TELEFONOS DE MEXICO S A B DE C V
Form 20-F
May 11, 2011


**As filed with the Securities and Exchange Commission on May 11, 2011.**

# SECURITIES AND EXCHANGE COMMISSION

**Washington, DC 20549**

# FORM 20-F

**ANNUAL REPORT PURSUANT TO SECTION 13 or 15 (d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended: December 31, 2010**

**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 México, D.F., México**

**(Address of principal executive offices)**

**Anna Domínguez González**

**Teléfonos de México, S.A.B. de C.V.**

**Parque Vía 198, piso 7, oficina 701**

**Colonia Cuauhtémoc**

**06599 México, D.F., México**

**ri@telmex.com**

**Tel: (52) 55 52 22 17 74**

**(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, 2010 was:**

| | |
|---|---|
| 7,840 million | AA Shares |
| 383 million | A Shares |
| 9,935 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).** N/A

**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 | ¨ | International Financial Reporting Standards as issued by the International Accounting Standards Board | ¨ | 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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## 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, indebtedness levels, 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 about our plans, objectives or goals, including those 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 interest rates, currency exchange rates and foreign securities markets;
- statements about the availability and cost of external financing for our operations, which have been affected by the stress experienced by the global financial markets;
- statements about the renewal, revocation or expropriation of our concessions, decisions of regulatory and judicial authorities, and 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 Item 3. Risk Factors beginning on page 6, include regulatory developments, economic and political conditions, which have been affected by the global economic crisis, competition, customer demand, government policies, inflation rates, exchange rates and technological changes. 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 undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information or future events or for any other reason.

You should evaluate any statements made by us in light of these important factors.

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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 consolidated financial statements for each of the five years in the period ended December 31, 2010, which have been audited 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 audited consolidated financial statements and notes thereto included elsewhere in this annual report.

Beginning in 2012, Mexican issuers with securities listed on a Mexican securities exchange will be required to prepare financial statements in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Issuers may voluntarily report using IFRS before the change in the reporting standards becomes mandatory. We will be presenting financial statements in accordance with IFRS for the fiscal year ending December 31, 2011, with an official IFRS adoption date as of January 1, 2011 and a transition date to IFRS of January 1, 2010.

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**

Due to the adoption of Mexican FRS B-10, effective January 1, 2008, we ceased to recognize the effects of inflation on our financial information. Through December 31, 2007, under Mexican Accounting Bulletin B-10, inflation accounting had extensive effects on the presentation of our financial statements. In our financial information, inflation adjustments for periods prior to 2008 have not been removed from stockholders equity and the re-expressed amounts for non-monetary assets and liabilities at December 31, 2007 became the accounting basis for those assets and liabilities beginning on January 1, 2008 and for subsequent periods, as required by Mexican FRS. Financial statements for periods prior to 2008 are presented in constant pesos as of December 31, 2007. See Item 5. *Operating and Financial Review and Prospects Effect of Inflation Accounting*.

In December 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, in an *escisión*, or split-up. See *Item 4. Information on the Company History*. The businesses we transferred to Telmex Internacional are presented as discontinued operations for dates and periods prior to the effective date of the *Escisión*, which was December 26, 2007 under Mexican FRS and June 10, 2008 under U.S. GAAP.

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| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2010[2] | 2009[2] | 2008[2] | 2007 | 2006 |
| | (2010, 2009 and 2008 in millions of pesos, previous years in millions of constant pesos as of December 31, 2007, except share and per share data) | | | | |
| **Income Statement Data:** | | | | | |
| Mexican FRS: | | | | | |
| Operating revenues | P. 113,563 | P. 119,100 | P. 124,105 | P. 130,768 | P. 129,755 |
| Operating costs and expenses | 85,146 | 84,736 | 84,362 | 86,884 | 83,491 |
| Operating income | 28,417 | 34,364 | 39,743 | 43,884 | 46,264 |
| Financing cost, net | 4,756 | 4,314 | 9,233 | 3,349 | 3,770 |
| Income from continuing operations, net of income tax | 15,371 | 20,469 | 20,177 | 28,889 | 27,701 |
| Income from discontinued operations, net of income tax | | | | 7,166 | 2,615 |
| Net income | 15,371 | 20,469 | 20,177 | 36,055 | 30,316 |
| Earnings per share[1] | 0.85 | 1.11 | 1.07 | 1.80 | 1.41 |
| Earnings per share from continuing operations | 0.85 | 1.11 | 1.07 | 1.46 | 1.32 |
| Earnings per share from discontinued operations | | | | 0.34 | 0.09 |
| Dividends paid per share (nominal)[1] | 0.490 | 0.845 | 0.413 | 0.440 | 0.403 |
| Weighted average number of shares outstanding (millions) | 18,189 | 18,383 | 18,906 | 19,766 | 20,948 |
| U.S. GAAP: | | | | | |
| Operating revenues | P. 113,563 | P. 119,100 | P. 124,105 | P. 130,768 | P. 129,755 |
| Operating costs and expenses | 86,618 | 87,128 | 85,749 | 89,983 | 87,676 |
| Operating income | 26,945 | 31,972 | 38,356 | 40,785 | 42,079 |
| Income from continuing operations, net of income tax | 14,981 | 19,818 | 19,782 | 28,985 | 27,087 |
| Income from discontinued operations, net of income tax | | | 2,173 | 6,848 | 1,081 |
| Net income | 14,981 | 19,818 | 21,955 | 35,833 | 28,168 |
| Earnings per share[1] | 0.82 | 1.08 | 1.16 | 1.79 | 1.37 |
| Earnings per share from continuing operations | 0.82 | 1.08 | 1.05 | 1.47 | 1.29 |
| Earnings per share from discontinued operations | | | 0.11 | 0.32 | 0.08 |
| Dividends paid per share (nominal)[1] | 0.490 | 0.845 | 0.413 | 0.440 | 0.403 |

*(See footnotes on following page)*

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| | December 31, | | | | |
|---|---|---|---|---|---|
| | 2010[2] | 2009[2] | 2008[2] | 2007 | 2006 |
| | (2010, 2009 and 2008 in millions of pesos, previous years in millions of constant pesos as of December 31, 2007, except share and per share data and ratios) | | | | |
| **Balance Sheet Data:** | | | | | |
| Mexican FRS: | | | | | |
| Plant, property and equipment, net[3] | P. 99,421 | P. 106,048 | P. 115,534 | P. 122,396 | P. 126,758 |
| Total assets from continuing operations | 157,754 | 178,397 | 187,125 | 172,826 | 188,182 |
| Total assets from discontinued operations | | | | | 107,366 |
| Total assets | 157,754 | 178,397 | 187,125 | 172,826 | 295,548 |
| Short-term debt and current portion of long-term debt | 11,952 | 19,769 | 22,883 | 12,282 | 9,041 |
| Long-term debt | 62,569 | 83,105 | 84,172 | 79,180 | 81,376 |
| Total stockholders equity | 44,224 | 38,321 | 39,371 | 42,159 | 121,321 |
| Capital stock | 9,009 | 9,020 | 9,139 | 9,403 | 28,011 |
| Number of outstanding shares (millions) | | | | | |
| Series AA | 7,840 | 8,115 | 8,115 | 8,115 | 8,115 |
| Series A | 383 | 395 | 407 | 430 | 446 |
| Series L | 9,935 | 9,682 | 10,033 | 10,815 | 11,642 |
| U.S. GAAP: | | | | | |
| Plant, property and equipment, net[3] | P. 100,903 | P. 108,196 | P. 118,345 | P. 126,572 | P. 132,360 |
| Total assets from continuing operations | 145,352 | 167,494 | 177,033 | 163,263 | 183,815 |
| Total assets from discontinued operations | | | | 132,191 | 87,807 |
| Total assets | 145,352 | 167,494 | 177,033 | 295,454 | 271,622 |
| Short-term debt and current portion of long-term debt | 11,952 | 19,769 | 22,883 | 12,282 | 9,041 |
| Long-term debt | 62,569 | 83,105 | 84,172 | 79,180 | 81,376 |
| Total stockholders equity | 10,447 | 7,465 | 11,309 | 122,414 | 103,195 |
| Capital stock | 9,009 | 9,020 | 9,139 | 27,231 | 28,011 |
| **Other Data:** | | | | | |
| Mexican FRS: | | | | | |
| Ratio of earnings to fixed charges[4] | 5.1 | 5.7 | 4.9 | 7.1 | 6.7 |
| U.S. GAAP: | | | | | |
| Ratio of earnings to fixed charges[5] | 5.1 | 5.6 | 4.9 | 7.0 | 6.7 |

(1) 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. At a regular meeting held on December 1, 2009, the stockholders agreed to declare an extraordinary cash dividend of P.0.40 per outstanding share, paid in a single payment on December 17, 2009.

(2) Note 1 to our audited consolidated financial statements describes accounting pronouncements under Mexican FRS that became effective on January 1, 2008, which were applied on a prospective basis. As a result, the financial statements of prior years, which are presented for comparative purposes, have not been modified and may not be comparable to our financial statements for 2008 through 2010.

(3) The caption of inventories for operation of the telephone plant, net has been reclassified as part of the caption plant, property and equipment, net.

(4) Earnings for this purpose consist of earnings from continuing operations 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.

(5) Earnings for this purpose consist of earnings from continuing operations 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 exchange rate expressed in pesos per U.S. dollar.

| Period | High | Low | Average[1] | Period End |
|---|---|---|---|---|
| 2006 | P. 10.43 | P. 11.46 | P. 10.90 | P. 10.80 |
| 2007 | 10.67 | 11.27 | 10.84 | 10.92 |
| 2008 | 9.92 | 13.94 | 11.21 | 13.83 |
| 2009 | 12.63 | 15.41 | 13.58 | 13.06 |
| 2010 | 12.16 | 13.19 | 12.67 | 12.38 |
| 2010: | | | | |
| November | 12.21 | 12.57 | 12.34 | 12.45 |
| December | 12.33 | 12.47 | 12.39 | 12.38 |
| 2011: | | | | |
| January | 12.04 | 12.25 | 12.13 | 12.15 |
| February | 11.97 | 12.18 | 12.06 | 12.11 |
| March | 11.92 | 12.11 | 12.00 | 11.92 |
| April | 11.52 | 11.86 | 11.71 | 11.52 |

Sources: The U.S. Federal Reserve Bank of New York and the U.S. Federal Reserve Board.

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

On May 6, 2011, the exchange rate was P.11.58 to U.S.$1.00, according to the U.S. Federal Reserve Board.

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.B. 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

***Competition and shifting usage patterns are adversely affecting our revenues and profitability***

Our revenues and our profitability continue to be adversely affected by increasing competition and by changes in how customers use telecommunications services. Our fixed-line network services face increasing competition from other technologies including wireless telephone service, wireless data service, cable television providers that offer telephone service, Voice over Internet Protocol (VoIP) service and others and the substitution of fixed-line telephony by these technologies. This process has adversely affected our traffic volume and our results of operations and will likely continue to do so in the future.

In addition to competition from other technologies, we also have numerous competitors in local service and in long-distance services. Governmental authorities in Mexico continue to grant new licenses and concessions to new market entrants, which results in increased competition.

The Mexican authorities have also adopted regulations to permit cable television providers 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, 2010, 32 cable television providers, through more than 300 concessions, have been authorized to provide local fixed-line voice-transmission service in various cities in Mexico. Regulations have also been adopted to allow other local telephone service providers to provide paid television and audio services, but to date we have been unable to obtain authorization to do so.

The effects of competition on our business are highly uncertain and 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 competition. Our ability to compete successfully depends 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 the commercial strategies of our 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.

***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 that limit our ability to modify our business strategy. In particular, the regulatory developments described below could adversely affect us.

Beginning 2007, the Competition Commission (*Comisión Federal de Competencia*) began eight industry-wide investigations into market power and monopolistic practices in certain segments of the Mexican telecommunications market. In four of these investigations, final resolutions have concluded that we and our subsidiary, Teléfonos del Noroeste, S.A. de C.V. or Telnor, have substantial power in the relevant markets investigated. Based on these final resolutions, the Mexican Federal Telecommunications Commission (*Comisión Federal de Telecomunicaciones*, or Cofetel) could impose specific tariff requirements or other special regulations such as additional requirements regarding disclosure of information or quality of service. We have filed petitions for constitutional protection (*amparo*) to challenge these resolutions, all of which are pending. Of the four remaining cases relating to monopolistic practices, two remain under investigation and in the other two the Competition Commission has issued a notice of probable fault *(Oficio de Probable Responsabildad)*, to which we have objected. Findings adverse to us in any of the Competition Commission proceedings may lead to the imposition of additional regulations, prohibitions or monetary penalties, which in turn could have an adverse effect on our business and results of operations.

In February 2009, Cofetel published a Fundamental Technical Plan of Interconnection and Inter-Operability, or the Fundamental Technical Plan, which requires operators with the greatest number of access points to provide other operators with access to our network on an unbundled basis that disaggregates the prices for different service elements. We believe this may result in pricing network access at rates below the recovery cost for our infrastructure investments and may have a negative impact on us and the Mexican telecommunications sector in general. In October 2009, Cofetel issued two resolutions determining that we and Telnor are operators with the largest number of access points in our respective concession coverage areas. We have filed petitions for constitutional protection (*amparo*) against the Fundamental Technical Plan and these resolutions, which are pending.

In November 2005, Cofetel issued guidelines for making changes to local service areas, including the consolidation of such local service areas. We are challenging the legality of the underlying guidelines in the Mexican courts. If the guidelines are upheld and new resolutions to consolidate our local service areas are implemented, we believe this consolidation would have an adverse impact on our revenues from long-distance service.

On April 12, 2011, Cofetel published in the *Official Gazette*, guidelines for developing cost models to be used to settle disputes regarding interconnection rates between public telecommunication networks providers. We believe that these guidelines could have an adverse impact on our revenues from interconnection services and on our operating results.

***Adverse global economic conditions and, in particular, the slowdown of the U.S. and Mexican economies, could have a negative impact on our operating results and financial condition***

Our business is influenced by general economic conditions worldwide and in Mexico. Further deterioration in the economic environment could have an adverse effect on demand for some of our products and services. The Mexican economy is influenced by the U.S. economy, so a deterioration in economic conditions or delayed recovery of the U.S. economy may hinder a recovery in Mexico. In difficult economic conditions our customers may seek to reduce discretionary spending. Under these conditions our business customers may delay purchasing decisions, delay full implementation of service offerings or reduce their use of services. Adverse economic conditions may also lead to an increase in the number of our residential and business customers that are unable to pay for services. If these events were to occur, it could have a material adverse effect on our business and results of operations.

***The ongoing uncertainty in global financial markets could adversely affect our financing costs and exposure to our customers and counterparties***

The recent instability in the global financial markets and ongoing uncertainty affecting these markets have resulted in extreme volatility in the credit, equity and fixed income markets. This volatility has limited many companies access to funding. If access to credit tightens further and borrowing costs rise, our costs could be adversely affected. Difficult financial markets may also adversely affect some of our customers, including other telecommunications carriers that pay us for interconnection and other services. In addition, we enter into derivative transactions with large financial institutions to support our

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treasury operations, including contracts to hedge our exposure to interest rates and foreign exchange, and we could be adversely affected by severe financial difficulties faced by our counterparties.

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

The telecommunications industry is subject to 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.

***Developments in the telecommunications sector may result in substantial write-downs of the carrying value of certain of our assets***

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

***A network 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 physical damage to our network, natural disasters such as hurricanes, earthquakes, floods and storms, among others, and other disruptions beyond our control. Although we carry casualty insurance against loss and we have implemented redundancy in our network and installed backup technologies, disruptions may cause interruptions in service or reduced capacity for customers, either of which could cause us to lose customers and revenues or incur additional expenses.

***We are exposed to currency and interest rate risk on our debt, and we have entered into derivatives contracts to limit these risks***

A substantial part of our indebtedness is denominated in U.S. dollars, and we have relatively limited assets and revenues denominated in U.S. dollars. As of December 31, 2010, our U.S. dollar-denominated indebtedness amounted to P.40,853 million. In addition, a substantial part of our indebtedness bears interest at variable rates. As a result, we are exposed to risks from changing currency exchange rates and interest rates.

To offset these risks, we enter into derivative financial instruments with large financial institutions to minimize the impact of fluctuations in exchange rates and variable interest rates on our indebtedness. We have not entered into derivative financial instruments for any other purposes, although we may do so in the future. The types of derivative instruments we have typically entered into in recent periods include cross-currency swaps (in which we generally pay peso amounts based on peso interest rates and receive U.S. dollar amounts based on dollar interest rates), interest-rate swaps (in which we generally pay amounts based on fixed interest rates and receive amounts based on variable interest rates) and forward exchange contracts (in which we generally agree to use pesos to purchase U.S. dollars at a future date).

Our derivative financial instruments do not provide complete protection against the exchange rate or interest-rate risk of our indebtedness. We may determine that the risks are acceptable or that the protection available through derivative financial instruments in the market is insufficient or too costly. These determinations depend on many factors, including market conditions, the specific risks in question, and our expectations concerning future market developments. We review and change our derivatives positions regularly, and our hedging policies change from time to time.

