,882 million) aggregate principal amount of senior notes outstanding at December 31, 2007. We have four outstanding series of senior notes issued outside of Mexico:

Maturity	**Issuance**	**Interest**	**Original Amount (millions)**
November 2008	November 2003	4.50%	U.S.$ 1,000
January 2010	January/February 2005	4.75%	U.S.$ 950
January 2015	January/February 2005	5.50%	U.S.$ 800
January 2016	January 2006	8.75%	P. 4,500

Peso-denominated senior notes issued in Mexico. We have issued peso-denominated senior notes (*certificados bursátiles*) from time to time in the Mexican market. Some of these notes bear interest at fixed rates and some bear interest at specified spreads below the Mexican interbank equilibrium interest rate (*Tasa de Interés Interbancaria de Equilibrio*). At December 31, 2007, we had P.10,700 million of such notes outstanding, maturing from 2009 to 2037, and the weighted average interest rate was 8.2%.

In April 2007, we issued P.9,500 million of peso-denominated senior notes in two tranches. One tranche matures in 2037 and bears an 8.36% fixed rate of interest, while the other tranche matures in 2012 and bears a floating rate of interest at the Mexican interbank equilibrium interest rate less 10 basis points.

We also have smaller amounts of other categories of outstanding indebtedness, including peso-denominated loans from Mexican banks, financial leases and supplier credits for equipment financing. We rely primarily on borrowings in the Mexican and international capital markets and from international banks, although if market conditions change, we may seek funding from export credit agencies or other sources. A number of our financing instruments are subject to either acceleration or repurchase at the holder s option if there is a change of control, as defined in the respective instruments. The definitions of change of control vary, but none of them is met so long as Carso Global Telecom or its present controlling shareholders continue to control a majority of our voting stock.

At December 31, 2007, 80.1% of our total consolidated indebtedness was denominated in U.S. dollars, 19.7% was denominated in Mexican pesos and the remainder was denominated in euros. Our currency hedging practices are described below.

At December 31, 2007, 54.1% of our debt obligations bore interest at floating rates. The weighted average cost of all borrowed funds at December 31, 2007 (including interest and reimbursement of certain lenders for Mexican taxes withheld, but excluding fees and the effect of interest rate swaps) was approximately 5.8%. The inclusion of fees and the effect of interest rate swaps in the calculation of weighted average cost of all borrowed funds at December 31, 2007 would increase such cost by 1.1%, to 6.9%.

Hedging

Our hedging activities are described below. Our hedging practices vary from time to time depending on our judgment about the level of exposure to interest rate and currency risk, and the costs of hedging. We may stop hedging or modify our hedging practices at any time.

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Because our U.S. dollar-denominated indebtedness far exceeds our U.S. dollar-denominated assets and revenues, from time to time Telmex enters into hedging transactions to protect to some degree against the short-term risks of devaluation of the Mexican peso. Under Mexican FRS, we account for these transactions on a fair value basis, and such amounts offset gains and losses on the foreign currency liabilities that are hedged. At December 31, 2007, our U.S. dollar-peso exchange rate swaps covered liabilities of U.S.$3,160 million and our cross currency swaps covered liabilities of U.S.$3,420 million out of our total U.S. dollar-denominated liability of P.73,213 million (approximately U.S.$6,738 million), but the amount of our hedging position varies substantially from time to time. In addition, in 2007 Telmex entered into cross-currency coupon swaps that cover interest rate flows of U.S.$300 million. In 2007, we recognized a net charge of P. 578.9 million and a net credit of P.93.1 million in our results of operations, reflecting the effects of exchange rate variations (principally the devaluation of the U.S. dollar against the peso in 2007) under our exchange rate and cross currency swaps, respectively. See Note 9 to our audited consolidated financial statements.

Approximately 35% of our peso-denominated indebtedness (P. 18,000 million at December 31, 2007) bears interest at floating rates. We have engaged in extensive hedging transactions to reduce our exposure to changes in Mexican interest rates. Specifically, we have entered into interest rate swaps in which we pay interest at a fixed rate and receive interest at a floating rate, on a notional amount in Mexican pesos or U.S. dollars. The general effect of these swaps is to replace an obligation to pay floating-rate interest on our debt with an obligation to pay fixed-rate interest. Because the peso-denominated swap market is not highly liquid, we do not ordinarily obtain interest rate swaps that precisely match the terms or amounts of our floating-rate liabilities. The aggregate notional amount of our interest rate swaps may be greater or less than the principal amount of our floating-rate peso-denominated debt, and we may discontinue hedging at any time. At December 31, 2007, the aggregate notional amount of our peso-denominated interest rate swaps was P. 23,752 million. As of December 31, 2007, we had interest rate swaps with a notional value of U.S.$1,050 million under which we pay six-month LIBOR rates and receive fixed rates, and interest rate swaps with a notional value of U.S.$1,150 million under which we pay fixed rates and receive six-month LIBOR rates. The net effect of these swaps in 2007 was a net reduction in our interest payments of 0.740%, compared to a net reduction of 0.907% in 2006, with the difference primarily due to our entry in 2007 into a new interest rate swap with a notional value of U.S.$100 million in 2007. In 2007, Telmex recognized a net expense of P. 940.9 million (compared to P. 750.8 million in 2006) in connection with these swaps, which was included in comprehensive financing cost. This amount includes an expense of P. 267.0 million for the substitution of peso-denominated interest rate swaps in 2007.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements of the type that we are required to disclose under Item 5E of Form 20-F.

U.S. GAAP Reconciliation

For purposes of this description of U.S. GAAP reconciliation, we have incorporated by reference the registration statement on Form 20-F of Telmex Internacional, filed with the SEC on May 30, 2008.

Under Mexican FRS, the *Escisión* was deemed effective as of December 26, 2007, and therefore the businesses transferred to Telmex Internacional pursuant to the *Escisión* have been treated as discontinued operations for all periods. Under U.S. GAAP, however, the *Escisión* was deemed effective as of June 10, 2008, the date on which the Telmex Internacional share certificates were delivered to our shareholders, and therefore the businesses transferred to Telmex Internacional pursuant to the *Escisión* were treated as part of our continuing operations as of December 31, 2007.

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Net income under U.S. GAAP was P.35,375 million in 2007, P.28,638 million in 2006 and P.29,221 million in 2005. Compared to Mexican FRS, net income under U.S. GAAP was 1.9% lower in 2007, 5.5% lower in 2006 and 9.2% lower in 2005.

There are certain differences between Mexican FRS and U.S. GAAP that affect our net income and stockholders equity. The most significant effects concern the treatment of the *Escisión* described above and elements of inflation accounting that are determined differently under U.S. GAAP than under Mexican FRS. See *Effects of Inflation Accounting* above.

Other differences that affected net income relate to accounting for costs of pension and seniority premium plans, business combinations, capitalization of interest on assets under construction, deferred profit sharing and the treatment of non-controlling interest. The differences in stockholders equity under Mexican FRS and U.S. GAAP reflect these same matters. For a discussion of the principal differences between Mexican FRS and U.S. GAAP, see Note 18 to our audited consolidated financial statements.

Use of Estimates in Certain Accounting Policies

In preparing our financial statements, we make estimates concerning a variety of matters. Some of these matters are highly uncertain, and our estimates involve judgments we make based on the information available to us. In the discussion below, we have identified several of these matters for which our financial presentation would be materially affected if either (a) we used different estimates that we could reasonably have used or (b) in the future we change our estimates in response to changes that are reasonably likely to occur.

The discussion addresses only those estimates that we consider most important based on the degree of uncertainty and the likelihood of a material impact if we used a different estimate. There are many other areas in which we use estimates about uncertain matters, but the reasonably likely effect of changed or different estimates is not material to our financial presentation.

Estimated Useful Lives of Plant, Property and Equipment

We estimate the useful lives of particular classes of plant, property and equipment in order to determine the amount of depreciation expense to be recorded in each period. Depreciation expense is a significant element of our costs, amounting in 2007 to P.18,291 million, or 21.1% of our operating costs and expenses, under Mexican FRS, and P.26,456 million, or 18.3% of our operating costs and expenses, under U.S. GAAP. See Notes 5 and 18 to our audited consolidated financial statements.

The estimates are based on historical experience with similar assets, anticipated technological changes and other factors, taking into account the practices of other telecommunications companies. We review estimated useful lives when we consider it necessary to determine whether they should be changed, and at times we have changed them for particular classes of assets. We may shorten the estimated useful life of an asset class in response to technological changes, changes in the market or other developments. This results in increased depreciation expense, and in some cases it can result in our recognizing an impairment charge to reflect a write-down in value. The same kind of developments can also lead us to lengthen the useful life of an asset class, resulting in reduced depreciation expense.

Employee Pensions and Seniority Premiums

We recognize liabilities on our balance sheet and expenses in our income statement to reflect our obligations to pay employees under defined benefit retirement and seniority premium plans. The amounts we recognize are determined on an actuarial basis that involves many estimates and accounts for post-retirement and termination benefits in accordance with Mexican FRS. In 2007, we recognized net period cost relating to these obligations of P.4,496 million under Mexican FRS and P.3,870 million under U.S. GAAP.

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We use estimates in three specific areas that have a significant effect on these amounts: (a) the real discount rates that we use to calculate the present value of our future obligations, (b) the real rate of increase in salaries that we assume we will observe in future years and (c) the rate of return we assume our pension fund will achieve on its investments. The assumptions we have applied are identified in Note 8 (Mexican FRS) and Note 18 (U.S. GAAP) to our audited consolidated financial statements. These estimates are based on our historical experience, on current conditions in the financial markets and on our judgments about the future development of our salary costs and the financial markets. We review the estimates each year, and if we change them, our reported expense for pension costs may increase or decrease. In 2008, we began using nominal rates instead of real rates in preparing these estimates as a result of the cessation of inflation accounting under Mexican FRS.

Our liability for future pensions and seniority premiums is also affected by our estimate of the number of retired employees and our pension fund is affected by the estimated rate of return on investments. Actual results may vary from these estimates. In 2007, an actuarial loss of P.18,706 million was primarily attributable to modifications in the discount rates used to calculate the present value of our future obligations, using as reference long-term, low-risk financial instruments. The actuarial loss in 2007 was also due in part to changes in retired personnel trends and differences between the rate of inflation and the estimated rate of salary increases.

The return on investments of our pension fund amounted to a gain of P.10,867 million in 2007, due to the performance of plan assets invested in shares of companies listed on the Mexican Stock Exchange. As of December 31, 2007, 53.8% of fund assets consisted of peso-denominated fixed-income securities and 46.2% consisted of variable-income securities of Mexican companies. The fund has experienced volatile returns on its investments in equity securities, which resulted in net losses on plan assets in prior years. Our actuarial assumptions as of December 31, 2007 include an assumed annual return of 6.3% in real terms on plan assets.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts based on our estimates of losses we may experience because our customers or other telecommunications carriers do not pay the amounts they owe us. At December 31, 2007, the amount of the allowance was P.1,726 million. For our customers, we perform a statistical analysis based on our past experience, current delinquencies and economic trends. For carriers, we make individual estimates that may reflect our evaluation of pending disputes over amounts owed. Our allowance could prove insufficient if our statistical analysis of our customer receivables is inadequate, or if one or more carriers refuse or are unable to pay us. See Note 4 to our audited consolidated financial statements.

Revenues from Prepaid Telephone Cards

We recognize revenues from the sale of our prepaid telephone service cards based on our estimate of the usage of time covered by the prepaid card. We estimate the period for usage of prepaid telephone cards in accordance with available statistics that reflect the total usage of cards and the total amounts sold. The cards do not have an expiration date.

The prepaid telephone card contains a data chip that tracks the number of units of service the card can provide. Each time the card is used, the telephone equipment records the number of units used and reduces the number of available units on the chip. When the number of available units in the chip is reduced to zero, it ceases to function. We track the aggregate number of units sold and the aggregate number of units used, but we do not track the number of units used on a card-by-card basis.

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Impairment of Long-Lived Assets

We have large amounts of long-lived assets on our balance sheet. Under Mexican FRS and U.S. GAAP, we are required to test long-lived assets for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable for plant, property and equipment and licenses and trademarks. Impairment testing for goodwill is required to be performed on an annual basis. At December 31, 2007, these include plant, property and equipment (P.120,649 million, net of accumulated depreciation), goodwill (P.432 million) and licenses (P.904 million, net of accumulated depreciation). To estimate the fair value of long-lived assets, we typically make various assumptions about the future prospects for the business that the asset relates to, consider market factors specific to that business and estimate future cash flows to be generated by that business. Based on these assumptions and estimates, and guidance provided by Mexican FRS and U.S. GAAP relating to the impairment of long-lived assets, we determine whether we need to take an impairment charge to reduce the net carrying value of the asset stated on our balance sheet to reflect its estimated fair value. Assumptions and estimates about future values and remaining useful lives are complex and often subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy and our internal forecasts. Different assumptions and estimates could materially impact our reported financial results. More conservative assumptions of the anticipated future benefits from these businesses could result in impairment charges, which would decrease net income and result in lower asset values on our balance sheet. Conversely, less conservative assumptions could result in smaller or no impairment charges, higher net income and higher asset values.

Item 6. Directors, Senior Management and Employees

Directors

Management of our business is vested in the Board of Directors and the chief executive officer. Our bylaws provide for the Board of Directors to consist of a maximum of 21 directors and up to an equal number of alternate directors. A majority of the directors and a majority of the alternate directors must be Mexican nationals and elected by Mexican shareholders. Each alternate director may attend meetings of the Board of Directors and vote in the absence of a corresponding director.