When the financial markets are volatile, as they have been in recent periods, our results of operations may be substantially affected by variations in exchange rates and, to a lesser degree, interest rates. These effects include foreign exchange gain and loss on assets and liabilities denominated in U.S. dollars, fair value gain and loss on derivative financial instruments, and changes in interest income and interest expense. These effects can be much more volatile than our operating performance or our operating cash flows.

We attempt to match the cash flows on our derivative financial instruments with the cash flows on our indebtedness. The net effects on our reported results in any period are difficult to predict and depend on market conditions and on the specifics of our derivatives positions. For example, in 2010 the peso appreciated against the U.S. dollar by 5.4%. As a result, in 2010, we recognized a net exchange gain on our U.S. dollar denominated debt and a net fair value loss on currency derivatives. In 2010, we also recognized lower interest expense due to a lower average level of debt.

Our derivative financial instruments are also subject to the risk that counterparties will default or seek bankruptcy protection. The instability and uncertainty in the financial markets has made it more difficult to assess the risk of counterparties to derivatives contracts. Moreover, in light of the greater volatility in the global securities and exchange markets, there may be fewer financial entities available with which we could continue entering into derivative financial instruments to protect against currency and interest rate risks.

***Substantially all our business is in Mexico, so we are affected by adverse economic or political conditions in Mexico***

Substantially all of our business operations and assets are located in Mexico. Our financial performance may be affected by general economic, political and social conditions in Mexico. 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. Mexico has also experienced high levels of inflation and high domestic interest rates in the past, which significantly lowered the purchasing power of consumers and businesses. Mexico began to enter a recession in the fourth quarter of 2008, during which GDP fell by approximately 1.6%. GDP fell by an additional 6.5% in 2009. By 2010, GDP rose by 5.5%. If the Mexican economy experiences a downturn 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.

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***Our corporate restructuring may affect our stock price***

On April 4, 2011, we announced that at the extraordinary meeting held on that date, our shareholders approved a corporate restructuring which contemplates the creation of a subsidiary company that will provide telecommunications and interconnection services in rural areas where our fixed telephony competitors have not invested. The subsidiary company will be named Telmex Social. This may affect our stock price. The restructuring is subject to the authorization and confirmation of the applicable governmental authorities as well as the authorizations required under the Mexican companies law.

**Risks Relating to Our Controlling Shareholder and Capital Structure**

***We are controlled by one shareholder***

A majority of the voting shares of our company (74.1% as of February 24, 2011) is owned by América Móvil, S.A.B. de C.V., or América Móvil, indirectly through Carso Global Telecom, S.A.B. de C.V., or Carso Global Telecom. América Móvil 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. América Móvil may be deemed to be controlled by Carlos Slim Helú and members of his immediate family, who, taken together, own a majority of the common stock of América Móvil.

***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, our directors or our 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) América Móvil and its subsidiaries, (b) Grupo Carso, S.A.B. de C.V., or Grupo Carso, and its subsidiaries and (c) Grupo Financiero Inbursa, S.A.B. de C.V., or Grupo Financiero Inbursa, and its subsidiaries. Our transactions with América Móvil include interconnection between our respective networks and the completion of international traffic in each other s countries of operation, América Móvil s printing and distribution of our directories and América Móvil s access to our customer database and our billing and collection system in connection with its directories business. In addition, we recently entered into loan agreements with América Móvil. Transactions with Grupo Carso include the purchase of network construction services and materials, and transactions with Grupo Financiero Inbursa include financial services and insurance. We also have agreements with AT&T International that provide for the completion of calls in our respective countries of operation.

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.

***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.

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***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, all or a substantial portion of our assets and the assets of our directors, officers and controlling persons 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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**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 94.7% of our 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 our broadband Internet access service by 12.8% in 2010 to 7.4 million. At the same time, we are extending our voice and Internet access services to remote areas.

In 2010, 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 in order to provide our customers with packages that combine voice, data and eventually video.

We intend to provide paid television and audio services and to expand our multi-service products to include triple play packages, which would include telephone, Internet access and paid television services in a single subscription. However, we have not been able to obtain the regulatory authorization we need to offer television and audio services. A Convergence Agreement (*Acuerdo de Convergencia*), issued in October 2006 by the Communication Ministry, established the requirements that market participants must meet to foster full convergence of telephone, Internet and television services in Mexico. Even though we believe we have met all the requirements, we still do not have authorization to offer television and audio services, and we believe that this situation is negatively affecting the technological development of our country.

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 continue selling computer equipment at our Telmex stores and increase the Internet penetration rate in Mexico.

We are a Mexican corporation headquartered in Mexico City, 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 México, D.F., México. Our telephone number at this location is (52) 55 5222 1774. Our website can be accessed at www.telmex.com.

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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.

**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 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. In December 2007, we transferred our Latin American and yellow pages directory businesses to a new, separate entity, Telmex Internacional, in a second *escisión*, or split-up (the *Escisión*). 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 by our shareholders on December 21, 2007. The establishment of Telmex Internacional became effective on December 26, 2007. As of the effective date of the *Escisión*, 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, the shares and ADSs of Telmex Internacional began trading separately from our shares and ADSs on the Mexican Stock Exchange and the New York Stock Exchange.

In May 2010, América Móvil launched two separate but concurrent public exchange offers to acquire the outstanding capital stock of Carso Global Telecom and Telmex Internacional. At that time, Carso Global Telecom was the direct holder of 59.4% of the outstanding capital stock of Telmex. In June 2010, América Móvil completed its first public exchange offer. Through this offer, América Móvil directly acquired 99.4% of the outstanding capital stock of Carso Global Telecom and indirectly acquired 59.1% of the outstanding capital stock of Telmex. In November 2010, América Móvil launched a second public exchange offer, which was completed in December 2010, and increased América Móvil´s indirect ownership of the outstanding capital stock of Telmex to 59.5%. América Móvil may be deemed to be controlled by Carlos Slim Helú and members of his immediate family.

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On April 4, 2011, we announced that at the extraordinary meeting held on that date, our shareholders approved a corporate restructuring which contemplates the creation of a subsidiary company that will provide telecommunications and interconnection services in rural areas where our fixed telephony competitors have not invested. The subsidiary company will be named Telmex Social.

Telmex Social will provide services mainly in rural areas. A substantial number of Mexican migrant workers hail from these rural areas and make telephone calls to these places. These areas have high call termination volumes from the United States, where negotiated interconnection rates have declined 95% since 1990. These interconnection rates are lower than those charged in many other countries, particularly taking into account that most of these areas are remote and sparsely populated.

Considering that these regions experience significant economic and social disadvantages, we expect that this restructuring will promote access to telecommunications services by demonstrating the importance of both investing in the expansion and modernization of these services and encouraging the growth of digital culture. This should improve the quality of life of rural inhabitants and integrate rural communities into Mexico s socio-economic development.

Telmex Social s network infrastructure could be complemented with investments from other telecommunications operators and, if the Mexican federal government approves, with investments and support for providing access to voice, data, and video from both the Mexican federal government and decentralized public sector companies.

The interconnection rates to be determined by Telmex Social will be the same for all telecommunications operators, including Telmex.

We estimate that Telmex Social will serve approximately 1.5 million lines, with a density of 14.8 inhabitants per line, located in 10,453 communities which are not being served by competitors. The local service areas of Telmex Social comprise approximately 40% of the country where there are more than 22 million inhabitants.

The restructuring is subject, if needed, to the approval of the Communications Ministry, as well as the authorization and confirmation of the rest of the corresponding authorities and government entities.

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**Significant Subsidiaries and Investees**

The following table sets forth our significant subsidiaries and affiliated companies accounted for using the equity method at December 31, 2010:

| 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% | Intermediate holding company. |
| Alquiladora de Casas, S.A. de C.V. | Mexico | 100% | Real estate company owning our facilities. |
| Compañía de Teléfonos y Bienes Raíces, S.A. de C.V. | Mexico | 100% | Real estate company owning our facilities. |
| Consorcio Red Uno, S.A. de C.V. | Mexico | 100% | Supplier of telecommunications network integration services and information systems. |
| Teléfonos del Noroeste, S.A. de C.V. | Mexico | 100% | 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% | Provider of corporate networks and Internet access services to Telmex and corporate customers. |
| Telmex USA, L.L.C. | Delaware | 100% | Authorized long-distance service re-seller, provider of prepaid telephone cards and payment collection services for lines in Mexico (installation and monthly rental), and authorized by the FCC to provide facility-based long-distance services, data transmission and cross-border data transit services. |
| **Affiliated companies** | | | |
| Grupo Telvista, S.A. de C.V. | Mexico | 45% | Provider of telemarketing services in the United States and Mexico. |

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## OPERATIONS

Of our revenues in 2010, 36.1% was attributable to local service, 15.8% to long-distance service, 13.2% to interconnection and 29.0% to data services. Other services, including primarily sales of computers, telephones and accessories at Telmex stores and billing and collection services to third parties, which accounted for 5.9% of revenues.

### Overview

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

| | December 31, | | | | |
|---|---|---|---|---|---|
| | 2010 | 2009 | 2008 | 2007 | 2006 |
| Internet access accounts (thousands) | 7,449 | 6,651 | 5,217 | 3,320 | 2,660 |
| Billed lines (thousands) (1) | 15,591 | 15,882 | 17,589 | 17,800 | 18,251 |
| Total local calls (millions) | 19,261 | 20,835 | 22,583 | 24,892 | 26,575 |
| Domestic long-distance call minutes for the year (millions) | 18,292 | 19,837 | 19,687 | 18,275 | 18,108 |
| International long-distance call minutes for the year (millions)(2) | 8,887 | 7,526 | 8,733 | 9,531 | 8,997 |

(1) Until 2008, includes lines with at least two months behind on bill payments.

(2) Includes incoming and outgoing traffic.

### Local Service

We are a nationwide provider of local telephone service in Mexico. We provide local telephone service to 23,194 communities throughout Mexico. Of all lines in service, 31.4% are in the Mexico City, Monterrey and Guadalajara metropolitan areas, with 21.4% in the Mexico City metropolitan area alone. We provide service to 21,733 communities with fewer than five thousand inhabitants, exceeding our obligations to extend services to rural areas.

Local traffic in 2010 decreased by 7.6% compared to 2009, for a total of 19,261 million calls. The decrease in traffic in 2010 was attributable primarily to a smaller number of billed lines as a result of the competition from mobile phone operators, fixed-line local service providers and cable television providers, the change in the consumption profile of our customers, as well as the migration of switched traffic to corporate networks, virtual private networks, VoIP and other alternative service offerings. We expect that further market penetration by alternative service offerings and increasing competition will continue to adversely affect 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.

In order to promote local service among our customers, we have introduced multi-service offers that include unlimited local and domestic long-distance calls. We also have introduced packages of

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telecommunications services that include a certain number of local calls and/or minutes for domestic long-distance. In 2010, 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 31.2 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 decreased 7.8% in 2010 and increased 0.8% in 2009, reaching a total of 18,292 and 19,837 million minutes, respectively. The decrease in domestic long-distance traffic in 2010 was primarily due to the decrease in traffic delivered by mobile operators and other long distance operators to us for completion.

We expect that further market penetration by alternative service offerings and increasing competition will continue to adversely affect domestic long-distance service growth.

Our rates for domestic long-distance service are based on call duration and type of service (direct-dial or operator-assisted) once customers exceed the number of minutes included in their service packages.

We offer a variety of domestic long-distance discount plans that reduce the effective rates paid by our customers based on their total monthly consumption and whether calls were made at peak or off-peak times. We also offer plans that include a certain number of minutes at no extra cost or include unlimited minutes.

In 2010 we did not increase our rates for domestic long-distance calls. This continues our trend of offering lower rates in real terms 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 2010, incoming international long-distance traffic increased by 21.2%, for a total of 7,482 million minutes, and outgoing international long-distance traffic increased by 3.9% for a total of 1,405 million minutes.

We believe international long-distance traffic has been affected by, among other things, the increased 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. International long-distance traffic generated by mobile phone companies also affects our revenues.

Charges for international long-distance calls are based on call duration, type of service (direct-dial or operator-assisted) and the destination of the call once customers exceed the number of minutes included in their plan. Customers can choose from a variety of discount rate plans.

In 2010, we did not increase our rates for international long-distance calls, continuing our trend of offering lower rates in real terms every year since March 1999.

Bilateral agreements with foreign carriers govern the rates we pay to foreign carriers for completing international calls from Mexico and the rates foreign carriers pay 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.

**Interconnection**

We provide interconnection services pursuant to which (a) long-distance, local and mobile phone 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 that other long-distance carrier s network. Excluding the calling party pays service, we have only one rate for interconnecting all categories of carriers and all types of calls. As a result of Mexico s bill and keep system, under which local carriers and cable television providers do not pay interconnection fees to other local carriers, we do not receive an interconnection fee from these calls.

In 2010, interconnection traffic decreased 0.8%, for a total of 43,008 million minutes, and fell by 5.7%, for a total of 43,367 million minutes, in 2009. The decrease in 2010 was the result of a decrease in interconnection minutes of long distance carriers offset by an increase in minutes for the interconnection of local operators. 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. Without local bypass, we would receive a domestic termination fee for completing these incoming calls. Although we have requested regulatory intervention to eliminate local bypass, we believe our interconnection revenues will continue to be adversely affected by what we consider to be an unlawful practice.

**Data services**

Our data service business is comprised of corporate network services and Internet access service.

Corporate networks consist of the transmission of voice, video and data between two or more end points using private circuits. Our principal product offerings for corporate networks are *Ladaenlaces* (Ladalinks) and Multi-service Virtual Private Networks, which allows us to provide different levels of service for voice, data and video applications. We also provide specialized assistance and technical support for these applications.

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We provide network outsourcing services that include maintenance, support and integration of communication networks and information systems.

Internet access services connect both business and residential customers to the Internet through either a dial-up or a broadband connection. In 2010, the number of our Internet customers increased to approximately 7.5 million at year-end, an increase of 12.0% compared with 2009.

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 2010, as a result of improved ADSL service packages and a price reduction that took effect in April 2007, we increased our ADSL customer base by approximately 835 thousand accounts. At year-end 2010, we had 7.4 million ADSL customer accounts, an increase of 12.8% over 2009. For *WiFi Móvil in Infinitum*, our high-speed wireless service for residential and business customers, during 2010 we increased the speed of access links. At December 31, 2010, we maintained public hot spots (more than 3,500) in over 225 cities in Mexico, provided coverage at approximately 95% of commercial airports in Mexico, and entered into international agreements to provide our customers with Internet access at over 200,000 sites worldwide.

In October 2010, we began the marketing of 20 Mbps Internet access for residential customers.

**Telecommunications Services Packages**

Consistent with our strategy of retaining our current customers and maximizing the value of residential and business Internet accounts, in 2010 we continued to offer flexible plans permitting Infinitum customers to create their own individualized packages of additional voice services, including a combination of local and long-distance calls.

In March 2008, we introduced a plan that includes a monthly line rental, broadband Internet access, 200 local calls, unlimited minutes of domestic long-distance service, six digital services and special rates for international long-distance calls, for a fixed monthly payment. In June 2008, we launched a plan aimed at low-income residential customers for a lower monthly price that includes a monthly line rental, 100 local calls, 100 domestic long distance minutes, six digital services, and special rates for long-distance calls.

In June 2009, we began to double the speed for the following high speed Internet access packages: Paquete Conectes en Infinitum , Paquete Acerques and Paquete Todo México sin Límites . In addition, Paquete Todo México sin Límites had its free international long-distance minutes to the U.S. increased from 200 minutes to 300 minutes.

**Other Products and Services**

We provide various telecommunications and telecommunications-related products and services that include sales of computers, telecommunications equipment and accessories, public phones and billing and collection services to third parties.

In July 2009, we launched a new financing offer for computer equipment under which, for a small down payment and a monthly fee of only P.100, customers can acquire home computers.

In November 2008, we entered into several agreements with Dish México and its affiliates, which operate a direct-to-home (DTH) pay television system in Mexico. We are currently providing customary billing and collection services, customer equipment and access to the Telmex retail distribution network. Subject to specified authorizations, we could invest directly in a joint venture with Dish.

***Telmex Stores***

We use our network of 388 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, which may be purchased outright or through installment payment plans. 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 source of revenue. Our computer sales strategy, including store financings of up to 36 months, has substantially helped increase broadband coverage in Mexico.

***Billing and Customer Service***

Our invoices detail the number and destination of local and long-distance calls made, and charges for other services. On our website (www.telmex.com) our customers can view their statements in detail: SI@NA for corporate customers and Mi Telmex for residential and commercial customers. On our website we provide information about our services, corporate information and access to online transactions such as order services and the payment of invoices.

We provide support to our customers through our customer service centers, call centers and our website. We service our corporate clients through our integrated service plans that can be customized to meet the specific needs of individual clients. We assign specialized staff to service large corporate clients.

We also offer billing and collection services to other companies through our phone bill. We currently provide billing and collection services to companies such as Medicalhome, Socio Águila, Teletón, Telecomunicaciones de México and Dish México.

***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 661 thousand fixed-line public telephones in operation at December 31, 2010. In the increasingly competitive market to provide telecommunications services, independent operators have installed public telephones for which we provide access. There were more than 91 thousand independently operated public telephones at December 31, 2010, an increase of 4.4% compared with 2009.