Directors are elected by a majority of the holders of the AA Shares and A Shares voting together, provided that any holder or group of holders of at least 10% of the total AA Shares and A Shares is entitled to name one of such directors and one of such alternate directors, and two directors and two alternate directors are elected by a majority vote of the holders of L Shares. Directors and alternate directors are elected at each annual ordinary general meeting of shareholders and each annual ordinary special meeting of holders of L Shares. Pursuant to our bylaws and Mexican law, at least 25% of our directors must qualify as independent, as determined by our shareholders at their annual ordinary general meeting pursuant to the Mexican Securities Market Law (*Ley del Mercado de Valores*). In order to have a quorum for a meeting of the Board of Directors, a majority of those present must be Mexican nationals.

Each of Carso Global Telecom and AT&T International has agreed to vote for the directors and alternate directors named by the other in accordance with their respective share ownership.

Our bylaws provide that the members of the Board of Directors are appointed for terms of one year and may be reelected. The names and positions of the current 14 members of our Board of Directors elected at the annual ordinary general meeting of our shareholders held on April 25, 2008, their dates of birth and information on their principal business activities outside Telmex are as follows:

Jaime Chico Pardo Chairman; member of the executive committee	Born:	1950
	First elected:	1991
	Term expires:	2009
	Principal occupation:	Chairman of the board of directors of Teléfonos de México, S.A.B. de C.V.; Co-Chairman of the board of directors of IDEAL (Impulsora del Desarrollo y el Empleo en América Latina)
	Other principal directorships:	Member of the board of directors of América Móvil, S.A.B. de C.V., Carso Global Telecom, S.A.B. de C.V., Grupo Carso, S.A.B. de C.V. and Honeywell International
	Business experience:	Chief Executive Officer of Teléfonos de México, S.A.B. de C.V.; Chief Executive Officer of Grupo Condumex, S.A. de C.V.; Chairman of Corporación Industrial Llantera (Euzkadi General Tire de México)
Carlos Slim Domit Co-Chairman; chairman of the executive committee	Born:	1967
	First elected:	1995
	Term expires:	2009
	Principal occupation and other directorships:	Chairman of the board of directors of Grupo Carso, S.A.B. de C.V., Grupo Sanborns, S.A. de C.V. and U.S. Commercial Corp., S.A.B. de C.V.; Vice Chairman of the board of directors of Carso Global Telecom, S.A.B. de C.V.
	Business experience:	Chief Executive Officer of Sanborn Hermanos, S.A.
Antonio Cosío Ariño Director; member of the audit committee; alternate member of the executive committee	Born:	1935
	First elected:	1991
	Term expires:	2009
	Principal occupation:	Chief Executive Officer of Cía. Industrial de Tepeji del Río, S.A. de C.V. and Tejidos Puente Sierra, S.A de C.V.
	Other directorships:	Chairman of the board of directors of Bodegas de Santo Tomás, S.A. de C.V. and Grupo Hotelero Brisas, S.A. de C.V.; member of the board of directors of Grupo Sanborns, S.A. de C.V., Grupo Carso, S.A.B. de C.V., Grupo Financiero Inbursa, S.A.B. de C.V. and Grupo Financiero Banamex-Accival, S.A. de C.V.

Amparo Espinosa Rugarcía	Born:	1941
Director	First elected:	1991
	Term expires:	2009
	Principal occupation:	Chief Executive Officer of Documentación y Estudios de Mujeres, A.C.
	Business experience:	Newspaper columnist; speaker at various national and international events
Élmer Franco Macías	Born:	1940
Director	First elected:	1991
	Term expires:	2009
	Principal occupation:	Chief Executive Officer and member of the board of directors of Infra, S.A. de C.V.
	Other directorships:	Member of the board of directors of Corporativo Infra, S.A. de C.V., Electrodos Infra, S.A. de C.V., Envases de Aceros, S.A. de C.V., Corporacion Infra, S.A. de C.V. and Conglomerado Industrial y Metaloides and Banco Nacional de México, S.A.
	Business experience:	Various positions at Grupo Infra since 1958
José Kuri Harfush	Born:	1949
Director; member of the audit committee	First elected:	1995
	Term expires:	2009
	Principal occupation:	Chief Executive Officer of Productos Dorel, S.A. de C.V. and Janel, S.A. de C.V.
	Other directorships:	Member of the board of directors of Banco Inbursa, Cigarros La Tabacalera Mexicana, Seguros Inbursa, Grupo Financiero Inbursa, S.A.B. de C.V., Grupo Carso, S.A.B. de C.V., Inbursa Sociedad de Inversión de Capitales, Sanborn Hermanos, S.A., Sears Roebuck de México, S.A. de C.V., América Telecom, S.A. de C.V., Carso Global Telecom, S.A.B. de C.V. and Minera Tayahua
Ángel Losada Moreno	Born:	1955
Director	First elected:	1991
	Term expires:	2009
	Principal occupation:	Chairman of the board of directors and Chief Executive Officer of Grupo Gigante, S.A.B. de C.V.
	Other directorships:	Chairman of the board of directors of Office Depot de México, S.A. de C.V.; member of the board of directors of Grupo Financiero Banamex Accival, S.A. de C.V., Price Smart, Inc and Food Market Institute
	Business experience:	President of the Advisory Board of the National Association of Autoservice and Department Stores (ANTAD); member of the Board of Directors of Chamber of Commerce of Mexico City, Casa de Bolsa Inverlat, S.A., Seguros de América, S.A. and Food Market Institute

Juan Antonio Pérez Simón	Born:	1941
Vice Chairman; chairman of the corporate practices committee; member of the executive committee	First elected:	1991
	Term expires:	2009
	Principal occupation and other directorships:	Chairman of the board of directors and member of the executive committee of Sanborn Hermanos, S.A.; member of the board of directors of Grupo Carso, S.A.B. de C.V., Grupo Financiero Inbursa, S.A.B. de C.V., Carso Global Telecom, S.A.B. de C.V., Cigarros La Tabacalera Mexicana, América Telecom, S.A. de C.V. and Sears Roebuck de México, S.A. de C.V.
Marco Antonio Slim Domit	Born:	1968
Director	First elected:	1995
	Term expires:	2009
	Principal occupation:	Chairman of the board of directors and Chief Executive Officer of Grupo Financiero Inbursa, S.A.B. de C.V.
	Other directorships:	Member of the board of directors of Grupo Carso, S.A.B. de C.V., Carso Global Telecom, S.A.B. de C.V. and Grupo Sanborns, S.A. de C.V.
	Business experience:	Various positions in the financial and commercial area at Grupo Financiero Inbursa, S.A.B. de C.V.
Héctor Slim Seade	Born:	1963
Director; alternate member of the executive committee	First elected:	2007
	Term expires:	2009
	Principal occupation:	Chief Executive Officer of Teléfonos de México, S.A.B. de C.V.
	Other directorships:	Member of the board of directors of Grupo Financiero Inbursa, S.A.B. de C.V.
	Business experience:	Chief Operational Support and Procurement Officer of Teléfonos de México, S.A.B. de C.V.; Chief Executive Officer of Fianzas Guardiana Inbursa; Administrative Officer of Banco Inbursa
John J. Stephens	Born:	1959
Director; member of the executive committee	First elected:	2008
	Term expires:	2009
	Principal occupation:	Senior Vice President and Controller, AT&T Inc.
	Business experience:	Various positions at AT&T Inc. since 1992