In 2010, we sold 43.7 million prepaid cards under the brand name Ladatel for use in public phones, a decrease of 28.0% from 2009, and 19.5 million prepaid cards under the brand name Multifón for use in public and residential telephones, a decrease of 12.2% from 2009.

**Operations in the United States**

Our U.S. subsidiary, Telmex USA, L.L.C., or Telmex USA, holds a facilities-based authorization from the U.S. Federal Communications Commission permitting Telmex USA to install and operate telecommunications facilities in the United States. Telmex USA offers data transmission and cross-border data transit services. 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. We sold our 13.0% interest in 2Wire in October 2010.

**Network**

Through our network we offer many advanced services that include voice, data and video transmission, Internet access and integrated solutions to all types of customers. These services encompass public, rural and residential telephony; specific solutions for small and medium sized commercial customers; and integrated offers for large domestic and international corporations.

Our local and long-distance fiber optic network consists of 112,570 kilometers, reaches more than 90% of Mexico s population, connects the major cities in Mexico and connects Mexico via submarine cables with 28 other countries. Our network included 15.6 million local fixed billed lines at December 31, 2010, a decrease of 1.8% compared to December 31, 2009.

Our network consists of five principal components: (i) an access network, which includes access to end customers via cable, copper, fiber-optic or wireless transmission; (ii) a switch network, which controls communications and services; (iii) a transport network, which transmits information between the nodes of our network; (iv) a convergent network, which allows us to provide integrated services of voice, data and video through a common platform based on IP, and (v) a management network, which allows us to verify the performance of our networks and services in real time.

***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 plus, or ADSL2+, which allows us to use existing telephone lines at speeds close to 20 Mbps and VDSL 2 (Very High Speed Digital Subscriber Line version 2), which allows speeds of 20 Mbps or higher. Currently we are offering high speed Internet access with speeds of up to 20 Mbps to our residential customers.

Access by fiber-optic is available to our corporate customers for broadband multi-services with robust and highly reliable solutions. We offer dedicated services with speeds from 64 kbps to 1 Gbps and are incorporating services of N x 1 Gbps and 10 Gbps, using conventional connections as well as Ethernet.

Access by fiber-optic is increasing for our residential customers. We have installed fiber optic lines based on the Fiber to the Node and Fiber to the Building models as part of our strategy to increase the bandwidth available for all our customers by extending our fiber-optic lines and reducing the length of our external copper network.

In the second half of 2010 we began the deployment of fiber optic penetration stage at the client s premise (Fiber To The Home or FTTH). This has allowed us to offer Internet access and a range of new broadband services at speeds of 20 Mbps or higher since the first half of 2011. The fiber optic penetration scenario in conjunction with the GPON (Gigabit Passive Optical Network) technology, will enable us to gradually replace our copper infrastructure with fiber optics.

We also have wireless access platforms that are supported by radio direct access and multiple access systems, WLL (Wireless Local Loop) systems, Wimax systems as well as satellite systems to

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provide voice, data and Internet access services to customers who are geographically remote from our fiber optic infrastructure.

***Switch Network***

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 currently can manage close to 50 applications and value-added services with high levels of reliability. Furthermore, this platform is capable of implementing new services and applications throughout our network in a short amount of time. As part of our network evolution, we have installed a centralized control platform based on the IMS (Internet Multimedia Subsystem) model. The aim of this new platform is to offer new multimedia services to our customers.

***Transport Network***

In 2010 we consolidated the national deployment of transport equipment with Carrier Ethernet technology, which provides us with a solution of native and highly efficient transport for services based on Internet protocol (IP) and Ethernet, consolidating a convergent platform All IP to support the growth of multimedia services. This network is the best and most efficient extension of network IP/MPLS from the core of our infrastructure to access premises.

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.

In order to increase our transmission capacities, we also 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 400 Gbps over one optic fiber pair, equivalent to managing more than 4.8 million simultaneous telephone conversations.

We have introduced optical cross-connect technology equipment, which enables the interconnection of signals transported optically, allowing us to connect the signals transmitted by fiber more effectively in the network.

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

***Convergent Network***

Part of our core network operates under a *Next Generation Network* architecture that uses a format of switching information packages 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. It allows us to provide voice, data and video services with different 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.

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All of our IP-based services are offered through a multi-service 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, with 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. The technology used in our network provides the necessary flexibility to offer speeds of access from 64 Kbps to 155 Mbps for virtual private multiservice network or IP VPN s.

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 efficiently offer a wide variety of services such as Internet access for residential and corporate customers, corporate networks, VoIP, wireless access and multimedia applications.

***Management Network***

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 comply with the Service Level Agreements required by our business customers.

During 2010, in order to be consistent with the evolution of telecommunications towards the next generation network and ensure continuity of service, we integrated our model of operational management, strengthened our centralized operations and consolidated on a firm-wide basis an approach of attention to customers.

**Competition**

We face competition from a large number of market participants using a variety of technologies to address different elements of the demand for telecommunications services. Currently our principal competitors include: holders of long-distance licenses; holders of licenses to provide fixed-line local service, of which Axtel and Maxcom are the largest; cable television operators with licenses to provide telephone and internet services, led by Megacable, Cablevisión and Cablemás; and the mobile telecommunications operators, of which Telcel and Movistar are the largest.

The Mexican telecommunications market is increasingly complex, and the barriers between formerly distinct markets are eroding as a result of regulatory and technological change. While we have a strong share in certain segments of the local fixed-line, such as switched local service, long-distance service or broadband data connections, our overall share of the telecommunications market is difficult to evaluate. For example, according to Select Estrategia, S.C., a leading market research firm in Mexico, at year-end 2010 we had approximately 15.6 million billed lines in service in our network, while mobile phone carriers had an estimated combined total of 90.0 million mobile lines in service. At the same date, the other local fixed-line operators, mobile fixed-line operators and cable television providers, together, had approximately 4.3 million fixed lines in service, an increase of 11.9% over the previous year.

We anticipate continued intense competition as mobile phone carriers promote mobile-to-mobile calls and text messages as less expensive 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.

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## 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 Vías 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 the regulations and oversight by the Agency for Consumer Protection (*Procuraduría Federal del Consumidor*) and the Competition Commission.

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 federal government agency principally responsible for regulating telecommunications services. Approval from the Communications Ministry 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 was established by the Federal Telecommunications Law as a separate administrative body that enjoys operative, budgetary and management independence from the Communications Ministry. Cofetel is charged with the regulation, promotion and supervision of the telecommunications and radio broadcasting markets in Mexico, with full autonomy to issue its own resolutions. Cofetel is headed by five commissioners appointed by the President of Mexico, one of whom serves as chairman. Many of the faculties and obligations of the Communications Ministry under the Federal Telecommunications Law and the Telecommunications Regulations were transferred 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 must inform 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. Currently set to expire in 2026, our Concession may be extended for an additional 15-year term. Our subsidiary Telnor holds a separate concession in a region located in two states in northwestern Mexico, which will also expire in 2026 and may be extended for an additional 15-year term thereafter. 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.

**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 that 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.

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;

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- Transfer or assignment without the 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 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.

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**Competition**

The Telecommunications Regulations and the Concession contain various provisions designed to foster 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 18 competing long-distance carriers operating in Mexico (including Telmex and Telnor), all of which also have concessions for international long-distance services.

As of December 31, 2010, there were 35 local fixed-line licensees (including Telmex and Telnor), three of which also hold local wireless licenses (including Telmex). Fixed local competitors are operating in 133 local service areas covering the main cities of the country, like Mexico City, Guadalajara, Monterrey and Puebla. See *Operations Competition*. Concessionaires are not required to operate certain private local telecommunications networks or to provide value-added services, although other authorizations may be required.

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.

The Communications Ministry has greatly expanded the ability of cable television operators to compete with us. Since 2003, it has permitted them to provide bidirectional transmission of data. Since 2004, it has permitted them to provide signal-transmission services to local fixed-line operators and data and broadband Internet access services to the public. Since 2006, it has permitted some of them to provide fixed-line local telephone services. See *Regulation Television and Audio Services*.

We also experience competition from unregulated sources. For example, some operators offer VoIP services, although the application of current regulations to these services is unclear.

The competitive environment in the Mexican telecommunications market has been the subject of controversy and of attention from Mexican regulators and from abroad. In the past, 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. These resolutions and regulations were later held invalid and were nullified by Mexican federal courts. The Competition Commission also has repeatedly ruled that we have engaged in certain monopolistic practices. Most, but not all, of these past Competition Commission rulings also have been declared null and void by federal courts or have been withdrawn by the Competition Commission. The Competition Commission is currently conducting investigations relating to monopolistic practices and recently issued final resolutions concluding that we and Telnor have substantial power in certain markets. See *Regulatory Initiatives Relating to Competition* below and *Item 8. Financial Information Legal Proceedings*.

In 2005, Mexico resolved a WTO dispute brought by the United States by adopting regulations authorizing resale of outgoing international and domestic long-distance service, adding to the downward pressure on the rates we charge our customers for our long-distance services.

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**Regulatory Initiatives Relating to Competition**

The Federal Telecommunications Law provides that, if a company is determined to have substantial market power in a relevant market, the Communications Ministry may adopt specific regulations on rates, quality of service and information to be provided by the dominant company. In addition, if a company is determined by the Competition Commission to have engaged in monopolistic practices, it may be subject to prohibitions or monetary sanctions.

Beginning 2007, the Competition Commission began eight industry-wide investigations to determine whether any operators, including Telmex and certain of its affiliates, possess substantial market power or are engaged in monopolistic practices in certain segments of the Mexican telecommunications market. Four final resolutions have determined that, in the geographic areas covered by our network, Telmex and Telnor have substantial power in the following markets: (i) switched call completion provided to other concessionaires of local and long-distance service; (ii) call origination offered to other concessionaires of long-distance service; (iii) transit services offered to concessionaires of local and long-distance services in 198 areas of local service that such concessionaires cover; and (iv) certain wholesale markets for dedicated, leased local and domestic long-distance links, as well as the wholesale markets for dedicated, leased international long-distance and interconnection. We and Telnor filed administrative appeals with the Competition Commission for reconsideration of these four resolutions, which were rejected. As a result, we filed petitions for constitutional protection (*amparo*), which are pending.

If the four final resolutions are upheld, Cofetel could impose specific tariff requirements or other special regulations such as additional requirements regarding disclosure of information or quality of service. We cannot predict the form any such regulations will take or their impact on our business, but we believe they would reduce our flexibility and ability to adopt competitive market policies. We also cannot predict the timing of the proposed adoption of any such regulations, or whether we will be able to challenge their implementation.

In two of the remaining cases, the Competition Commission is investigating whether we engaged in monopolistic practices in the following markets: (i) interconnection service in fixed networks; and (ii) interurban transport for exchanged long-distance traffic, the Competition Commission issued a notice of probable fault *Oficio de Probable Responsabildad*, to which we objected. With respect to the remaining two cases, which are still pending, the Competition Commission is investigating whether we engaged in monopolistic practices in the following markets: (i) broadband Internet access service for residential customers in Mexico and (ii) wholesale markets for dedicated, leased local and domestic long distance links. Findings adverse to us in any of the Competition Commission proceedings may lead to the imposition of regulations, prohibitions or monetary penalties on us and we cannot predict their outcome.

**Television and Audio Services**

The regulatory framework governing the provision of television and audio services by telecommunications companies and of telecommunications services by television and audio providers has been the subject of an ongoing amendment process since 2003. The outcome of this process and the resulting changes in the regulatory framework may affect our business.

In 2003, the Communications Ministry expanded the concessions granted to cable television operators to permit them to provide bidirectional transmission of data. 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.

In April 2006, the Mexican Congress approved an amendment to the Federal Telecommunications Law and the Federal Radio and Television Law. 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. In June 2007, the Mexican Supreme Court (*Suprema Corte de Justicia de la Nación*) declared various provisions of the law invalid, 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 permit paid television and audio concessionaires to provide fixed-line local telephone services and local telephone service providers like us to provide paid television and audio services. These regulations facilitate the convergence of voice, data and video services into one integrated product that could be delivered over a broadband network. The regulations allow concessionaires to provide these new services, subject to certain regulatory steps to be taken by Cofetel. As of December 31, 2010, 32 cable television providers, through more than 300 concessions, provide or have been authorized to provide local fixed-line voice-transmission and one fixed-line local service provider offers paid television services. In the case of Telmex, due to certain restrictions on our concession, additional conditions have been imposed, 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. Telephone number portability was initiated in July 2008, allowing customers to change their telephone provider and keep their telephone number. We intend to provide television and audio services and we believe we have met all the requirements necessary to do so; however, to date we have been unable to obtain authorization.

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.

**Consolidation of Local Service Areas**

In November 2005 Cofetel issued guidelines for making changes to local service areas, including the consolidation of such local service areas. We contested these guidelines in an administrative proceeding that was rejected by the Communications Ministry. We subsequently challenged the legality of the guidelines before the Third Metropolitan Regional Federal Court of Justice for Tax and Administrative Matters, which is pending. In addition, beginning in March 2007 Cofetel issued several resolutions pursuant to these guidelines to consolidate 198 local service areas, reducing the number of local service areas from the current total of 397. These resolutions were nullified by a federal court in November 2009. If the guidelines are upheld and new resolutions to consolidate our local service areas are implemented by Cofetel, we believe this consolidation could have an adverse impact on our revenues from long-distance service. See *Item 8. Financial Information Legal Proceedings*.

**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 get permission from Cofetel before our rates can 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 (minus a productivity factor set for the telecommunications industry), 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, voice mail, as well as three-way conference and call transfer.

In June 2010, pursuant to the terms of the Concession, we provided Cofetel with a study and proposal of rates for basic telephone services that would apply during the 2011-2014 period. Cofetel decided that our proposal would be submitted for review to a panel of three experts. One expert was selected by Cofetel, another was selected by Telmex, and the third expert will be selected by mutual agreement.

**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.

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. In 2002, we agreed with competing long-distance carriers to set an interconnection rate of U.S.$0.00975 per minute and per interconnection point. This rate will remain in effect so long as we and the other carriers do not agree to set a new rate.

As of December 31, 2010, we have entered into interconnection agreements with all operators that have requested interconnection services. Nevertheless, in 2008, Cofetel notified us of several resolutions to reduce interconnection and transit rates, and to eliminate resale charges. We have appealed these resolutions and a final determination is pending. We will continue collecting the rates that have been applied since 2002 until these proceedings are concluded.

In Mexico, under the calling party pays service, our fixed-line customers pay us an interconnection charge when they call a mobile telephone, and during 2010 we paid 66.2% of that amount to the mobile phone 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

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and international long-distance calls, while concurrently eliminating the fee that mobile phone carriers charge their customers for receiving long-distance calls from fixed-line and mobile callers.

In February 2009, Cofetel published the Fundamental Technical Plan, which requires operators with the greatest number of access points to provide other operators with access to our network on an unbundled basis that disaggregates the prices for different service elements. This plan could have a negative impact on us and on the telecommunications sector in general, since it establishes additional obligations to concessionaries. In particular, we believe this may result in pricing network access at rates below the recovery cost for our infrastructure investments. In October 2009, Cofetel issued two resolutions determining that we and Telnor are operators with the largest number of access points in our respective concession coverage areas. We have filed petitions for constitutional protection (*amparo*) against the Fundamental Technical Plan and these resolutions, which are pending.

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## CAPITAL EXPENDITURES

The following table sets forth, our capital expenditures, before retirements, for each year in the three-year period ended December 31, 2010. Like other financial information in this annual report, the amounts shown below for capital expenditures reflect only our continuing operations and include only the investments corresponding to each year.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| | (In millions of pesos) | | |
| Data, connectivity and transmission network | P. 5,955 | P. 6,061 | P. 7,506 |
| Internal plant | 475 | 334 | 608 |
| Outside plant | 918 | 753 | 851 |
| Information Technologies | 309 | 165 | 319 |
| Other | 2,931 | 1,685 | 797 |
| Total capital expenditures | P. 10,588 | P. 8,998 | P. 10,081 |

In 2010, our total capital expenditures increased by 17.7%. Our consolidated capital expenditures totaled P.10.6 billion (U.S.$839.6 million) in 2010. The investments in our data, connectivity and transmission networks as a percentage of our consolidated capital expenditures (P.5.9 billion or U.S.$472.2 million in 2010) was 56.2% in 2010, 67.4% in 2009 and 74.4% in 2008.

We have budgeted capital expenditures in an amount equivalent to approximately P.10.8 billion (U.S.$871.0 million) for the year 2011, of which 72.6% (P.7.9 billion or U.S.$632.0 million) are budgeted for investments in our data, connectivity and transmission network. Budgeted capital expenditures for 2011 exclude any other investments we may make to acquire other companies. For subsequent years, our capital expenditures will depend on economic and market conditions. If we receive authorization to provide triple-play services, we will evaluate whether to increase our capital expenditures to invest in related equipment. Our budgeted capital expenditures are financed through operating cash flows and limited borrowing.

## 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.

In May 2010, we acquired for P.296 million the 51.5% equity interest in Scitum, S.A. de C.V. (Scitum), which offers services in the design, implementation and management of infrastructures of security of information in Mexico.

### 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 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**

In 1996, we helped create the Telmex Foundation (*Fundación Telmex, A.C.*), 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 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 consolidated financial statements under U.S. GAAP.

**Overview**

Our total revenues have fallen in recent years, as declining average revenues from local, interconnection and long-distance services have been only partly offset by increasing revenues from the data and other businesses. In response to competitive market pressures, we have not raised our nominal rates since 2001, and we have given discounts for our services, particularly domestic long-distance. Revenues have also declined partly because of the wide range of voice services included in our packages with Infinitum ADSL services that include preferential rates.

Competition and changing technologies have had important effects on our financial performance. We expect continued pressure on prices for basic telephone services. In local service, rapid growth in mobile telecommunications has made mobile phone operators the main competitors for local networks. In addition, local and long-distance services face competition from other means of communication such as cable providers, private circuits and the Internet, including VoIP. On the other hand, the number of our broadband Internet access subscribers (Infinitum ADSL) grew by 12.8% in 2010 and 30.2% in 2009, and we expect that it will continue to grow and might affect the usage of other services.

Our mix of revenues has been changing as a result. Revenues from voice services represented 65.1% of our total revenues in 2010 compared to 69.2% in 2009, while revenues from data services represented 29.0% of our total revenues in 2010 compared to 25.9% in 2009. These changes have also affected our profit margins. In 2010, total revenues decreased by 4.6% and our operating income decreased by 17.3%. In 2009, total revenues decreased by 4.0% and our operating income decreased by 13.5%. Our operating margin decreased to 25.0% in 2010 from 28.9% in 2009 because of the changing mix of our revenues.

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We expect that our revenues attributable to voice services will continue to decline as a result of continued pressure on prices and continued migration of customers to mobile and alternative products. We expect our revenues from data services will continue to increase as a percentage of our total revenues as demand for integrated telecommunications solutions among corporate customers and Internet penetration rates among residential and commercial customers continue to rise. We expect that the decline in revenues from voice services will be partly offset by an increase in data services revenues.

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 contribute to the volatility of our financing cost, which we manage through the use of derivative instruments. Exchange gain, net, was P.394 million in 2010 and P.1,097 million in 2009.

We may be affected by actions taken by regulatory authorities and legal proceedings in connection with regulatory matters. See Item 4. *Information on the Company Regulation* and Item 8. *Legal Proceedings.*

**Transition to IFRS**

Beginning in 2012, Mexican issuers with securities listed on the Mexican National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores or CNBV ) will be required to prepare financial statements in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Issuers may voluntarily report using IFRS before the change in the reporting standards becomes mandatory. We began presenting our financial statements in accordance with IFRS for periods beginning January 1, 2011.

**Effect of Inflation Accounting**

Historically, Mexican FRS required that that we recognize the effects of inflation on our financial information. Upon the adoption of Mexican FRS B- 10, effective January 1, 2008, we ceased to recognize the effects of inflation on our financial information, because we currently operate in a non-inflationary economic environment 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). Accordingly, our financial statements contained in this annual report are presented without inflationary effects, except for those non-monetary items that included inflation effects through December 31, 2007. Subsequent additions are recognized at historical cost.

We will be presenting our annual financial statements in accordance with IFRS for the fiscal year ending December 31, 2011, with an official IFRS adoption date as of January 1, 2011 and a transition date to IFRS of January 1, 2010.

IFRS does not establish an absolute rate of inflation at which hyperinflation is deemed to arise. Instead, it considers certain economic characteristics of a country (e.g. whether the general population keeps its wealth in non-monetary assets or in a relatively stable foreign currency, whether sales account receivables are indexed to inflation until collection, whether interest rates, wages, and prices are linked to a price index) to be strong indicators of the existences of hyperinflation. Also, once the cumulative inflation rate over three years approaches or exceeds 100% hyperinflation, may be deemed to exist.

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**Changes in Mexican FRS**

Note 1 to our audited consolidated financial statements discusses new accounting pronouncements under Mexican FRS that became effective in 2010. The pronouncements that became effective on January 1, 2010 were fully implemented in the financial statements included in this annual report. The accounting pronouncements discussed in Note 1 to our audited consolidated financial statements that became effective on January 1, 2008, were applied on a prospective basis and prior years financial statements have not been adjusted. As a result, our financial statements from 2008 through 2010 may not be comparable to our financial statements of prior years.

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**Summary of Operating Income and Net Income**

The table below summarizes our consolidated income statement for the past three years.

| | Year ended December 31, 2010 (millions of pesos) | 2010 (percentage of operating revenues) | 2009 (millions of pesos) | 2009 (percentage of operating revenues) | 2008 (millions of pesos) | 2008 (percentage of operating revenues) |
|---|---|---|---|---|---|---|
| Operating revenues: | | | | | | |
| Local service | P. 41,007 | 36.1% | P. 45,028 | 37.8% | P. 48,982 | 39.5% |
| Domestic long-distance service | 12,265 | 10.8 | 14,143 | 11.9 | 15,742 | 12.7 |
| International long-distance service | 5,646 | 5.0 | 6,662 | 5.6 | 8,793 | 7.1 |
| Interconnection service | 15,023 | 13.2 | 16,573 | 13.9 | 19,140 | 15.4 |
| Data services | 32,879 | 29.0 | 30,817 | 25.9 | 25,387 | 20.4 |
| Other | 6,743 | 5.9 | 5,877 | 4.9 | 6,061 | 4.9 |
| | 113,563 | 100.0 | 119,100 | 100.0 | 124,105 | 100.0 |
| Operating costs and expenses: | | | | | | |
| Cost of sales and services | 34,711 | 30.6 | 34,178 | 28.7 | 32,523 | 26.2 |
| Commercial, administrative and general expenses | 22,351 | 19.7 | 20,811 | 17.5 | 19,863 | 16.0 |
| Interconnection | 10,561 | 9.3 | 11,796 | 9.9 | 14,043 | 11.3 |
| Depreciation and amortization | 17,523 | 15.4 | 17,951 | 15.0 | 17,933 | 14.5 |
| | 85,146 | 75.0 | 84,736 | 71.1 | 84,362 | 68.0 |
| Operating income | 28,417 | 25.0% | 34,364 | 28.9% | 39,743 | 32.0% |
| Other expenses, net | 78 | | 1,350 | | 679 | |
| Financing cost: | | | | | | |
| Interest income | (584) | | (711) | | (913) | |
| Interest expense | 5,734 | | 6,122 | | 7,652 | |
| Exchange (gain) loss, net | (394) | | (1,097) | | 2,494 | |
| | 4,756 | | 4,314 | | 9,233 | |
| Equity interest in net income (loss) of affiliates | 196 | | 255 | | (62) | |
| Income before income tax | 23,779 | | 28,955 | | 29,769 | |
| Income tax | 8,408 | | 8,486 | | 9,592 | |
| Net income | P. 15,371 | | P. 20,469 | | P. 20,177 | |
| Distribution of net income: | | | | | | |
| Controlling interest | P. 15,384 | | P. 20,469 | | P. 20,177 | |
| Non-controlling interest | (13) | | | | | |
| | P. 15,371 | | P. 20,469 | | P. 20,177 | |
| Earnings per share | P. 0.85 | | P. 1.11 | | P. 1.07 | |

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**Revenues**

Total revenues in 2010 were P.113,563 million, a decrease of 4.6% compared to 2009, primarily due to a decline in revenues from local, long-distance and calling party pays services, partly offset by the increase in revenues generated from data services and other revenues. The percentage of our revenues attributable to voice services (including local, long-distance and interconnection services) declined from 69.2% in 2009 to 65.1% in 2010, while revenues from data services grew to 29.0% of our revenues in 2010 compared to 25.9% in 2009.

***Local Service Revenues***

Operating revenues from local services 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 billed lines, 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 8.9% in 2010 and 8.1% in 2009. The decreases in 2010 and 2009 were principally due to lower average revenue per local billed call, reductions in local traffic due to competition from both wireless and other fixed-line service providers and the reduction in billed lines.

***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. The amount of operating revenues from domestic long-distance service depends on rates and traffic volume.

Domestic long-distance revenues decreased by 13.3% in 2010 and by 10.2% in 2009. The decrease in 2010 was due to a reduction in traffic flow, lower average revenue per minute in termination traffic with long distance operators and cellular carriers and higher penetration of service packages that include domestic long distance service. The decrease in 2009 was primarily due to lower average revenue per minute due to our increased offerings of telecommunications services packages with Infinitum ADSL services that include long-distance minutes, which promote traffic volume but reduce average revenue per minute.

***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. 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 2010, settlement payments from foreign carriers represented 2.1% of our consolidated revenues and 43.1% 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 15.3% in 2010 and by 24.2% in 2009. The decrease in 2010 was primarily due to a decrease in average revenue per minute of outgoing traffic resulting from the inclusion of international long distance minutes in some telecommunications services packages with Infinitum ADSL services, which was partially offset by a 3.9% increase in outgoing traffic. Incoming international long distance traffic revenues decreased by 5.6% compared with the previous year due to a decrease in the interconnection rates received from U.S. carriers which was partially offset by an increase of 21.2% in incoming traffic. The decrease in 2009 was primarily due to a decline in outgoing traffic of 31.8%, reflecting a decrease in Mexico s economic activity as well as a decrease in traffic from mobile operators, partially offset by an increase in average revenue per minute. Revenues from incoming international long-distance traffic decreased by 22.8% in 2009, mainly due to an 8.6% decline in incoming traffic and a reduction in the average revenue per minute.

***Revenues from Interconnection Service***

Revenues from interconnection service are comprised of 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 service, which covers long-distance calls as well as local calls. In the case of local and domestic long-distance services, under the calling party pays services, our fixed-line customers pay us an interconnection charge when they call a mobile telephone. Of that amount, we pay a percentage to the mobile carrier that completed the call (66.2% in 2010). We recognize the amount paid to us under interconnection revenue, and we recognize the amount we pay under interconnection cost.

Revenues from interconnection service decreased by 9.4% in 2010 and by 13.4% in 2009. The decreases in both years were primarily due to decreases in the calling party pays rates of 5.6% in 2010 and 7.0% in 2009 and a decline in traffic due to increased market penetration by mobile phone operators. In 2010, revenues from fixed-to-mobile calls accounted 85.0% of interconnection revenues (84.2% in 2009) and revenues from local and long-distance operators represented 9.9% of interconnection revenue (10.6% in 2009). The balance of interconnection revenues represented payments from mobile phone carriers for mobile-to-fixed calls. Pursuant to a new agreement with some mobile phone operators, the calling party pays rates for local, domestic long-distance and international long-distance revenues could decline between 2011 and 2014.

***Revenues from Data Services***

Revenues from data services consist of revenues from Internet access service and corporate networks. Revenues from Internet access service include service fees for broadband and dial-up Internet access. Revenues from corporate networks mainly consist of revenues from installing and leasing dedicated private lines, revenues from virtual private network (VPN) services and revenues from the sale of value-added services to these customers.

Revenues from data services increased by 6.7% in 2010 and by 21.4% in 2009. The increases in 2010 and 2009 were primarily due to increases in the number of Internet access accounts with Infinitum ADSL by 12.8% in 2010 and 30.2% in 2009 (totaling 7.4 million in 2010 and 6.5 million in 2009), partially offset by lower average revenues per Internet access account with Infinitum ADSL. Revenue from data services also increased in 2010 and 2009 due to higher revenues from VPN services and data-related value-added services for the corporate market.

***Other Revenues***

The main 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 14.7% in 2010 and decreased by 3.0% in 2009. The increase in 2010 was mainly due to increased sales of computers at Telmex stores and increased revenues from our billing and collection services. The decrease

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in 2009 was mainly due to lower revenues from our billing and collection services, partially offset by increased sales of computers at Telmex stores.

**Operating Costs and Expenses**

***Cost of Sales and Services***

Cost of sales and services increased by 1.6% in 2010 and by 5.1% in 2009. The increase in 2010 was primarily due to the higher cost of third party products and services for corporate customers and the cost of goods sold attributable to increased sales of computers and telecommunications equipment. The increase in 2009 was primarily due to higher labor costs, cost of goods sold attributable to higher sales of computers and telecommunications equipment and third party services for corporate customers.

***Commercial, Administrative and General Expenses***

Commercial, administrative and general expenses increased by 7.4% in 2010 and 4.8% in 2009. The increase in 2010 was primarily due to higher labor costs, maintenance expenses and advertising, partially offset by lower charges for doubtful accounts receivable. The increase in 2009 was primarily due to higher charges for doubtful accounts receivable, higher labor costs and higher sales activities related to the growth of Internet broadband services, effects partially offset by various initiatives to reduce costs.

***Interconnection Costs***

Interconnection costs include payments to mobile phone carriers for calling party pays services. Interconnection costs decreased by 10.5% in 2010 and by 16.0% in 2009. The decreases in 2010 and 2009 were due to both a decline in the rate paid to mobile phone operators for calls under the calling party pays services and a decline in fixed-to-mobile traffic.

***Depreciation and Amortization***

Depreciation and amortization decreased by 2.4% in 2010 and remained stable in 2009. The decrease in 2010 was due to lower expenditures on plant, property and equipment in recent years.

**Operating Income**

In 2010, operating income decreased by 17.3%, reflecting a 4.6% decrease in revenues and a 0.5% increase in operating costs and expenses. Operating margin decreased to 25.0% in 2010 from 28.9% in 2009. In 2009, operating income decreased by 13.5%, reflecting a 4.0% decrease in revenues and a 0.4% increase in operating costs and expenses. Operating margin decreased to 28.9% in 2009 from 32.0% in 2008. The decrease in operating margins in both periods reflects the changing mix of our revenues.

**Other Expenses, Net**

Other expenses, net, amounted to P.78 million in 2010 and P.1,350 million in 2009. Other expenses, net, mainly consist of the net amount we are required to recognize under our employee profit sharing obligations expense. In addition in 2010, other expenses, net, included a gain related to the liquidation of a trust fund in connection with a social security proceeding that was resolved in our favor and a gain that arose from the sale of 2Wire. Telmex, like other Mexican companies, is required by law to pay to its 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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**Financing Cost, Net**

Under Mexican FRS, net financing cost reflects interest income, interest expense, and foreign exchange gain or loss. A substantial proportion of our indebtedness (54.8% at December 31, 2010) is denominated in U.S. dollars, and we engage in derivative transactions to manage our exposure to exchange rate variation.

In 2010, net financing cost was P.4,756 million compared with P.4,314 million in 2009. The changes in each component were as follows:

Interest income decreased by 17.9% in 2010 and by 22.1% in 2009. The decreases in 2010 and 2009 were both due to a lower level of average interest-bearing assets.

Interest expense decreased by 6.3% in 2010 and by 20.0% in 2009. The decrease in 2010 and 2009 was primarily due to a lower average level of debt. In each year, we recognized a net expense on interest-rate swaps (P.1,688 million in 2010, and P.1,942 million in 2009) and the ineffective portion of our cash flow hedges (P.507 million in 2010 and P.115 million in 2009).

We recorded net exchange gain of P.394 million in 2010 and of P.1,097 million in 2009. In 2010 and 2009, the net exchange gain was due to a gain caused by the appreciation of the peso against the U.S. dollar by approximately 5.4% 2010 and 3.5% 2009, based on the period-end exchange rates, partly offset by net fair value losses on currency hedging instruments.

We did not recognize the effects of inflation in the Income Statement in 2010, 2009 and 2008 as we adopted Mexican FRS B-10, effective January 1, 2008.

**Income Tax**

The statutory rate of the Mexican corporate income tax was 30% in 2010 and 28% in 2009 and 2008. Under the Mexican Tax Reform Law approved in December 2009, the corporate income tax rate was increased from 28% to 30% for 2010 through 2012, and will be scaled back to 29% in 2013 and 28% in 2014 and future years.

Our effective rate of corporate income tax as a percentage of pre-tax profit was 35.4% in 2010, 29.3% in 2009 and 32.2% in 2008. Although after 2007 we no longer recognize the effects of inflation in our financial statements, we do continue to recognize the impact of inflation for tax reporting purposes. This causes our taxable income to be affected by taxable monetary gain on our net monetary liabilities and by higher depreciation due to the application of inflation indexation on our assets. Our effective tax rate in 2010 was higher than in 2009 due to a higher statutory rate (from 28% to 30%) and due to a higher rate of inflation of 4.4%. In 2009 our effective tax rate was lower than in 2008 due to a lower rate of inflation of 3.6% in 2009 compared to 6.5% in 2008.

On January 1, 2008, the Flat-Rate Business Tax Law (FRBT or *Impuesto Empresarial a Tasa Única*) became effective. The FRBT is computed by applying the applicable rate to income determined on the basis of cash flows, which is determined by deducting authorized deductions from all income collected from those activities that are subject to the tax. As established under the FRBT, certain FRBT credits also may be deducted from the FRBT payable. The FRBT rate is 16.5% in 2008, 17% in 2009 and 17.5% in 2010 and succeeding years.

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FRBT is payable only to the extent it exceeds income tax for the same period. To determine FRBT payable, income tax paid in a given period is first subtracted from the FRBT of the same period. For the years ended December 31, 2010, 2009 and 2008, no FRBT was due.