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Larry I. Boyle	Born:	1957
Director; alternate member of the executive committee	First elected:	2006
	Term expires:	2009
	Principal occupation:	Chief Financial Officer of AT&T Mexico, Inc.
	Business experience:	Various positions at AT&T, Inc. since 1985
Rafael Moisés Kalach Mizrahi	Born:	1946
Director; chairman of the audit committee	First elected:	1995
	Term expires:	2009
	Principal occupation:	Chairman of the board of directors and Chief Executive Officer of Grupo Kaltex, S.A. de C.V.
	Other directorships:	Member of the board of directors of Grupo Carso, S.A.B. de C.V., Sears Roebuck, S.A. de C.V., Grupo Sanborns, S.A. de C.V. and U.S. Commercial Corp., S.A.B. de C.V.
	Business experience:	Member of the board of directors of Banco Nacional de México and Bursamex Casa de Bolsa
Ricardo Martín Bringas	Born:	1960
Director	First elected:	1998
	Term expires:	2009
	Principal occupation:	Chief Executive Officer of Organización Soriana, S.A.B. de C.V.
	Other directorships:	Member of the board of directors of Banco HSBC México, S.A., Grupo Financiero Banamex Accival, S.A. de C.V., Grupo Financiero Banorte, S.A.B. de C.V. and ING de México; member of Consejo Mexicano de Hombres de Negocios, A.C.
	Business experience:	Various positions in the management and financial area at various companies, including Organización Soriana, La Ciudad de París and Restaurantes Martin s

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The alternate directors elected at the annual ordinary general meeting of our shareholders held on April 25, 2008, each of whom serves a one-year term, are as follows:

	First Elected Director or Alternate Director
Patrick Slim Domit	1999
José Humberto Gutiérrez-Olvera Zubizarreta	1996
Antonio Cosío Pando	2002
Agustín Franco Macías	1991
Eduardo Tricio Haro	2005
Jaime Alverde Goya	1993
Eduardo Valdés Acra	2000
Jorge A. Chapa Salazar	2002
Jorge C. Esteve Recolons	2004

The Secretary of the Board of Directors is Sergio F. Medina Noriega.

Of our directors and alternate directors, Élmer Franco Macías and Agustín Franco Macías are brothers; Antonio Cosío Pando is the son of Antonio Cosío Ariño; Carlos Slim Domit, Marco Antonio Slim Domit and Patrick Slim Domit are sons of Carlos Slim Helú; and Héctor Slim Seade is the nephew of Carlos Slim Helú.

Executive Committee

Our bylaws provide that the executive committee may generally exercise the powers of the Board of Directors. The Board of Directors is also required to consult the executive committee before deciding on certain matters set forth in the bylaws, and the executive committee must provide its views within 10 calendar days following a request from the Board of Directors.

The executive committee is elected from among the directors and alternate directors by a majority vote of the AA Shares and A Shares voting together. Under an agreement entered into in December 2000 between Carso Global Telecom and AT&T International, the executive committee consists of four members. The majority of its members must be of Mexican nationality and elected by Mexican shareholders. Carso Global Telecom and AT&T International have agreed to vote for three members named by Carso Global Telecom and one member named by AT&T International. The current members of the executive committee are Jaime Chico Pardo, Juan Antonio Pérez Simón and Carlos Slim Domit, all nominated by Carso Global Telecom and elected by various other Mexican investors, and John J. Stephens, named upon nomination by AT&T International. The current alternate members of the executive committee are Antonio Cosío Ariño, José Humberto Gutiérrez-Olvera Zubizarreta and Héctor Slim Seade, all nominated by Carso Global Telecom and elected by various other Mexican investors, and Larry I. Boyle, named upon nomination by AT&T International. The current members and alternate members of the executive committee were appointed at the annual ordinary general meeting of shareholders held on April 25, 2008.

Audit Committee

The audit committee consists of Rafael Moisés Kalach Mizrahi (the audit committee s chairman, appointed at the annual ordinary general meeting of shareholders held on April 25, 2008), Antonio Cosío Ariño and José Kuri Harfush, all three of whom are directors. Each member of the audit committee qualifies as independent, as determined by our shareholders at their annual ordinary general meeting pursuant to the Mexican Securities Market Law, and also meets the independence requirements of Rule 10A-3 under the U.S. Securities Exchange Act of 1934, as amended, or the Exchange Act. See *Item 16A. Audit Committee Financial Expert*. The audit committee operates under a written charter approved by our Board of Directors.

The mandate of the audit committee is to establish and monitor procedures and controls to ensure that the financial information we distribute is useful, appropriate and reliable and accurately reflects our financial position. The mandate of our audit committee includes the following functions, among others:

- give an opinion to the Board of Directors with respect to matters assigned to it under the Mexican Securities Market Law, including: (a) our internal control and internal audit guidelines, (b) our accounting policies by reference to financial reporting standards, (c) our financial statements, (d) the appointment of our external auditors, and (e) transactions that either are outside the ordinary course of our business or, in relation to the results for the immediately preceding fiscal quarter, in any of the following cases: (i) the acquisition or disposition of assets or (ii) the provision of guaranties or the assumption of liabilities, in each case, equal to or greater than 5% of our consolidated assets;

- evaluate, analyze and supervise the work performed by our external auditors, including (a) review with them our annual and interim financial statements; (b) approve non-audit services provided by them; (c) resolve any disagreements between them and management; and (d) ensure their independence and objectivity;

- discuss our financial statements with the persons responsible for their preparation and review and issue a recommendation to the Board of Directors with respect to committee s approval thereof;

- inform the Board of Directors of the status of our internal control and internal audit system, including any detected irregularities;

- prepare the opinion required by the Mexican Securities Market Law with respect to the annual report of our chief executive officer and submit it to our Board of Directors, for subsequent presentation at the shareholders meeting;

- assist the Board of Directors in the preparation of the reports required by the Mexican Securities Market Law regarding our principal accounting and financial information policies and criteria, and the Board of Directors activities and operations;

- seek the opinion of independent experts and other advisors when required or deemed necessary;

- investigate possible violations of operational guidelines and policies or of the internal control, internal audit and accounting records system by examining the documentation, records and other evidence deemed necessary;

- request periodic meetings with management and any information related to our internal control and internal audit;

- call a shareholders meeting and request the inclusion of matters it considers appropriate on the agenda;

report to the Board of Directors on any detected significant irregularities and on its activities in general, propose corrective actions, and conduct an annual self-evaluation;

receive from our external auditors a report that includes an analysis of: (a) all critical accounting policies utilized by us; (b) all policies and financial reporting standards that differ from those utilized by us and that have been discussed with management, including the implications of using such policies and practices; and (c) any other written communications regarding significant matters between our external auditors and management, including the annual letter to management, in which our external auditors summarize their recommendations regarding our internal controls and the non-adjusted differences in inventory identified during the audit process;

establish procedures for receiving, retaining and addressing complaints regarding our accounting, internal control and audit matters, including procedures for confidential submission of such complaints;

set aside times during meetings for discussions and deliberations, and establish a schedule for meeting with the head of our internal audit department and with our external auditors, without the presence of the chief executive officer and other executive officers;

review and analyze with management and our external auditors this Annual Report and the quarterly financial results presented to the SEC;

oversee that the chief executive officer executes the resolutions adopted by our shareholders or by the Board of Directors;

oversee the establishment of mechanisms and internal controls that allow to verify that our actions and operations comply with applicable rules, as well as implement methodologies that allow review of the fulfillment of the foregoing function;

assist the Board of Directors in monitoring the principal risks to which we are exposed, as identified on the basis of the information presented by the committees of our Board of Directors, our chief executive officer and our External Auditors, as well as in monitoring our accounting, internal control, internal audit, records, archive and information systems; and

perform any other functions pursuant to its mandate or expressly conferred by our shareholders or the Board of Directors.