**Net Income**

Net income, decreased by 24.9% in 2010 and increased by 1.4% in 2009. The decrease in 2010 was due primarily to a decline in revenues from voice services and the other factors described above. The increase in 2009 was primarily due to lower financing cost and income taxes, which offset a decline in revenues from voice services.

**Liquidity and Capital Resources**

Our main capital requirements are capital expenditures, dividend payments, share repurchases and the repayment of debt. We have generally met our capital requirements primarily from operating cash flows and some limited borrowing. Cash flows provided by operating activities were P.39,476 million in 2010 and P.40,235 million in 2009.

We had a working capital surplus of P.4,316 million at December 31, 2010 and of P.14,452 million at December 31, 2009. We believe that our working capital is sufficient to cover our current requirements.

Our capital expenditures were P.10,588 million in 2010, P.8,998 million in 2009 and P.10,081 million in 2008. In 2010, we used 56.2% of our capital expenditures for projects in data, connectivity and transmission networks, and the balance for operational support projects. We expect that our capital expenditures in 2011 will be approximately P.10.8 billion (U.S.$871.0 million), excluding expenditures for any business acquisitions we may make. If we receive authorization to provide triple-play services, we will evaluate whether to increase our capital expenditures to invest in related equipment.

The amount we spent on share repurchases was P.340 million in 2010, P.4,095 million in 2009 and P.12,872 million in 2008. The amount spent on share repurchases is determined from time to time by the Board of Directors taking into account factors including the price of our shares and our capital resources. See *Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers.*

Dividends paid totaled P.8,737 million in 2010, P.15,093 million in 2009 and P.7,609 million in 2008.

In the table below we set forth certain contractual obligations as of December 31, 2010, consisting of debt 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 financial instruments, which provide for payment flows that vary depending on exchange rates and interest rates. Purchase obligations include capital commitments primarily for equipment supply and maintenance contracts. The table below does not include pension liabilities, deferred taxes or current accounts payable.

| | Payments Due by Period (as of December 31, 2010) | | | | |
|---|---|---|---|---|---|
| | Total | 2011 | 2012-2013 | 2014-2015 | 2016 and beyond |
| | (in millions of pesos) | | | | |
| Contractual obligations: | | | | | |
| Total debt[1] | P .74,521 | P .11,952 | P .23,089 | P .19,005 | P .20,475 |
| Purchase obligations | 5,346 | 4,489 | 857 | | |
| Total | P .79,867 | P .16,441 | P .23,946 | P .19,005 | P .20,475 |

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

At December 31, 2010, we had total indebtedness of P.74,521 million (approximately U.S.$6,031 million) compared to total indebtedness of P.102,874 million (approximately U.S.$7,878 million) at December 31, 2009. In 2010, we incurred additional U.S. dollar and peso-denominated debt and reduced our debt by repaying P.35,728 million.

The primary repayments in 2010 consisted of the repayment of senior notes in the amount of P.12,294 million (U.S. $950 million) in January, the repayment of a syndicated loan in the amount of P.3,116 million (U.S.$250 million) in March and the prepayment of a syndicated loan in the amount of P.12,260 million (U.S.$1,000 million) in November that was originally scheduled to mature in October 2011.

Of our total debt at year-end 2010, P.11,952 million (U.S.$967 million) is scheduled to come due in 2011. This includes U.S.$500 million of indebtedness to América Móvil, which is scheduled to mature in October 2011. For 2011, we expect to refinance part of our maturing debt with new borrowings, depending on market conditions may be in the capital markets, from financial institutions.

The major categories of indebtedness are as follows:

*Foreign currency-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 London Interbank Offered Rate (LIBOR). The weighted average interest rate at December 31, 2010 was approximately 0.8%. We had U.S.$1,753 million (P.21,666 million) in bank loans outstanding at December 31, 2010. Of the credit facility we obtained in August 2006 of U.S.$3,000 million, we have a tranche of U.S.$700 million that remains outstanding and matures in 2013. In June 2006, we obtained a U.S.$500 million syndicated loan facility divided into two equal tranches, of which one tranche of U.S.$250 million remains outstanding and matures in 2012.

Certain of our bank loans contain financial and operating covenants. The financial covenants require us to maintain a consolidated ratio of EBITDA to interest expense of no 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.$1,298 million (P.16,044 million) and P.4,500 million aggregate principal amounts of senior notes outstanding at December 31, 2010. We have three outstanding series of senior notes issued outside of Mexico:

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| Maturity | Issuance | Interest | Outstanding Amount (millions) | |
|---|---|---|---|---|
| January 2015 | January/February 2005 | 5.50% | U.S.$ | 798 |
| January 2016 | January 2006 | 8.75% | P. | 4,500 |
| November 2019 | November 2009 | 5.50% | U.S.$ | 500 |

In February 2011, América Móvil offered to acquire from eligible bondholders our 5.5% senior notes due 2015 and our 5.5% senior notes due 2019 in exchange for new debt securities of América Móvil. As a result, in March 2011, América Móvil acquired U.S.$243.6 million of senior notes due 2015 and U.S.$122.6 million of senior notes due 2019. We purchased from América Móvil all the notes that América Móvil acquired in the exchange offer for an aggregate price of U.S.$394 million, which represents a premium of U.S.$27.8 million over par, and we extinguished those senior notes. The price we paid was based on the market value of the América Móvil notes issued in the exchange offer.

*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 based on the Mexican interbank equilibrium interest rate (*Tasa de Interés Interbancaria de Equilibrio*). At December 31, 2010, we had P.25,900 million of such notes outstanding, maturing from 2011 to 2037, and the weighted average interest rate was 6.3%.

We also have smaller amounts of other categories of outstanding indebtedness, including peso-denominated loans from Mexican banks and supplier credits for equipment financing. We rely primarily on borrowings in the Mexican and international capital markets and from Mexican and 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, 2010, 54.8% of our total consolidated indebtedness was denominated in U.S.dollars, 40.9% was denominated in Mexican pesos and the remainder was denominated in other currencies. Our currency hedging practices are described below.

At December 31, 2010, 61.9% of our debt obligations bore interest at floating rates. The weighted average cost of all borrowed funds at December 31, 2010 (including interest and reimbursement of certain lenders for Mexican taxes withheld, but excluding fees and the effect of interest-rate swaps) was approximately 4.3% (compared to approximately 4.0% at December 31, 2009). 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, 2010 would increase such cost by 2.3% to approximately 6.6% (compared to approximately 5.9% at December 31, 2009). Such cost does not include the effect of exchange rate variations. We have not pledged any assets as security for our debt.

**Derivatives and Hedging**

A substantial part of our indebtedness is denominated in U.S. dollars (54.8% as of December 31, 2010), and we have relatively limited assets and revenues denominated in U.S. dollars. As of December 31, 2010, our U.S. dollar-denominated indebtedness amounted to P.40,853 million. In addition, a substantial part of our indebtedness bears interest at variable rates (61.9% as of December 31, 2010). As a result, we are exposed to risks from changing currency exchange rates and interest rates.

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To offset these risks, we enter into derivative financial instruments with large financial institutions to minimize the impact of fluctuations in exchange rates and variable interest rates on our indebtedness. We have not entered into derivative financial instruments for any other purposes, although we may do so in the future. The types of derivative instruments we have typically entered into in recent periods include cross-currency swaps (in which we generally pay peso amounts based on peso interest rates and receive U.S. dollar amounts based on dollar interest rates), interest-rate swaps (in which we generally pay amounts based on fixed interest rates and receive amounts based on variable interest rates) and forward exchange contracts (in which we generally agree to use pesos to purchase U.S. dollars at a future date).

Our use of derivatives varies from time to time, depending on our judgment about our level of exposure to exchange rate and interest rate risk, and the costs of derivative instruments. The aggregate notional amount of our interest-rate swaps may be greater or less than the principal amount of our debt, and we may discontinue hedging at any time. We review and change our derivatives positions regularly, and our derivatives policies change from time to time. Under Mexican FRS, we account for the derivative instruments on a fair value basis. See Note 7 to our audited consolidated financial statements.

We have engaged in derivatives transactions to reduce our exposure to changes in exchange rates. As of December 31, 2010, our cross-currency swaps covered foreign currency liabilities of U.S.$3,487 million and short-term forwards contracts covered U.S. dollar liabilities of U.S.$40 million, although the amount of our derivatives position varies substantially from time to time.

We have also engaged in derivatives transactions to reduce our exposure to changes in interest rates. Specifically, we have entered into interest-rate swaps in which we pay interest at a fixed rate and receive interest at a variable rate, on a notional amount in Mexican pesos or U.S. dollars. From time to time, we have also entered into interest-rate swaps in which we pay variable rates and receive fixed rates, as part of the management of our overall position. The general effect of these swaps is to replace an obligation to pay variable-rate interest on our debt with an obligation to pay fixed-rate interest. As of December 31, 2010, the aggregate notional amount of our peso-denominated variable rate to fixed rate interest-rate swaps was P.16,649 million.

The net fair value of our derivative instruments was an asset of P.5,396 as of December 31, 2010.

**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**

Under Mexican FRS, the *Escisión* was deemed effective as of December 26, 2007. 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 included in our consolidated balance sheet as of December 31, 2007 and in our consolidated income statement for part of 2008.

Net income under U.S. GAAP was P.14,981 million in 2010, P.19,818 million in 2009 and P.21,955 million in 2008. Compared to Mexican FRS, net income under U.S. GAAP was 2.5% lower in 2010, 3.2% lower in 2009 and 8.8% higher in 2008.

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

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above and elements of inflation accounting that are determined differently under U.S. GAAP than under Mexican FRS. See *Effect of Inflation Accounting Effects of inflation accounting on U.S. GAAP reconciliation for periods prior to 2008* above.

Other differences that affected net income relate to accounting for costs of pension and seniority premium plans, capitalization of interest on assets under construction and deferred profit sharing. 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 2010 to P.17,392 million, or 20.4% of our operating costs and expenses, under Mexican FRS, and P.18,058 million, or 20.8% of our operating costs and expenses, under U.S. GAAP. See Notes 4 and 18 to our audited consolidated financial statements.

The estimates were 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 2010, we recognized net period cost relating to these obligations of P.5,528 million under Mexican FRS and P.5,519 million under U.S. GAAP.

We use estimates in four specific areas that have a significant effect on these amounts: (a) the discount rates that we use to calculate the present value of our future obligations, (b) the rate of increase in salaries that we assume we will observe in future years, (c) the rate of return we assume our pension fund will achieve on its investments and (d) the expected rate of inflation. The assumptions we have applied are identified in Note 10 (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 2010, the net actuarial loss of P.6,479 million was due to (i) the effect of an actuarial gain of P.1,130 million due to variations in reference rates that resulted in an increase in the value of plan assets invested in equity securities and fixed-income instruments, offset by (ii) an actuarial loss of P.7,609 million attributable mainly to a higher than estimated number of employees retiring and higher than estimated salaries and pension benefits of retired employees.

As of December 31, 2010, 46.4% of fund assets consisted of peso-denominated fixed-income securities and 53.6% consisted of variable-income securities. The fund has experienced volatile returns on its investments in equity securities, which resulted in net losses on plan assets in prior years.

***Allowance for Doubtful Accounts Receivable***

We maintain an allowance for doubtful accounts receivable 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, 2010, the balance of the allowance was P.5,035 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 mainly consists of accounts that are over 90 days delinquent. 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 3 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, Intangibles and Goodwill***

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, licenses and trademarks. Impairment testing for goodwill is required to be performed on an annual basis. At December 31, 2010, these assets include plant, property and equipment (P.99,421 million, net of accumulated depreciation), licenses (P.851 million, net of accumulated amortization), trademarks (P.457 million) and goodwill (P.103 million). To estimate the fair value of long-lived assets, we typically make various assumptions about the future prospects for the business to which the asset relates, consider market factors specific to that business and estimate future cash flows to be generated by that business. Based on these assumptions and estimates, as well as 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.

During 2010, 2009 and 2008, we did not recognize any impairment of plant, property and equipment, licenses, trademarks or goodwill.

***Fair Value of Derivatives***

Under Mexican FRS (Bulletin C-10, *Instrumentos Financieros Derivados y Operaciones de Cobertura* (Derivative Financial Instruments and Hedging Activities)) and U.S. GAAP (*ASC 815, Derivatives and Hedging*), we are required to recognize all derivatives as either assets or liabilities on our balance sheet and measure those instruments at fair value. Accounting for derivative transactions allows us to use the fair values as determined by the financial institutions with whom we enter into these transactions, which we use as the basis for recognition of the derivative financial instruments in our financial statements. The fair value of derivative financial instruments is based on estimated settlement costs or quoted market prices supported by confirmations of these values received from the counterparties to these financial instruments and by determinations of independent third parties applying technical models based on statistical and market data. Changes in the fair value of derivative financial instruments are recorded each year in net income or as a component of accumulated other comprehensive income, based on the type of hedging instrument and the effectiveness of the hedge and whether or not the derivative has been designated, and qualifies, as an accounting hedge.

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## 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 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 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.

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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 20 members of our Board of Directors elected at the annual ordinary general meeting of our shareholders held on April 28, 2011, their dates of birth and information on their principal business activities outside Telmex are as follows:

| | | |
|---|---|---|
| Carlos Slim Domit<br>Chairman; chairman of the executive committee | Born: | 1967 |
| | First elected: | 1995 |
| | Term expires: | 2012 |
| | Principal occupation and other directorships: | Chairman of the board of directors of Teléfonos de México, S.A.B. de C.V.; 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. de C.V.; 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<br>Director; member of the audit committee; alternate member of the executive committee | Born: | 1935 |
| | First elected: | 1991 |
| | Term expires: | 2012 |
| | Principal occupation: | Chief Executive Officer of Cía. Industrial de Tepeji del Río, S.A. de C.V. and Fábrica de Hilados y 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., Grupo Hotelero Brisas, S.A. de C.V. and Cía. Industrial de Tepeji del Río, S.A. de C.V. |

| | | |
|---|---|---|
| Antonio del Valle Ruiz | Born: | 1938 |
| Director | First elected: | 2011 |
| | Term expires: | 2012 |
| | Principal occupation: | Chairman of the board of directors of Grupo Empresarial Kaluz, S.A. de C.V. |
| | Other directorships: | Member of the board of directors of Mexichem, S.A.B. de C.V., Escuela Bancaria y Comercial, Minera las Cuevas, Polímeros de México and Fundación Pro Empleo, A.C. |
| | Business experience: | Founder of Grupo Empresarial Kaluz, S.A. de C.V., founder and Chief Executive Officer of Grupo Financiero Bital, Chairman of the Mexican Business Round Table, President of the Mexican Bankers Association. |
| Laura Diez Barroso de Laviada | Born: | 1951 |
| Director | First elected: | 2011 |
| | Term expires: | 2012 |
| | Principal occupation: | President of Tenedora y Promotora Azteca, S.A. de C.V. |
| | Business experience: | Member of the board of directors of Grupo Financiero Inbursa, S.A.B. de C.V., Fundación del Centro Histórico de la Ciudad de México A.C. and Royal Caribbean International. |
| Amparo Espinosa Rugarcía | Born: | 1941 |
| Director | First elected: | 1991 |
| | Term expires: | 2012 |
| | Principal occupation: | Chief Executive Officer of Documentación y Estudios de Mujeres, A.C. |
| | Business experience: | Newspaper columnist; speaker at various domestic and international events. |
| Elmer Franco Macías | Born | 1940 |
| Director | First elected: | 1991 |
| | Term expires: | 2012 |
| | Principal occupation: | Chief Executive Officer and president of the board of directors of Infra, S.A. de C.V. |

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| | | |
|---|---|---|
| | Other directorships: | Member of the board of directors of Corporación Infra, S.A. de C.V., Comercial Infra, S.A de C.V., ICA, S.A. de C.V. and Banco Nacional de México, S.A. |
| | Business experience: | Various positions at Grupo Infra since 1958. |
| Daniel Hajj Aboumrad | Born: | 1966 |
| Director; alternate member of the executive committee | First elected: | 2011 |
| | Term expires: | 2012 |
| | Principal occupation: | Chief Executive Officer of América Móvil, S.A.B. de C.V. |
| | Other directorships: | Director of América Móvil, S.A.B. de C.V., Director of Grupo Carso, S.A.B. de C.V. and Director of Carso Global Telecom, S.A.B. de C.V. |
| | Business experience: | Chief Executive Officer of Hulera Euzkadi, S.A. de C.V. |
| Roberto Kriete Ávila | Born: | 1953 |
| Director | First elected: | 2011 |
| | Term expires: | 2012 |
| | Principal occupation: | Chairman and CEO, TACA Airlines; President Compañía of Kriete Group and Principal Escuela Superior de Economía y Negocios (ESEN) in El Salvador. |
| | Other directorships: | President of the board of directors, Real Intercontinental Hotel of San Salvador and President of Coatepeque Foundation. |
| | Business experience: | Director, Camino Real Hotel; Director and Secretary, Banco Agrícola Commercial of El Salvador. |
| José Kuri Harfush | Born: | 1949 |
| Director; member of the audit committee | First elected: | 1995 |
| | Term expires: | 2012 |
| | 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, S.A., Seguros Inbursa, S.A.B. de C.V., Grupo Carso, S.A.B. de C.V., Carso Global Telecom, S.A.B. de C.V. and Impulsora del Desarrollo y el Empleo en América Latina S.A.B. de C.V. |
| Ángel Losada Moreno | Born: | 1955 |
| Director | First elected: | 1991 |
| | Term expires: | 2012 |

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| | | |
|---|---|---|
| | 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 Controempresas, S.A. de C.V.; member of the board of directors of Grupo Financiero Banamex Citigroup, S.A. de C.V. and Compañìa Mexicana de Aviación, S.A. de C.V. |
| | 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 América, S.A. and Food Market Institute. |
| Francisco Medina Chávez | Born: | 1956 |
| Director | First elected: | 2011 |
| | Term expires: | 2012 |
| | Principal occupation: | President and Chief Executive Officer of Grupo Fame, S.A. de C.V. |
| | Other directorships: | Member of the board of directors of Banamex Citigroup Mexico and Aeroméxico. |
| | Business experience: | Director of several companies involving real estate, automobiles and financing. |
| Juan Antonio Pérez Simón | Born: | 1941 |
| Vice Chairman; chairman of the corporate practices committee; member of the executive committee | First elected: | 1991 |
| | Term expires: | 2012 |
| | 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, 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: | 2012 |
| | 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. and Carso Global Telecom, S.A.B. de C.V. |

| | | |
|---|---|---|
| | Business experience: | Various positions in the financial and commercial area at Grupo Financiero Inbursa, S.A.B. de C.V. |
| Patrick Slim Domit | Born: | 1969 |
| Director | First elected: | 1999 |
| | Term expires: | 2012 |
| | Principal occupation: | Chairman of the board of directors of América Móvil, S.A.B. de C.V. and Chief Commercial Officer of Teléfonos de México, S.A.B. de C.V. |
| | Other directorships: | Vice President of the board of directors of Grupo Carso, S.A.B. de C.V. and member of the board of Impulsora del Desarrollo y el Empleo de América Latina, S.A.B. de C.V. and Carso Global Telecom S.A.B. de C.V. |
| | Business experience: | Chief Executive Officer of Industrias Nacobre, S.A. de C.V. and Chief Executive Officer of Proveedora Inbursa, S.A. de C.V. |
| Héctor Slim Seade | Born: | 1963 |
| Director; member of the executive committee | First elected: | 2007 |
| | Term expires: | 2012 |
| | 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: | Director of Operational Support of Teléfonos de México, S.A.B. de C.V.; Chief Executive Officer of Fianzas Guardiana Inbursa, S.A. and Administrative Officer of Banco Inbursa, S.A. |

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| | | |
|---|---|---|
| Fernando Solana Morales | Born: | 1931 |
| Director | First elected: | 2011 |
| | Term expires: | 2012 |
| | Principal occupation: | President of the Mexican Board of International Affairs; President of the Mexican Fund for Education and Development; President of Solana Advisers; member of the board of directors of Analítica. |
| | Other directorships: | Member of the board of directors of banks, industrial enterprises, universities, philanthropic and cultural organizations. |
| | Business experience: | Member of the Mexican Senate; Chief Executive Officer of Banco Nacional de México, S.A.; Secretary to the Mexican Ministry of International Affairs; Ministry of Education; Ministry of Commerce. |
| Michael J. Viola | Born: | 1954 |
| Director; member of the executive committee | First elected: | 2009 |
| | Term expires: | 2012 |
| | Principal occupation: | Senior Vice President-Finance of AT&T, Inc. |
| | Business experience: | Various positions at AT&T, Inc. since 2000. |
| Michael Bowling | Born: | 1967 |
| Director; alternate member of the executive committee | First elected: | 2011 |
| | Term expires: | 2012 |
| | Principal occupation: | Pressident of AT&T Mexico, Inc. |
| | Business experience: | Vice President of Converged Services and Platform Development of AT&T, Inc., Vice President of Marketing of AT&T, Inc. and Product Management for Broadband of AT&T, Inc. |
| Rafael Moisés Kalach Mizrahi | Born: | 1946 |
| Director; chairman of the audit committee | First elected: | 1995 |
| | Term expires: | 2012 |
| | Principal occupation: | Chairman of the board of directors and Chief Executive Officer of Grupo Kaltex, S.A. de C.V., Chairman of the board of directors of Coltejer, S.A. |
| | Other directorships: | Member of the board of directors of Grupo Carso, S.A.B. de C.V., Sears Roebuck, S.A. de C.V. |
| | Business experience: | Member of the board of directors of Banco Nacional de México and Bursamex Casa de Bolsa. |

| | | |
|---|---|---|
| Ricardo Martín Bringas<br>Director | Born: | 1960 |
| | First elected: | 1998 |
| | Term expires: | 2012 |
| | 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; Vitro S.A.B. de C.V., Aeroméxico S.A. de C.V. and 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. |

The alternate directors elected at the annual ordinary general meeting of our shareholders held on April 28, 2011, each of whom serves a one-year term, are as follows:

| | First Elected Director or Alternate Director |
|---|---|
| José Humberto Gutiérrez-Olvera Zubizarreta | 1996 |
| Antonio Cosío Pando | 2002 |
| Marcos Franco Hernaiz | 2009 |
| Eduardo Tricio Haro | 2005 |
| Jaime Alverde Goya | 1993 |
| Eduardo Valdés Acra | 2000 |
| Oscar Von Hauske Solís | 2007 |
| 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, Marcos Franco Hernaiz is the nephew of Elmer Franco Macías; 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 Carlos Slim Domit, Juan Antonio Pérez Simón and Héctor Slim Seade, all nominated by Carso Global Telecom and elected by various other Mexican investors, and Michael J. Viola, named upon nomination by AT&T International. The current alternate members of the executive committee are Oscar Von Hauske Solís, Antonio Cosío Ariño and Daniel Hajj Aboumrad, all nominated by Carso Global Telecom and elected by various other Mexican investors, and Michael Bowling, 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 28, 2011.

**Audit Committee**

The audit committee consists of Rafael Kalach M. (the audit committee s chairman, appointed at the annual ordinary general meeting of shareholders held on April 28, 2011), José Kuri Harfush and Antonio Cosío Ariño, 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 oversee that proper procedures and controls have been established and ensure that the financial information is useful, proper, 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;

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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;

- inform the Board of Directors of the activities performed by the audit committee; 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 (a director and the corporate practices committee s chairman, appointed at the annual ordinary general meeting of shareholders held on April 28, 2011), Jaime Alverde Goya and Antonio Cosío Pando (both of whom are alternative directors). 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 senior 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.

**Executive Officers**

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

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

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

**Compensation of Directors and Officers**

For the year ended December 31, 2010, the aggregate compensation of all of our directors and executive officers paid for services in all capacities was approximately P.50.1 million, which included bonus payments totaling P.5.0 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.58.8 thousand for each meeting of the Board of Directors attended in 2010. Members of committees of the Board of Directors received an average fee of P.19.6 thousand for each committee meeting attended in 2010. 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.

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, 2010:

| | December 31, | | |
|---|---|---|---|
| | **2010** | **2009** | **2008** |
| End-of-period number of employees | 52,062 | 52,946 | 54,317 |
| Employees by category of activity: | | | |
| Local | 32,955 | 34,364 | 35,505 |
| Long-distance | 4,548 | 4,518 | 4,801 |
| Other | 14,559 | 14,064 | 14,011 |

At December 31, 2010, the Telephone Workers Union of Mexico (known by its Spanish acronym, STRM) represented approximately 75.9% of our employees, and members of other unions represented approximately 6.2% 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. We have good relations with the STRM.

## Item 7. Major Shareholders and Related Party Transactions

### MAJOR SHAREHOLDERS

The AA Shares represented 43.3% of the total capital stock and 95.4% of the full voting shares (AA shares and A Shares) as of February 24, 2011. The AA Shares are owned by (1) Carso Global Telecom, (2) AT&T International Inc. (AT&T International) and (3) various other Mexican investors. As described below, América Móvil acquired a substantial majority of the shares of Carso Global Telecom in 2010. América Móvil may be deemed to control us. According to reports of beneficial ownership of our shares filed with the SEC, América Móvil may be deemed to be controlled by Mr. Carlos Slim Helú and members of his immediate family.

On May 11, 2010 América Móvil launched two separate but concurrent public exchange offers to acquire the outstanding capital stock of Carso Global Telecom and Telmex Internacional. At the time Carso Global Telecom was the direct holder of 59.4% of the outstanding shares of Telmex. On June 16, 2010, América Móvil completed its first public exchange offer. Through this offer, América Móvil directly acquired 99.4% of the outstanding capital stock of Carso Global Telecom and indirectly acquired 59.1% of our outstanding capital stock.

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On November 19, 2010, América Móvil launched a second public exchange offer which was completed on December 17, 2010. As a result, América Móvil is the holder of over 99.9% of Carso Global Telecom s capital stock. Carso Global Telecom is the holder of approximately 59.5% of our outstanding capital stock. Thus, América Móvil indirectly owns 59.5% of our outstanding capital stock. América Móvil may be deemed to be 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, which was amended on February 28, 2011, providing for certain matters. Pursuant to the amendment, upon receipt of a notice of a proposed transfer by AT&T International, Carso Global Telecom will have 30 calendar days to elect to purchase any of the AA Shares proposed to be sold by AT&T International. Upon receipt of a notice of proposed transfer by Carso Global Telecom, AT&T International will have 30 calendar days to elect to purchase up to that number of AA shares that AT&T International holds prior to the notice of proposed transfer of the AA Shares proposed to be sold by Carso Global Telecom; provided that if AT&T is prohibited by Mexican law from acquiring the AA Shares proposed to be sold by Carso Global Telecom, AT&T International may exercise its right to purchase through a third party, trust or other legal entity legally allowed to hold AA Shares. 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, Senior Management and Employees Directors* and *Item 6. Directors, Senior Management and Employees Executive Committee*) and for each party to enter into a Management Services Agreement with us (see *Related Party Transactions* below).

The following table identifies each owner of five percent or more of any class of our shares as of February 24, 2011, unless otherwise indicated. Except as described below, we are not aware of any holder of five 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 of voting shares(5) |
|---|---|---|---|---|---|---|---|
| | Shares (millions) | Percent of class | Shares (millions) | Percent of class | Shares (millions) | Percent of class | |
| América Móvil, S.A.B. de C.V.(6) | 6,000.0 | 76.5% | 92.0 | 24.1% | 4,718.5 | 47.7% | 74.1% |
| AT&T International, Inc.(6)(7) | 1,524.5 | 19.4% | | | 0.8 | 0.0 | 18.5% |

(1) As of February 24, 2011, there were 7,840 million AA Shares outstanding, representing 95.4% of the total full voting shares (AA Shares and A Shares).

(2) As of February 24, 2011, there were 382 million A Shares outstanding, representing 4.6% of the total full voting shares (AA Shares and A Shares).

(3) As of February 24, 2011, there were 9,895 million L Shares outstanding.

(4) Based on reports of beneficial ownership filed with the SEC, (i) .Brandes Investment Partners, beneficially owned less than 5% of our L Shares as of December 31, 2010 and December 31, 2009, compared to 7.6% as of June 11, 2008 and (ii) Capital Research Global Investment beneficially owned less than 5% of our L Shares as of December 31, 2010 and December 31, 2009, compared to 5.9% as of May 13, 2009.

(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 International holds its AA Shares through a Mexican trust, pursuant to the terms of which the trustee votes AT&T International 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) Based on report of beneficial ownership filed with the SEC on March 1, 2011.

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The following table sets forth the share ownership, as of February 24, 2011, 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, are the majority shareholders of Carso Global Telecom through América Móvil. Carso Global Telecom and other companies own 6,000 million AA Shares, 93.7 million A Shares and 5,115.2 million L Shares of Telmex.

| | AA Shares(1) | | A Shares(1) | | L Shares(1) | | Percent of voting shares(2) |
|---|---|---|---|---|---|---|---|
| | Shares (millions) | Percent of class | Shares (millions) | Percent of class | Shares (millions) | Percent of class | |
| Carlos Slim Domit(3) | 6,000.0 | 76.5% | 93.7 | 24.5% | 5,124.7 | 51.8% | 74.1% |
| Marco Antonio Slim Domit(4) | 6,000.0 | 76.5 | 93.7 | 24.5 | 5,124.7 | 51.8 | 74.1 |
| Patrick Slim Domit(5) | 6,000.0 | 76.5 | 93.7 | 24.5 | 5,125.8 | 51.8 | 74.1 |
| Antonio Cosío Ariño(6) | 130.4 | 1.7 | | | | | 1.6 |
| Antonio Cosío Pando(6) | 130.4 | 1.7 | | | | | 1.6 |

(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 February 24, 2011, 4,216,196,082 AA Shares and all A Shares 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 9,529,864 L Shares owned directly by Marco Antonio Slim Domit.
(5) Includes 10,578,738 L Shares owned directly by Patrick Slim Domit.
(6) Owned jointly by Antonio Cosío Ariño and Antonio Cosío Pando.

At December 31, 2010, 44.6% of our outstanding L Shares were represented by L Share ADSs, each representing the right to receive 20 L Shares, and 99.2% of the holders of L Share ADSs (10,040 holders, including The Depository Trust Company) had registered addresses in the United States. In November 2000, we established a sponsored ADS program for the A Share ADSs. 25.7% of our outstanding A Shares were held in the form of A Share ADSs at December 31, 2010, each representing the right to receive 20 A Shares, and 99.4% of the holders of A Share ADSs (3,880 holders, including The Depository Trust Company) had registered addresses in the United States.

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 2010, we purchased 33.9 million L Shares and 6,906 A Shares, representing 0.19% of the shares outstanding at the beginning of 2010, with an aggregate value of P.340 million.

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 24.0% on December 31, 2010, 23.3% on December 31, 2009 and 22.6% on December 31, 2008. Carso Global Telecom s percentage ownership of L Shares was 47.5% on December 31, 2010, 48.7% on December 31, 2009 and 46.4% on December 31, 2008.

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## RELATED PARTY TRANSACTIONS

### General

We engage in a variety of transactions with affiliates in the ordinary course of business. 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.

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 América Móvil, Grupo Carso and Grupo Financiero Inbursa and their respective subsidiaries. Our transactions with América Móvil include interconnection between our respective networks and the completion of international traffic in each other s countries of operation, América Móvil s printing and distribution of our directories and América Móvil s access to our customer database and our billing and collection system in connection with its directories business. In addition, we recently entered into two loan agreements with América Móvil. Transactions with Grupo Carso include the purchase of network construction, services and materials, and transactions with Grupo Financiero Inbursa include financial services and insurance. We also have agreements with affiliates of AT&T International that provide for the completion of calls in our respective countries of operation. Several of the directors of our affiliates are also members of our Board of Directors. See *Item 6. Directors, Senior Management and Employees Directors*.

The aggregate amount of our purchases from affiliates was P.13,626 million in 2010, P.14,142 million in 2009 and P.17,993 million in 2008. The aggregate amount of our sales to these affiliates was P.7,407 million in 2010, P.8,681 million in 2009 and P.10,732 million in 2008. We believe that these transactions are at market prices. See Note 13 to our audited consolidated financial statements.

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 Olimpia, an Italian company that owned 18% of the total capital of Telecom Italia, in 2007. This transaction was not completed.

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 in December 2006, we sold an approximate 5.5% in 2Wire to AT&T International, decreasing our ownership to approximately 13.0%. We sold our remaining ownership in 2Wire to Pace Plc in October 2010.

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

We also pay fees to Carso Global Telecom and AT&T Mexico, Inc. 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. We paid an aggregate amount of U.S.$12.5 million in 2010, U.S.$22.5 million in 2009 and U.S.$25.0 million in 2008. In 2008, Telmex Internacional reimbursed us U.S.$22.5 million of the U.S.$45.0 million we paid to Carso Global Telecom. The agreement with Carso Global Telecom was renewed for 2010 on substantially similar terms to the prior agreement and with an agreed upon fee of U.S.$22.5 million. We agreed to terminate the agreement with Carso Global Telecom in July 2010 and we paid U.S. $11.3 million through such date.

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 and the chairman of our Board of Directors and to the chief executive officer. Certain executives of our affiliates periodically use our corporate aircraft in accordance with those policies.

**Ongoing Transactions with Telmex Internacional**

We have a variety of contractual relationships with Telmex Internacional, which was acquired by América Móvil in 2010. The terms of our arrangements with Telmex Internacional are generally similar to those on which each company does business with other, unaffiliated parties. These ongoing relationships include the following:

- We complete international traffic from Telmex Internacional in Mexico.
- Telmex Internacional completes international traffic from us in Brazil, Colombia, Argentina, Chile, Peru and Ecuador.
- Telmex Internacional prints our white pages telephone directories.
- 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.
- We provide a variety of administrative services to Telmex Internacional, including certain data processing and corporate support and administrative services, generally at cost plus a specified percentage.

**Transactions Relating to the *Escisión of Telmex Internacional***

The creation of Telmex Internacional and the transfer of assets and liabilities from Telmex to Telmex Internacional was effected pursuant to the *Escisión* in December 2007. We have not made any representations regarding the value of any of the assets we transferred to Telmex Internacional in the *Escisión*. For more information on the *Escisión*, see *Item 4. Information on the Company  History*.