The audit committee has reviewed this Annual Report, as well as our consolidated financial statements and notes thereto included elsewhere in this Annual Report, and recommended that such financial statements be included herein.

Corporate Practices Committee

The corporate practices committee consists of Juan Antonio Pérez Simón (the corporate practices committee s chairman, appointed at the annual ordinary general meeting of shareholders held on April 25, 2008), Antonio Cosío Pando and Jaime Alverde Goya. The corporate practices committee operates under a written charter approved by our Board of Directors.

The mandate of our corporate practices committee includes the following functions, among others:

give an opinion to the Board of Directors with respect to matters assigned to it under the Mexican Securities Market Law, including: (a) the policies and guidelines for the use of our assets, including by related parties; (b) the policies and guidelines applicable to related party transactions; (c) the appointment, election or dismissal and the compensation of the chief executive officer, and the policies relating to the appointment and compensation of members of management; (d) policies for the authorization of loans or guarantees to related parties; and (e) exemptions for directors and members of management to participate in business opportunities that belong to us or to entities over which we have a significant influence;

seek the opinion of independent experts when required or deemed necessary;

call a shareholders meeting and request the inclusion of matters it considers appropriate on the agenda;

assist the Board of Directors in the preparation of the reports required by the Mexican Securities Market Law regarding our principal accounting and financial information policies and criteria, and the Board of Directors activities and operations; and

perform any other functions pursuant to its mandate or expressly conferred by our shareholders or the Board of Directors.

Finance and Planning Committee

At the annual ordinary general meeting of our shareholders held on April 25, 2008, the finance and planning committee was disbanded and its functions are now performed by our Board of Directors. Until April 25, 2008, the finance and planning committee consisted of Juan Antonio Pérez Simón (chairman), Ángeles Espinosa Yglesias and Jaime Alverde Goya and operated under a written charter approved by our Board of Directors. Each member of the finance and planning committee qualified as independent, as determined by our shareholders at their annual ordinary general meeting pursuant to the Mexican Securities Market Law.

The mandate of the Finance and Planning Committee was to assist the Board of Directors in the following financial and planning functions: (a) review investment policies proposed by senior management; (b) evaluate the financing policies proposed by senior management and submit them for approval by the Board of Directors; (c) participate in presentations to the Board of Directors regarding the conformity of principal proposed investments and financing transactions to our guidelines; (d) weigh in on strategic planning and assist the Board of Directors in monitoring financial projections and the concurrence of investment and financing policies with strategic objectives; (e) advise on annual budget assumptions and submit them for approval by the Board of Directors; (f) monitor our budget and strategic plan; (g) identify risk factors and review policies for managing those risks; and (h) perform any other functions the Board of Directors may delegate to the finance and planning committee.

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Executive Officers

The names, responsibilities and prior business experience of our executive officers are as follows:

Héctor Slim Seade Chief Executive Officer	Appointed: Business experience:	2006 Director Operational Support of Teléfonos de México, S.A.B. de C.V.; Chief Executive Officer of Fianzas Guardiana Inbursa; Administrative Officer of Banco Inbursa
Adolfo Cerezo Pérez Chief Financial Officer	Appointed: Business experience:	1991 Various positions in finance at Teléfonos de México, S.A.B. de C.V., including treasurer
Arturo Elías Ayub Strategic Alliances, Communication and Institutional Relations	Appointed: Business experience:	2002 Chief Executive Officer of Sociedad Cadena and various positions at Telmex, including New Services, Regulation and Communication
Javier Mondragón Alarcón Regulation and Legal Affairs	Appointed: Business experience:	1999 General Counsel at Grupo Televisa S.A. de C.V.; executive vice president at Grupo Televicentro
Sergio Medina Noriega Legal	Appointed: Business experience:	1995 Various legal positions at Bancomer S.A. (now BBVA Bancomer); legal director of Empresas Frisco

Héctor Slim Seade is the nephew of Carlos Slim Helú, and Arturo Elías Ayub is the son-in-law of Carlos Slim Helú.

Compensation of Directors and Officers

For the year ended December 31, 2007, the aggregate compensation of all of our directors and executive officers paid for services in all capacities was approximately P.63.4 million, which included bonus payments totaling P.16.3 million. Annual bonus payments are approved by our corporate practices committee on the basis of various factors, including achievement of performance targets and seniority. Each director received an average fee of P.51.4 thousand (nominal) for each meeting of the Board of Directors attended in 2007. Members of committees of the Board of Directors received an average fee of P.17.2 thousand (nominal) for each committee meeting attended in 2007. None of our directors is a party to any contract with us or any of our subsidiaries that provides for benefits upon termination of employment. We do not provide pension, retirement or similar benefits to our directors in their capacity as directors. Our executive officers are eligible for benefits on the same terms as all other Telmex employees, and we do not separately set aside, accrue or determine the amount of our costs that is attributable to executive officers.

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Share ownership of Carlos Slim Helú and certain members of his immediate family is set forth in *Item 7. Major Shareholders and Related Party Transactions Major Shareholders*. Excluding the individuals discussed therein, our directors, alternate directors and executive officers as a group beneficially own less than 1% of any class of our capital stock.

Employees

We are one of the largest non-governmental employers in Mexico. The following table sets forth the number of employees and a breakdown of employees by main category of activity as of the end of each year in the three-year period ended December 31, 2007:

	December 31,		
	2007	**2006**	**2005**
End-of-period number of employees	56,796	57,941	58,463
Employees by category of activity:			
Local	37,683	37,660	38,430
Long distance	5,016	6,630	7,170
Other	14,097	13,651	12,863

At December 31, 2007, the Telephone Workers Union of Mexico (known by its Spanish acronym, STRM) represented approximately 73.3% of our employees, and members of other unions represented approximately 7.1% of our employees. All management positions are held by non-union employees. Salaries and certain benefits for unionized personnel are renegotiated every year and the collective bargaining agreements with our unionized employees are renegotiated every two years. In April 2008, we and the STRM agreed to a 4.4% nominal increase in basic wages and a 2.45% nominal increase in benefits.