In connection with the *Escisión,* we entered into a master transition agreement with Telmex Internacional, or the Master Transition Agreement. 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*. This agreement finalized in December of 2010, without effects for any of the parties.

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*. This agreement finalized in December of 2010, without effects for any of the parties.

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 made no representations concerning the assets transferred directly or indirectly in the *Escisión*.

**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 operator that was established in an *escisión* we completed in 2000, provide telecommunications services in different geographical markets including México, 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.

We have a loan in the amount of U.S.$500 million from América Móvil, which is scheduled to mature in October 2011.

In February 2011, América Móvil offered to acquire from eligible bondholders our 5.5% senior notes due 2015 and our 5.5% senior notes due 2019 in exchange for new debt securities of América Móvil. As a result, in March 2011, América Móvil acquired U.S.$243.6 million of senior notes due 2015 and U.S.$122.6 million of senior notes due 2019. We purchased from América Móvil all the notes that América Móvil acquired in the exchange offer for an aggregate price of U.S.$394 million, which represents a premium of U.S.$27.8 million over par, and we extinguished those senior notes. The price we paid was based on the market value of the América Móvil notes issued in the exchange offer.

**International Long-distance Settlement with AT&T Corp**

We have agreements with AT&T Corp, an affiliate of AT&T International, one of our principal shareholders. AT&T Corp completes our international calls to the United States and we complete AT&T Corp s calls from the United States. The rates of payment under our agreements are consistent with the rates that we have agreed upon with other international carriers.

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**Item 8. Financial Information**

**CONSOLIDATED FINANCIAL STATEMENTS**

See *Item 18. Financial Statements* and our consolidated financial statements beginning on page F-1. Since the date of the financial statements, no significant event has occurred that would affect the amounts recognized or disclosures made in those financial statements.

**LEGAL PROCEEDINGS**

We are involved in legal proceedings in the ordinary course of our business, none of which is material. In addition, we are subject to, and in some cases in the process of appealing various proceedings brought by our competitors alleging monopolistic practices by us before competition authorities in Mexico.

The Competition Commission is conducting industry-wide investigations into market power and monopolistic practices in the telecommunications market. In four of these investigations, the Competition Commission issued final resolutions determining that we have substantial market power in the relevant markets investigated, which we have challenged by filing petitions for constitutional protection (*amparo*). In two of the investigations, relating to monopolistic practices, the Competition Commission issued notices of probable fault, which we have challenged. The remaining two investigations are ongoing. All of these matters are pending, and we cannot predict their outcome. See *Item 4. Information on the Company Regulation Regulatory Initiatives Relating to Competition* and Note 12 to our audited consolidated financial statements.

In November 2005, Cofetel issued guidelines for making changes to local service areas, including the consolidation of such local service areas. We are currently challenging the legality of the underlying guidelines before the Third Metropolitan Regional Federal Court of Justice for Tax and Administrative Matters. In addition, in November 2009, a federal court nullified various resolutions that Cofetel had issued under these guidelines to consolidate a number of our local service areas. See *Item 4. Information on the Company Regulation Consolidation of Local Service Areas* and Note 12 to our audited consolidated financial statements.

In February 2009, Cofetel published the Fundamental Technical Plan, which requires operators with the greatest number of access points to provide other operators with access to our network on an unbundled basis that disaggregates the prices for different service elements. In October 2009, Cofetel issued two resolutions determining that we and Telnor are operators with the largest number of access points in our respective concession coverage areas. We have filed petitions for constitutional protection (*amparo*) against the Fundamental Technical Plan and these resolutions, which are pending. See *Item 4. Information on the Company Regulation Interconnection* and Note 12 to our audited consolidated financial statements.

Following an audit of our social security obligations for the period from 1997 to 2001, the Mexican Social Security Institute (*Instituto Mexicano del Seguro Social*) determined that we owed approximately P.330 million (historical amount) as of July 2, 2003 in past due obligations, penalties and accrued interest. We appealed these rulings to the Federal Administration and Taxation Court (*Tribunal Federal de Justicia Fiscal y Administrativa)* and posted a bond in the amount of P.568.7 million to guarantee payment of the tax assessment. In October 2009, we obtained a final resolution in our favor that nullified the schedule of rate payments, and, accordingly, we liquidated the bond on January 22, 2010.

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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.

| Year ended December 31, | Pesos per Share | Dollars per Share |
|---|---|---|
| 2010 | P. 0.4900 | U.S.$ 0.0391 |
| 2009 | 0.8450 | 0.0646 |
| 2008 | 0.4125 | 0.0370 |
| 2007 | 0.4400 | 0.0402 |
| 2006 | 0.4025 | 0.0365 |

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 2009, we declared a dividend of P.0.46 per share, which was paid in equal installments of P.0.1150 per share in June 2009, September 2009, December 2009 and March 2010. In December 2009, we declared a dividend of P.0.40 per share, which was paid in a single installment. On April 29, 2010, we declared a dividend of P.0.50 per share, which will be payable in equal installments of P.0.1250 per share in June 2010, September 2010, December 2010 and March 2011. In April 2011, we declared a dividend of P.0.55 per share, which will be payable in equal installments of P.0.1375 per share in June 2011, September 2011, December 2011 and March 2012.

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 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 reexpresed 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 May 10, 2011, the closing price of the L Shares on the Mexican Stock Exchange was P.10.47 and the closing price of the L Share ADSs on the New York Stock Exchange was U.S.$18.10.

| | 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** | | | | |
| 2010 | P. 11.16 | P. 8.60 | U.S.$ 17.38 | U.S.$ 13.00 |
| 2009 | 14.47 | 9.50 | 21.24 | 12.54 |
| 2008 | 22.19 | 10.47 | 42.94 | 15.08 |
| 2007 | 23.29 | 14.32 | 43.26 | 25.89 |
| 2006 | 15.97 | 10.01 | 29.35 | 17.61 |
| **Quarterly highs and lows** | | | | |
| 2011: | | | | |
| First quarter | P. 11.14 | P. 9.50 | U.S.$ 18.34 | U.S.$ 16.21 |
| 2010: | | | | |
| First quarter | 11.16 | 9.28 | 17.38 | 14.77 |
| Second quarter | 10.50 | 8.60 | 16.66 | 13.00 |
| Third quarter | 9.74 | 9.01 | 15.41 | 13.82 |
| Fourth quarter | 10.65 | 9.10 | 17.19 | 14.71 |
| 2009: | | | | |
| First quarter | 14.47 | 9.50 | 21.24 | 12.54 |
| Second quarter | 11.55 | 10.07 | 17.44 | 14.85 |
| Third quarter | 12.90 | 10.33 | 19.36 | 14.98 |
| Fourth quarter | 12.21 | 10.75 | 19.12 | 16.23 |
| **Monthly highs and lows** | | | | |
| 2010 | | | | |
| November | P. 10.06 | P. 9.25 | U.S.$ 16.04 | U.S.$ 14.97 |
| December | 10.65 | 9.60 | 17.19 | 15.21 |
| 2011 | | | | |
| January | 10.55 | 9.50 | 17.31 | 16.21 |
| February | 11.14 | 10.10 | 18.32 | 16.62 |
| March | 10.99 | 10.03 | 18.34 | 16.52 |
| April | 11.19 | 10.62 | 19.09 | 18.05 |

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The table below sets forth, for the periods indicated, the reported high and low sales prices for the A Shares on the Mexican Stock Exchange and the high and low bid prices for A Share ADSs published by NASDAQ. Bid prices published by NASDAQ for the A Share ADSs are inter-dealer quotations and may not reflect actual transactions. Prices have not been reexpresed 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 A Shares and A Share ADSs of Telmex and Telmex Internacional traded together. On May 10, 2011, the closing price of the A Shares on the Mexican Stock Exchange was P.10.40, and the closing price of the A Share ADSs on NASDAQ was U.S.$18.10.

| | Mexican Stock Exchange (pesos per A Share) | | NASDAQ (U.S. dollars per A Share ADS) | |
|---|---|---|---|---|
| | **High** | **Low** | **High** | **Low** |
| **Annual highs and lows** | | | | |
| 2010 | P. 11.00 | P. 8.60 | U.S.$ 17.44 | U.S.$ 12.69 |
| 2009 | 14.20 | 9.64 | 20.62 | 12.20 |
| 2008 | 22.15 | 10.50 | 42.99 | 11.95 |
| 2007 | 22.65 | 14.30 | 43.14 | 25.71 |
| 2006 | 15.79 | 10.30 | 29.07 | 17.04 |
| **Quarterly highs and lows** | | | | |
| 2011: | | | | |
| First quarter | P. 10.91 | P. 9.81 | U.S.$ 18.35 | U.S.$ 16.01 |
| 2010: | | | | |
| First quarter | 11.00 | 9.21 | 17.44 | 14.25 |
| Second quarter | 9.85 | 8.60 | 16.44 | 12.69 |
| Third quarter | 9.50 | 8.65 | 15.26 | 13.28 |
| Fourth quarter | 10.50 | 9.01 | 17.07 | 14.62 |
| 2009: | | | | |
| First quarter | 14.20 | 9.64 | 20.62 | 12.20 |
| Second quarter | 11.40 | 10.10 | 18.18 | 14.11 |
| Third quarter | 12.60 | 10.35 | 19.05 | 14.51 |
| Fourth quarter | 11.95 | 10.80 | 19.00 | 16.04 |
| **Monthly highs and lows** | | | | |
| 2010 | | | | |
| November | P. 9.90 | P. 9.20 | U.S.$ 15.99 | U.S.$ 14.92 |
| December | 10.50 | 9.33 | 17.07 | 15.00 |
| 2011: | | | | |
| January | 10.31 | 9.81 | 17.20 | 16.20 |
| February | 10.91 | 10.20 | 18.16 | 16.86 |
| March | 10.90 | 10.05 | 18.35 | 16.01 |
| April | 11.00 | 10.70 | 19.79 | 18.00 |

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## TRADING ON THE MEXICAN STOCK EXCHANGE

The Mexican Stock Exchange (*Bolsa Mexicana de Valores, S.A.B. de C.V.*), located in Mexico City, is the only stock exchange in Mexico. Founded in 1894 and in continuous operation since 1907, it is organized as a Mexican corporation operating under a concession granted by the Ministry of Finance and Public Credit (SHCP). Trading on the Mexican Stock Exchange takes place through automated systems. Trades in securities listed on the Mexican Stock Exchange can also be effected off the exchange. The Mexican Stock Exchange operates a system of automatic suspension of trading in shares of a particular issuer as a means of controlling excessive price volatility, but under current regulations this system does not apply to securities such as the A Shares or the L Shares that are directly or indirectly (for example, through ADSs) quoted on a stock exchange (including for these purposes NASDAQ) outside Mexico.

Settlement is effected three business days after a share transaction on the Mexican Stock Exchange. Deferred settlement, even by mutual agreement, is not permitted without the approval of the Mexican National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*, or the CNBV). Most securities traded on the Mexican Stock Exchange, including those of Telmex, are on deposit with S.D. Indeval, Institución para el Depósito de Valores, S.A. de C.V., a privately owned securities depositary that acts as a clearinghouse for Mexican Stock Exchange transactions.

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**Item 10. Additional Information**

## BYLAWS AND MEXICAN LAW

Set forth below is a brief summary of certain significant provisions of our bylaws. This description does not purport to be complete and is qualified by reference to our bylaws, which are filed as an exhibit to this annual report. For a description of the provisions of our bylaws relating to our Board of Directors and its committees, see *Item 6. Directors, Senior Management and Employees*.

### Organization and Register

Telmex is a *sociedad anónima bursátil de capital variable* organized in Mexico under the Mexican Companies Law (*Ley General de Sociedades Mercantiles*) and the Mexican Securities Market Law. It is registered with the Public Registry of Commerce of Mexico City under the number 5229.

### Purpose

Our main corporate purpose is to construct, install, maintain and operate a public telephony and telecommunications network to transmit voice, sound, data, text and images through local and domestic and international long-distance telecommunications services.

### Share Capital

Our capital stock comprises Series AA Shares, Series A Shares and Series L Shares, all such shares without par value. All of the outstanding shares are fully paid and non-assessable.

AA Shares and A Shares have full voting rights. Holders of L Shares may vote only in limited circumstances as described under *Voting Rights*. The rights of holders of all series of capital stock are otherwise identical except for limitations on non-Mexican ownership of AA Shares. The AA Shares, which must always represent at least 51% of the combined AA Shares and A Shares, may be owned only by holders that qualify as Mexican investors as defined in the Foreign Investment Law and our bylaws. See *Limitations on Share Ownership*.

Each AA Share or A Share may be exchanged at the option of the holder for one L Share, provided that the AA Shares may never represent less than 20% of our outstanding capital stock or less than 51% of our combined AA Shares and A Shares. As of December 31, 2010, the AA Shares represented 43.2% of our outstanding capital stock and 95.3% of our combined AA Shares and A Shares.

Each L Share is exchangeable at the option of the holder for one AA Share by delivering the L Share certificate to our treasury for cancellation and receiving the corresponding AA Share certificate. The right to exchange is subject to limitations on non-Mexican ownership of AA Shares and to the requirement that the AA Shares and A Shares together may never represent more than 51% of our outstanding capital stock. As of December 31, 2010, the AA Shares and A Shares together represented 45.3% of our outstanding capital stock.

### Voting Rights

Each AA Share and A Share entitles the holder thereof to one vote at any meeting of our shareholders. Each L Share entitles the holder to one vote at any meeting at which holders of L Shares are entitled to vote. Holders of L Shares are entitled to vote only to elect two members of the Board of Directors and the corresponding alternate directors and on the following matters:

- the transformation of Telmex from one type of company to another;
- any merger in which Telmex is not the surviving entity or any merger with an entity whose principal corporate purposes are different from those of Telmex (when Telmex is the surviving entity); and
- cancellation of the registration of Telmex on the Mexican National Registry of Securities and any foreign stock exchange on which they are registered.

A resolution on any of the specified matters requires the affirmative vote of both a majority of all outstanding shares and a majority of the AA Shares and the A Shares voting together.

Under Mexican law, holders of shares of any series are also entitled to vote as a class on any action that would affect the rights of holders of shares of such series. Additionally, holders of 20% or more of all outstanding shares would be entitled to request judicial relief against any such action taken without such a vote. The determination whether an action requires a class vote on these grounds would initially be made by the Board of Directors or any other party calling for shareholder action. A negative determination could be subject to judicial challenge by an affected shareholder, and a court would ultimately determine the necessity for a class vote. There are no other procedures for determining whether a proposed shareholder action requires a class vote, and Mexican law does not provide extensive guidance on the criteria to be applied in making such a determination.

**Shareholders Meetings**

General shareholders meetings may be ordinary meetings or extraordinary meetings. Extraordinary general meetings are those called to consider certain matters specified in Article 182 of the Mexican Companies Law, including, principally, amendments of the bylaws, liquidation, merger and transformation from one type of company to another, as well as to consider the removal of our shares from listing on the Mexican Stock Exchange or any foreign stock exchange. General meetings called to consider other matters are ordinary meetings. The two directors elected by the holders of L Shares are elected at a special meeting of holders of L Shares. All other matters on which holders of L Shares are entitled to vote would be considered at an extraordinary general meeting. Holders of L Shares are not entitled to attend or address meetings of shareholders at which they are not entitled to vote.

A special meeting of the holders of L Shares must be held each year for the election of directors. An ordinary general meeting of the holders of AA Shares and A Shares must be held each year to consider the approval of the financial statements for the preceding fiscal year, to elect directors and to determine the allocation of the profits of the preceding year.

The quorum for an ordinary general meeting of the AA Shares and A Shares is 50% of such shares, and action may be taken by a majority of the shares present. If a quorum is not available, a second meeting may be called at which action may be taken by a majority of the AA Shares and A Shares present, regardless of the number of such shares. Special meetings of holders of L Shares are governed by the same rules applicable to ordinary general meetings of holders of AA Shares and A Shares. The quorum for an extraordinary general meeting at which holders of L Shares may not vote is 75% of the AA shares and A Shares, and the quorum for an extraordinary general meeting at which holders of L Shares are entitled to vote is 75% of the outstanding capital stock. If a quorum is not available in either case, a second meeting may be called and action may be taken, provided a majority of the shares entitled to vote is present. Whether on first or second call, actions at an extraordinary general meeting may be taken by a majority vote of the AA Shares and A Shares outstanding and, on matters which holders of L Shares are entitled to vote, a majority vote of all the capital stock.

Holders of 20% of our outstanding capital stock may have any shareholder action set aside by filing a complaint with a court of law within 15 days after the close of the meeting at which such action was taken and showing that the challenged action violates Mexican law or our bylaws. In addition, any holder of our capital stock may bring an action at any time within five years challenging any shareholder action. Relief under these provisions is only available to holders:

- who were entitled to vote on, or whose rights as shareholders were adversely affected by, the challenged shareholder action; and

- whose shares were not represented when the action was taken or, if represented, were voted against it.