Item 7. Major Shareholders and Related Party Transactions

MAJOR SHAREHOLDERS

The AA Shares represented 42.8% of the total capital stock and 95.0% of the full voting shares (AA shares and A Shares) as of June 11, 2008. The AA Shares are owned by (1) Carso Global Telecom, (2) AT&T International and (3) various other Mexican investors. Carso Global Telecom holds interests in telecommunications and was created in an *escisión* of Grupo Carso in 1996. Carso Global Telecom may be deemed to control us. According to reports of beneficial ownership of our shares filed with the SEC, Carso Global Telecom is controlled by Mr. Carlos Slim Helú and members of his immediate family.

Carso Global Telecom and AT&T International are parties to an agreement entered into in December 2000 providing for certain matters relating to their ownership of AA Shares. Among other things, the agreement subjects certain transfers of AA Shares by either party to a right of first offer in favor of the other party, although the right of first offer does not apply to the conversion of AA Shares to L Shares, as permitted by our bylaws, or the subsequent transfer of L Shares. The agreement also provides for the composition of the Board of Directors and the executive committee (see *Item 6. Directors and Officers of Registrant Directors* and *Item 6. Directors and Officers of Registrant Executive Committee*) and for each party to enter into a Management Services Agreement with us (see *Related Party Transactions*).

The following table identifies owners of five percent or more of any class of our shares as of June 11, 2008, unless otherwise indicated. Except as described below, we are not aware of any holder of five

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percent or more of any class of our shares. Holders of five percent or more of any class of our shares have the same voting rights with respect to their shares as do holders of less than five percent of the same class.

	AA Shares[1]		A Shares[2]		L Shares[3][4]		Percent
	Shares (millions)	Percent of class	Shares (millions)	Percent of class	Shares (millions)	Percent of class	of voting shares[5]
Carso Global Telecom[6]	6,000.0	73.9%	92.0	21.7%	4,658.0	44.8%	71.3%
AT&T International[6]	1,799.5	22.2					21.1
Brandes Investment Partners, L.P.[7]					791.9	7.6	

(1) As of June 11, 2008, there were 8,115 million AA Shares outstanding, representing 95.0% of the total full voting shares (AA Shares and A Shares).
(2) As of June 11, 2008, there were 424 million A Shares outstanding, representing 5.0% of the total full voting shares (AA Shares and A Shares).
(3) As of June 11, 2008, there were 10,402 million L Shares outstanding.
(4) Based on reports of beneficial ownership filed with the SEC, (i) JPMorgan Chase & Co. beneficially owned less than 5% of our L Shares as of March 31, 2008 and as of March 31, 2007, compared to 7.5% as of March 31, 2006, and (ii) Franklin Resources, Inc. beneficially owned less than 5% of our L Shares as of March 31, 2008, compared to 5.5% as of April 10, 2007.
(5) AA Shares and A Shares.
(6) Holders of AA Shares and A Shares are entitled to convert a portion of these Shares to L Shares, subject to the restrictions set forth in our bylaws. In accordance with Mexican law and our bylaws, AT&T holds its AA Shares through a Mexican trust, pursuant to the terms of which the trustee votes AT&T s AA Shares in the same way as Carso Global Telecom does, other than with respect to the election of the members of our Board of Directors and the Executive Committee. See *Item 10. Additional Information Bylaws and Mexican Law*.
(7) As of March 31, 2008. Derived from reports of beneficial ownership of our shares filed with the SEC. For comparability purposes, percent of class is calculated based on the number of L Shares outstanding on June 11, 2008.

The following table sets forth the share ownership, as of June 11, 2008, of our officers and directors who own more than one percent of any class of our capital stock. Carlos Slim Domit, Marco Antonio Slim Domit and Patrick Slim Domit, together with certain other members of Carlos Slim Helú s immediate family, may be deemed to share beneficial ownership of 6,000 million AA Shares, 92.6 million A Shares and 4,879.3 million L Shares held by Carso Global Telecom and other companies that are under common control with us.

	AA Shares[1]		A Shares[1]		L Shares[1]		Percent
	Shares (millions)	Percent of class	Shares (millions)	Percent of class	Shares (millions)	Percent of class	of voting shares[2]
Carlos Slim Domit[3]	6,000.0	73.9%	92.6	21.8%	4,888.8	47.0%	71.4
Marco Antonio Slim Domit[4]	6,000.0	73.9	92.6	21.8	4,888.8	47.0	71.4
Patrick Slim Domit[5]	6,000.0	73.9	92.6	21.8	4,889.8	47.0	71.4
Antonio Cosío Ariño[6]	130.4	1.6					1.5
Antonio Cosío Pando[6]	130.4	1.6					1.5

(1) Holders of AA Shares and A Shares are entitled to convert a portion of these Shares to L Shares, subject to the restrictions set forth in our bylaws. See *Item 10. Additional Information Bylaws and Mexican Law*. Based on reports of beneficial ownership filed with the SEC, as of June 11, 2008, 4,326,334,850 AA Shares and all A Shares of which Carlos Slim Domit, Marco Antonio Slim Domit, Patrick Slim Domit and certain other members of Carlos Slim Helú s immediate family may be deemed to share beneficial ownership could be converted to L Shares.
(2) AA Shares and A Shares.
(3) Includes 9,516,264 L Shares owned directly by Carlos Slim Domit.
(4) Includes 9,516,264 L Shares owned directly by Marco Antonio Slim Domit.
(5) Includes 10,548,538 L Shares owned directly by Patrick Slim Domit.
(6) Owned jointly by Antonio Cosío Ariño and Antonio Cosío Pando.

At December 31, 2007, 55.1% of our outstanding L Shares were represented by L Share ADSs, each representing the right to receive 20 L Shares, and 99.1% of the holders of L Share ADSs (11,632 holders, including The Depository Trust Company, or DTC) had registered addresses in the United States. In November 2000, we established a sponsored ADS program for the A Share ADSs. 25.8% of our outstanding A Shares were held in the form of A Share ADSs at December 31, 2007, each representing the right to receive 20 A Shares, and 99.6% of the holders of A Share ADSs (4,090 holders, including The Depository Trust Company) had registered addresses in the United States.

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We have no information concerning holders with registered addresses in the United States that hold:

- A Shares;
- L Shares not represented by ADSs; or
- A Share ADSs that are held under the unsponsored A Share ADS programs, which pre-date the establishment of the sponsored program, and have not been exchanged for ADSs issued under such sponsored program. See *Item 9. The Offer and Listing Trading Market.*

We purchase our shares on the Mexican Stock Exchange from time to time up to a specified maximum aggregate value authorized by the holders of AA Shares and A Shares and our Board of Directors. In 2007, we purchased 839.9 million L Shares and 2.8 million A Shares, representing 4.2% of the shares outstanding at the beginning of 2007, with an aggregate value of P.15,782.8 million (P.15,475.8 million historical).

Since January 1, 1997, Carso Global Telecom has purchased A Shares and L Shares on the open market from time to time. In percentage terms, the ownership position of Carso Global Telecom has also increased as a result of our repurchase of our own shares. Carso Global Telecom s percentage ownership of A Shares was 21.4% on December 31, 2007, 20.6% on December 31, 2006 and 19.2% on December 31, 2005. Carso Global Telecom s percentage ownership of L Shares was 42.9% on December 31, 2007, 39.1% on December 31, 2006 and 28.5% on December 31, 2005.

RELATED PARTY TRANSACTIONS

General

We engage in a variety of transactions in the ordinary course of business with affiliates. Pursuant to Mexican law, our bylaws and applicable internal guidelines, provided that the corporate practices committee of our Board of Directors has opined favorably, our Board of Directors has to vote on whether or not to approve any transaction with a related party (1) the value of which exceeds 1% of our consolidated assets, (2) that is outside the ordinary course of our business or at non-market prices, or (3) that is with employees and is not on the same terms as transactions with any other customers and does not result from employee benefits of general character. A director with an interest in a transaction with a related party is not permitted to vote on its approval.

Our transactions with affiliates include making interconnection payments to América Móvil, purchasing network construction services and materials from a subsidiary of Grupo Carso and using insurance and bank services from Grupo Financiero Inbursa, S.A.B. de C.V., or Grupo Financiero Inbursa. In addition, we rent private circuits and provide long distance services to América Móvil, sell network construction materials to Grupo Carso and provide certain services to Grupo Carso and Grupo Financiero Inbursa. Grupo Carso and Grupo Financiero Inbursa are under common control with Carso Global Telecom, and several of their directors are also members of our Board of Directors. See *Item 6. Directors, Senior Management and Employees Directors*.

Following the *Escisión* of our Latin American and yellow pages directory businesses, which was effected on December 26, 2007 (see *Item 4. Information on the Company The* Escisión), there has been a variety of contractual relationships between Telmex and Telmex Internacional, both to accomplish the *Escisión* and to provide for ongoing relationships. For these purposes, we have entered into a master transition agreement with Telmex Internacional (the Master Agreement), the principal terms of which are described below. In addition, (1) we complete international traffic from Telmex Internacional in Mexico, (2) Telmex Internacional completes international traffic from us in Brazil, Colombia, Argentina, Chile, Peru and Ecuador, (3) Telmex Internacional prints our white pages telephone directories, and (4) we provide Telmex Internacional access to our customer database for use in its yellow pages directory business in Mexico and handle the billing and collection of payments from advertisers.

The aggregate amount of our purchases from affiliates was P.22,624 million in 2007, P.20,479 million in 2006 and P.21,928 million in 2005. The aggregate amount of our sales to these affiliates was P.9,306 million in 2007, P.8,340 million in 2006 and P.6,165 million in 2005. We believe that these transactions are at market prices.

From time to time we make investments together with affiliated companies, sell our investments to affiliates and buy investments from affiliates. Some of these transactions are described below.

- We pursued joint investments with América Móvil to acquire equity interests in Compañía Anónima Nacional Teléfonos de Venezuela in 2006 and Olimpia, an Italian company that owns 18% of the total capital of Telecom Italia, in 2007. Neither of these transactions was completed.

- We owned approximately 25.6 million shares of common stock of MCI. Other parties that may be deemed to be under common control with us held an additional interest. In May 2005, we and the other parties that may be deemed to be under common control with us sold all shares held.

- In January 2006, together with Alcatel and AT&T International (one of our principal shareholders), we acquired an aggregate 51% interest in the capital stock of 2Wire. Subsequently, we sold an approximate 5.5% in 2Wire to AT&T International, decreasing our ownership to approximately 13.0%.

- We own a 45% interest in Grupo Telvista S.A. de C.V. together with América Móvil (45%) and Grupo Financiero Inbursa (10%).

- We owned a 50% interest in Technology and Internet LLC, a company that invests in e-commerce enterprises in the United States and Latin America. We made this investment together with América Móvil (40.3%) and a subsidiary of Grupo Financiero Inbursa (9.7%). In June 2005, we sold our entire interest in Technology and Internet LLC to Grupo Condumex.

We also pay fees to Carso Global Telecom and AT&T International for consulting and management services, pursuant to agreements with each party negotiated on behalf of us by a special committee of directors unaffiliated with any of the parties. The current agreement with Carso Global Telecom was renewed for the period beginning December 21, 2007, and the current agreement with AT&T International was renewed for the period beginning December 31, 2007, each on substantially similar terms to the prior agreements. We paid to both companies an aggregate amount of U.S.$47.5 million in 2007, U.S.$39 million in 2006 and U.S.$39 million in 2005. Telmex Internacional has reimbursed us U.S.$22.5 million of the U.S.$45.0 million we have paid Carso Global Telecom for such services in 2008.

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Our corporate practices committee has established policies governing the use of our corporate aircraft. For security reasons and due to the various activities related to their positions, the corporate practices committee allocates an annual amount of time for personal use free of charge to the honorary chairman, the chairman and the co-chairman of our Board of Directors. Certain executives of our affiliates periodically use our corporate aircraft in accordance with those policies.

Transactions Relating to the *Escisión*

The creation of Telmex Internacional and the transfer of assets and liabilities from Telmex to Telmex Internacional was effected by the action of the extraordinary shareholders meeting of Telmex on December 21, 2007. We have not made any representations regarding the value of any of the assets we transferred to Telmex Internacional in the *Escisión*. Telmex Internacional has agreed to indemnify us against any liability, expense, cost or contribution asserted against us that arises out of the assets owned directly or indirectly by Controladora de Servicios de Telecomunicaciones, S.A. de C.V., or Consertel, the subsidiary whose shares were transferred to Telmex Internacional in the *Escisión*. For more information on the *Escisión*, see *Item 4. Information on the Company The* Escisión.

The Master Agreement includes provisions intended to ensure that the purposes of the *Escisión* are fully achieved. Among other things, this agreement provides in general terms as follows:

Telmex Internacional agrees to indemnify us against any loss or expense resulting from the assertion against us of any liabilities or claims that were transferred to Telmex Internacional in the *Escisión* or that relate to the businesses transferred to Telmex Internacional in the *Escisión*.

We agree to indemnify Telmex Internacional against any loss or expense resulting from the assertion against Telmex Internacional of any liabilities or claims that were retained by us in the *Escisión* or that relate to the businesses retained by us in the *Escisión*.

The parties agree to cooperate in obtaining consents or approvals, giving notices or making filings, as may be required as a result of the *Escisión* or in order to achieve the purposes of the *Escisión*.

Each party agrees to provide the other with information required to prepare financial statements, tax returns, regulatory filings or submissions and for other specified purposes.

Each party agrees to maintain the confidentiality of any information concerning the other that it obtained prior to the *Escisión* or that it obtains in connection with the implementation of the *Escisión*.

Each party agrees that it will not take any action that could reasonably be expected to prevent the *Escisión* from qualifying as tax-free under Mexican or U.S. federal tax laws.

Each party releases the other from certain claims arising prior to the *Escisión*. We make no representations concerning the assets transferred directly or indirectly in the *Escisión*.

Under the Master Agreement, we provide a variety of administrative services to Telmex Internacional on an interim basis, including certain data processing and corporate support and administrative services, generally at cost plus a specified percentage. We expect Telmex Internacional to be dependent on us for these services through 2008 and possibly longer.

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Transactions between Telmex and América Móvil

América Móvil has a variety of contractual relationships with us and with our subsidiaries. Because both we and América Móvil, the wireless operator that was established in an *escisión* we completed in 2000, provide telecommunications services in the same geographical markets, we have extensive operational relationships. These include interconnection between our respective networks; use by América Móvil of our private circuits; our provision of long distance service to América Móvil s customers; use of facilities, particularly for the co-location of equipment on premises we own; and use by each of the services provided by the other. These operational relationships are subject to a variety of agreements, which for the most part were in place prior to the *escisión* and were not significantly modified as a result of the *escisión*. Many of them are also subject to specific regulations governing all telecommunications operators. Interconnection fees represent the largest component of amounts paid under these agreements. In addition, we distribute América Móvil s handsets and prepaid cards in our stores. The terms of the arrangements with América Móvil are generally similar to those on which each company does business with other, unaffiliated parties.

International Long Distance Settlement with AT&T International

We have agreements with AT&T International, one of our principal shareholders, that provide for AT&T International completing our international calls to the United States and for our completing AT&T International s calls from the United States. The rates of payment under these agreements are consistent with the rates agreed with other international carriers.

Item 8. Financial Information

CONSOLIDATED FINANCIAL STATEMENTS

See *Item 18. Financial Statements* and our consolidated financial statements beginning on page F-1.

LEGAL PROCEEDINGS

We are involved in legal proceedings in the ordinary course of our business, none of which is material. In addition, we are in the process of appealing various proceedings brought by our competitors alleging anti-competitive practices by us before competition authorities in Mexico. Recently, between November 2007 and February 2008, the Competition Commission commenced several industry-wide investigations to determine whether any operators, including Telmex and certain of our affiliates, possess substantial market power or engage in relative anti-competitive practices in certain segments of the Mexican telecommunications market. These investigations are at the stage of information collection and analysis, and we cannot predict their outcome. Findings adverse to Telmex may lead to the imposition of restrictions or monetary penalties on us. See *Item 4. Information on the Company Regulation Dominant Carrier Regulations* and *Competition.*

The Mexican Social Security Institute (*Instituto Mexicano del Seguro Social*) conducted an audit of our social security obligations for the period from 1997 through 2001. Following the audit, we were ordered to pay a total of approximately P.330 million (nominal value) consisting of past due obligations, penalties and accrued interest as of July 2, 2003. We have appealed these rulings to the Federal Administration and Taxation Court (*Tribunal Federal de Justicia Fiscal y Administrativa*) and, in accordance with Mexican law, have posted a bond guaranteeing the amount alleged to be owed. Although we believe that the basis for our appeal is well founded, there can be no assurance that we will prevail.

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DIVIDENDS

We have paid cash dividends on our shares each year since 1958. The table below sets forth the nominal amount of dividends paid per share in each year indicated, in pesos and translated into U.S. dollars at the exchange rate on each of the respective payment dates. The figures below have been adjusted to give effect to the two-for-one stock split that occurred in May 2005.

Year ended December 31,	Pesos per Share		Dollars per Share	
2007	P.	0.4400	U.S.$	0.0402
2006		0.4025		0.0365
2005		0.3700		0.0340
2004		0.3325		0.0294
2003		0.3025		0.0278

Since 1998, we have paid dividends quarterly. The dividends from earnings in a given year are determined at the annual meeting of shareholders in April of the following year, and paid in June, September and December of such following year and in March of the year after that. In April 2006, we declared a dividend of P.0.41 per share, which we paid in equal installments of P.0.1025 per share in June 2006, September 2006, December 2006 and March 2007. In April 2007, we declared a dividend of P.0.45 per share, which we paid in equal installments of P.0.1125 per share in June 2007, September 2007, December 2007 and March 2008. In April 2008, we declared a dividend of P.0.40 per share, which will be payable in equal installments of P.0.10 per share in June 2008, September 2008, December 2008 and March 2009.

The declaration, amount and payment of dividends are determined by majority vote of the holders of AA Shares and A Shares, generally on the recommendation of the Board of Directors, and will depend on our results of operations, financial condition, cash requirements, future prospects and other factors deemed relevant by the holders of AA Shares and A Shares. Accordingly, we cannot assure you that we will continue to pay dividends or that future dividends will be comparable to historical dividends. Our bylaws do not distinguish among holders of the AA Shares, the A Shares and the L Shares with respect to dividend payments and other distributions.

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Item 9. The Offer and Listing

TRADING MARKET

The L Share ADSs, each representing 20 L Shares of Telmex, are issued by JPMorgan Chase Bank, N.A., or the Depositary, as depositary for the L Share ADSs. The L Share ADSs are traded on the New York Stock Exchange and listed on the Frankfurt Stock Exchange, and the L Shares are traded on the Mexican Stock Exchange and listed on the *Mercado de Valores Latinoamericano* (Latibex) in Madrid, Spain.

The A Share ADSs, each representing 20 A Shares of Telmex, are issued by the Depositary, as depositary for the A Share ADSs. The A Shares are traded on the Mexican Stock Exchange, and the A Share ADSs are traded on the NASDAQ Capital Market.

The following table sets forth, for the periods indicated, the reported high and low sales prices for the L Shares on the Mexican Stock Exchange and the reported high and low sales prices for the L Share ADSs on the New York Stock Exchange. Prices have not been restated in constant currency units, but have been adjusted to give effect to the two-for-one stock split that occurred in May 2005. Following the *Escisión* and until June 10, 2008, the L Shares and L Share ADSs of Telmex and Telmex Internacional traded together. On June 11, 2008, the closing price of the L Shares on the Mexican Stock Exchange was P.12.49, and the closing price of the L Share ADSs on the New York Stock Exchange was U.S.$23.92.

	Mexican Stock Exchange (pesos per L Share)		New York Stock Exchange (U.S. dollars per L Share ADS)	
	High	Low	High	Low
Annual highs and lows				
2007	P. 23.29	P. 14.32	U.S.$ 43.26	U.S.$ 25.89
2006	15.97	10.01	29.35	17.61
2005	13.27	8.92	24.79	16.49
2004	10.81	8.66	19.27	15.06
2003	9.53	7.48	17.25	14.42
Quarterly highs and lows				
2008:				
First quarter	P. 20.43	P. 16.96	U.S.$ 38.39	U.S.$ 30.88
2007				
First quarter	18.63	14.32	33.83	25.89
Second quarter	23.29	18.45	43.26	33.37
Third quarter	22.32	17.07	41.37	30.10
Fourth quarter	21.35	17.16	39.43	32.48
2006:				
First quarter	13.90	11.47	26.07	21.76
Second quarter	12.81	10.01	23.35	17.61
Third quarter	14.22	11.20	25.79	20.26
Fourth quarter	15.97	13.45	29.35	24.05
Monthly highs and lows				
2007				
December	P. 21.35	P. 18.76	U.S.$ 39.43	U.S.$ 34.45
2008				
January	20.30	16.96	37.33	30.88
February	20.10	17.33	37.40	