Shareholders meetings may be called by the Board of Directors, its chairman, co-chairman or secretary, by the committees that perform audit and corporate practices functions or their chairmen, or by a court. The Board of Directors or the committees that perform audit and corporate practices functions may be required to call a meeting of shareholders by the holders of 10% of the outstanding capital stock. Notice of meetings must be published in the Official Gazette or a newspaper of general circulation in Mexico City at least 15 days prior to the meeting. In order to attend a meeting, shareholders must deposit their shares with us at our office in Mexico City, with a Mexican or foreign banking institution or with a Mexican exchange broker. If so entitled to attend the meeting, a shareholder may be represented by proxy. The depositary for the L Share ADSs and the A Share ADSs does not satisfy this requirement, so ADS holders are not entitled to attend shareholder meetings. ADS holders must exercise their voting rights through the depositary.

**Dividend Rights**

At the annual ordinary general meeting of holders of AA Shares and A Shares, the Board of Directors submits our financial statements for the previous fiscal year, together with a report thereon by the Board of Directors, to the holders of AA Shares and A Shares for approval. The holders of AA Shares and A Shares, once they have approved the financial statements, determine the allocation of our net income for the preceding year. They are required by law to allocate 5% of such net income to a legal reserve, which is not thereafter available for distribution except as a stock dividend, until the amount of the legal reserve equals 20% of our capital stock. The remainder of net income is available for distribution.

All shares outstanding at the time a dividend or other distribution is declared are entitled to participate in such dividend or other distribution.

**Limitation on Capital Increases**

Our bylaws require that any capital increase be represented by new shares of each series in proportion to the number of shares of each series outstanding.

**Preemptive Rights**

In the event of a capital increase, a holder of existing shares of a given series has a preferential right to subscribe for a sufficient number of shares of the same series to maintain the holder s existing proportionate holdings of shares of that series. Preemptive rights must be exercised within 30 calendar days following the publication of notice of the capital increase in the Official Gazette and a newspaper of general circulation in Mexico City. Under Mexican law, preemptive rights cannot be traded separately from the corresponding shares that give rise to such rights. As a result, there is no trading market for the rights in connection with a capital increase. Holders of ADSs may exercise preemptive rights only through the depositary. We are not required to take steps that may be necessary to make this possible.

Under the Mexican Securities Market Law, however, if Telmex were to increase its capital stock to effect a public offering of newly issued shares or were to resell any repurchased shares, no preemptive rights would be available to the holders of outstanding shares as a result of the issuance or resale. As of December 31, 2010, Telmex had 14,032 million repurchased L Shares and 42 million repurchased A Shares in its treasury.

**Limitations on Share Ownership**

Ownership by non-Mexicans of shares of Mexican enterprises in certain economic sectors, including telephone services, is regulated by the Foreign Investment Law and the Regulations thereunder. The National Commission on Foreign Investment is responsible for administration of the Foreign Investment Law and Regulations. In order to comply with restrictions on the percentage of their capital stock that may be owned by non-Mexican investors, Mexican companies typically limit particular classes of their stock to Mexican ownership. Under the Foreign Investment Law, a trust for the benefit of one or more non-Mexican investors may qualify as Mexican if the trust meets certain conditions that will generally ensure that the non-Mexican investors do not determine how the shares are voted.

Non-Mexican investors are not permitted to own more than 49% of the capital stock of a Mexican corporation engaged in the telephone business. Pursuant to a decision of the Foreign Investment Commission dated August 10, 1990, the L Shares of Telmex, because of their limited voting rights, are not taken into account in determining compliance with this restriction and accordingly are not subject to Mexican ownership restrictions. The A Shares are also unrestricted. The AA Shares, however, which must always represent at least 51% of the combined AA Shares and A Shares, may be owned only by holders that qualify as Mexican investors as defined in the Foreign Investment Law and our bylaws. A holder that acquires AA Shares in violation of the restrictions on non-Mexican ownership will have none of the rights of a shareholder with respect to those AA Shares. As a consequence of these limitations, a non-Mexican investor cannot own AA Shares except through a trust that effectively neutralizes the votes of non-Mexican investors.

Pursuant to the Foreign Investment Law and Regulations, we have registered any foreign owner of our shares, and the depositary with respect to the ADSs representing our shares, with the National Registry of Foreign Investment.

In addition, pursuant to the Foreign Investment Law and Regulations, our Mexican shareholders retain the power to determine our administrative control and management.

Foreign states are prohibited under the General Communications Law from directly or indirectly owning shares of Telmex. The Telecommunications Regulations provide, however, that foreign state-owned enterprises organized as separate entities with their own assets may own minority interests in Telmex or any number of shares with limited voting rights. Ownership of A Shares or L Shares by such foreign state-owned companies, or by pension or retirement funds organized for the benefit of employees of state, municipal or other Mexican governmental agencies, is not considered direct or indirect ownership by foreign states for the purposes of the General Communications Law.

**Restrictions on Certain Transactions**

Our bylaws provide that any acquisition of more than 10% of our issued and outstanding shares, effected in one or more transactions by any person or group of persons acting in concert, requires prior approval by our Board of Directors.

**Restrictions on Deregistration in Mexico**

Our shares are registered with the National Registry for Securities, as required under the Mexican Securities Market Law. If we wish to cancel our registration, or if it is cancelled by the CNBV, we will be required to make a public offer to purchase all outstanding shares prior to such cancellation. Unless the CNBV authorizes otherwise, the offer price will be the higher of: (1) the average of the closing price during the previous 30 days on which the shares may have been quoted, or (2) the book value of the shares in accordance with the most recent quarterly report submitted to the CNBV and to the Mexican Stock Exchange. If, after the public offer is concluded, there are still outstanding shares held by the general public, we will be required to create a trust for a period of six months, into which we will be required to contribute funds in an amount sufficient to purchase, at the same price as the offer price, the number of outstanding shares held by the general public. Within the five days prior to the commencement of the public offer, after taking into account the opinion of the audit committee, our Board of Directors must publish its opinion regarding the offer price.

**Tender Offer Rules**

Our bylaws provide that any purchasers or group of purchasers that obtain or increase a significant participation (*i.e.*, 30% or more) in the capital stock of the company, without conducting a previous public offer in accordance with the Mexican Securities Market Law and applicable rules issued by the CNBV, would not have the right to exercise the corporate rights of their shares, and that the company will not register such shares in the share registry book.

**Other Provisions**

***Variable capital.*** We are permitted to issue shares constituting fixed and variable capital. All of our outstanding shares of capital stock constitute fixed capital. The issuance of variable-capital shares, unlike the issuance of fixed-capital shares, does not require an amendment of the bylaws, although it does require a majority vote of the AA Shares and the A Shares.

***Forfeiture of shares.*** As required by Mexican law, our bylaws provide that any alien who at the time of incorporation or at any time thereafter acquires an interest or participation in the capital of the corporation shall be considered, by virtue thereof, as Mexican in respect thereof and shall be deemed to have agreed not to invoke the protection of his own government, under penalty, in case of breach of such agreement, of forfeiture to the nation of such interest or participation. 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 the shareholder invokes such governmental protection in violation of this agreement, his shares could be forfeited to the Mexican government. Mexican law requires that such a provision be included in the bylaws of all Mexican corporations unless such bylaws prohibit ownership of shares by non-Mexican persons.

***Exclusive jurisdiction.*** Our bylaws provide that legal actions relating to the execution, interpretation or performance of the bylaws shall be brought only in Mexican federal courts.

***Duration.*** Telmex s existence under the bylaws is 100 years from the date of the public deed in which its incorporation is evidenced.

***Purchase of our own shares.*** We may repurchase our shares on the Mexican Stock Exchange at any time at the then prevailing market price. Any such repurchase must be made in compliance with the policies established by the Board of Directors. The shareholders meeting approves the maximum amount of funds that may be used during the year for the repurchase of shares. The ordinary shareholders meeting held on March 3, 2009 approved that up to an additional P.10.0 billion be used for share repurchases. Such funds may be used for the repurchase of shares through the Mexican Stock Exchange. The economic and voting rights corresponding to repurchased shares may not be exercised during the period in which we own such shares, and such shares are not deemed to be outstanding for purposes of calculating any quorum or vote at any shareholders meeting during such period.

***Conflict of interest.*** Shareholders with conflicting interests with Telmex with respect to a transaction are required to abstain from deliberating and voting on the specific transaction. A shareholder that votes on a specific business transaction in which its interest conflicts with Telmex s may be liable for damages, but only if the transaction would not have been approved without its vote. A determination of conflicting interest would initially be made by the shareholder subject to judicial challenge. Mexican law does not provide extensive guidance on the criteria to be applied in making such a decision.

***Appraisal rights.*** Whenever the shareholders approve a change of corporate purposes, change of nationality of the corporation or transformation from one type of company to another, any shareholder entitled to vote on such change that has voted against it may withdraw from Telmex and receive the book value attributable to its shares, provided such shareholder exercises its right within 15 days following the adjournment of the meeting at which the change was approved.

**Rights of Shareholders**

The protections afforded to minority shareholders under Mexican law are different from those in the United States and many other jurisdictions. The case law concerning fiduciary duties of directors has not been developed and has not been the subject of extensive judicial interpretation in Mexico, unlike many states in the United States where duties of care and loyalty elaborated by judicial decisions help to shape the rights of minority shareholders. Mexican civil procedure does not contemplate class actions, which permit shareholders in U.S. courts to bring actions on behalf of other shareholders. Shareholders cannot challenge corporate action taken at a shareholders meeting unless they meet certain procedural requirements, as described above under *Shareholders Meetings*. As a result of these factors, in practice it may be more difficult for our minority shareholders to enforce rights against us or our directors or controlling shareholders than it would be for shareholders of a U.S. company.

**Enforceability of Civil Liabilities**

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. It may also be difficult to enforce against them, either inside or outside the United States, judgments obtained against them in U.S. courts, or to enforce in U.S. courts judgments obtained against them in courts in jurisdictions outside the United States, 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.

## CERTAIN CONTRACTS

We are party to concession agreements that authorize us to provide certain telecommunications services on specific terms. These are described in *Item 4. Information on the Company Regulation*.

Our agreements with related parties are described in *Item 7. Major Shareholders and Related Party Transactions Related Party Transactions*.

## EXCHANGE CONTROLS

Mexico has had a free market for foreign exchange since 1991, and the Mexican government has allowed the peso to float freely against the U.S. dollar since December 1994.

## TAXATION

The following summary contains a description of certain Mexican federal and U.S. federal income tax consequences of the acquisition, ownership and disposition of our L Shares, A Shares, L Share ADSs, or A Share ADSs, but it does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase, hold or sell shares or ADSs.

The Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion and a Protocol thereto between the United States and Mexico became effective on January 1, 1994 and has been amended by an additional protocol that became effective on July 3, 2003 (together, the Tax Treaty ). The United States and Mexico have also entered into an agreement concerning the exchange of information with respect to tax matters.

This discussion does not constitute, and should not be considered as, legal or tax advice to holders. This discussion is for general information purposes only and is based upon the federal tax laws of Mexico (including the Mexican Income Tax Law and the Mexican Federal Tax Code) and the United States as in effect on the date of this annual report (including the Tax Treaty), which are subject to change, and such changes may have retroactive effect. Holders of our shares or ADSs should consult their own tax advisers as to the Mexican, U.S. or other tax consequences of the purchase, ownership and disposition of our shares or ADSs, including, in particular, the effect of any foreign, state or local tax laws.

### Mexican Tax Considerations

The following is a general summary of the principal consequences under the Mexican Income Tax Law (*Ley del Impuesto sobre la Renta*) and the rules and regulations thereunder, as currently in effect, of an investment in shares or ADSs by a holder that is not a resident of Mexico and that will not hold the shares or ADSs or a beneficial interest therein in connection with the conduct of a trade or business through a permanent establishment in Mexico (a nonresident holder ).

For purposes of Mexican taxation, the definition of residence is highly technical and residence arises in several situations. Generally, an individual is a resident of Mexico if he or she has established his or her home in Mexico, or if he or she has his or her center of interests in Mexico; a corporation is considered a resident if it has established its place of effective management in Mexico. However, any determination of residence should take into account the particular situation of each person or legal entity.

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If a legal entity or an individual is deemed to have a permanent establishment in Mexico for Mexican tax purposes, all income attributable to that permanent establishment will be subject to Mexican income taxes, in accordance with applicable tax laws.

This summary does not address all of the Mexican tax consequences that may be applicable to specific holders of the shares (including a holder that controls us, an investor that holds 10% or more of the shares or holders that constitute a group of persons for purposes of Mexican law). It also does not purport to be a comprehensive description of all the Mexican tax considerations that may be relevant to a decision to purchase, own or dispose of the shares. In particular, this summary does not describe any tax consequences arising under the laws of any state, locality, municipality or taxing jurisdiction other than certain federal laws of Mexico.

***Tax Treaties***

The Mexican Income Tax Law has established procedural requirements for a nonresident holder disposing of shares to be entitled to benefits under any of the tax treaties to which Mexico is a party. These procedural requirements include the obligation to (i) prove tax treaty residence, (ii) appoint a representative in Mexico for taxation purposes and (iii) present tax calculations prepared by authorized certified public accountants. These requirements are also applicable to provisions of the Tax Treaty that may affect the taxation of certain U.S. holders (as defined in *U.S. Federal Income Tax Considerations* below).

***Payment of Dividends***

Dividends, either in cash or in kind, paid with respect to our shares or ADSs will not be subject to Mexican withholding tax.

***Taxation of Dispositions***

Gains on the sale of shares or ADSs by a non-Mexican holder will generally not be subject to Mexican income tax, provided that the transaction is carried out through (a) the Mexican Stock Exchange, (b) other securities exchanges or markets approved by the Mexican Ministry of Finance or (c) other securities exchanges or markets with ample securities trading that are located in countries with which Mexico has entered into an income tax treaty, such as the New York Stock Exchange, NASDAQ and the *Mercado de Valores Latinoamericanos en Euros* (Latibex).

The tax exemption described in the previous paragraph will not be applicable to pre-negotiated trades executed through the facilities of a Mexican securities exchange. The exemption also will not be applicable in the case of a person or group of persons that, directly or indirectly, holds 10% or more of the shares representing our capital stock, or that holds a controlling interest in us, if in a period of 24 months, a sale of 10% or more of our fully paid shares, or of a controlling interest in us, is carried out through one or several simultaneous or successive transactions, including those carried out through derivative financial instruments or other similar transactions.

For a nonresident corporation or individual that does not meet the requirements summarized above, proceeds obtained from the sale or disposition of shares will be subject to a 25% tax. Under certain circumstances, nonresident corporations and individuals, alternatively, may elect to pay a 20% tax on the gain obtained from the transaction.

Pursuant to the Tax Treaty, gains realized by a U.S. holder (as defined in *U.S. Federal Income Tax Considerations*) eligible for the benefits of the Tax Treaty from the sale or other disposition of shares, even if the sale or disposition is not carried out under the circumstances described in the preceding paragraphs, will not be subject to Mexican income tax, provided that such U.S. holder owned less than 25% of the shares representing our capital stock (including ADSs), directly or indirectly, during the 12-month period preceding such disposition.

Gains realized by other nonresident holders that are eligible to receive benefits pursuant to other income tax treaties to which Mexico is a party may be exempt from Mexican income tax in whole or in part. If the holder is a corporation that is a resident of a tax haven (as defined by the Mexican Income Tax Law), the applicable rate will be 40% on the gross income obtained. Non-U.S. holders should consult their own tax advisers as to their possible eligibility under such treaties.

In other cases, nonresident holders will be subject to Mexican income tax on the sale or other disposition of shares or ADSs. Such nonresident holders should consult with their own tax advisers as to how Mexican income tax would apply to their circumstances.

***Other Mexican Taxes***

Under certain circumstances, a nonresident holder will not be liable for estate, inheritance or similar taxes with respect to its holdings of shares or ADSs. A gratuitous transfer of shares by a nonresident holder, however, may in certain circumstances result in the imposition of Mexican tax upon the recipient. There are no Mexican stamp, issue, registration or similar taxes payable by a nonresident holder with respect to shares or ADSs.

**U.S. Federal Income Tax Considerations**

The following is a summary of certain U.S. federal income tax consequences to U.S. holders (as defined below) of the acquisition, ownership and disposition of shares or ADSs. The summary does not purport to be a comprehensive description of all of the tax consequences of the acquisition, ownership or disposition of shares or ADSs that may be relevant to U.S. holders. The summary applies only to U.S. holders that will hold their shares or ADSs as capital assets and does not apply to special classes of U.S. holders such as dealers in securities or currencies, holders with a functional currency other than the U.S. dollar, holders of 10% or more of our voting shares (whether held directly or through ADSs or both), tax-exempt organizations, financial institutions, holders liable for the alternative minimum tax, securities traders electing to account for their investment in their shares or ADSs on a mark-to-market basis, certain short-term holders of shares or ADSs and persons holding their shares or ADSs in a hedging transaction or as part of a straddle or conversion transaction.

For purposes of this discussion, a U.S. holder is a holder or beneficial owner of shares or ADSs that is:

- a citizen or resident of the United States of America;
- a corporation organized under the laws of the United States of America or any state thereof; or
- otherwise subject to U.S. federal income taxation on a net income basis with respect to the shares or ADSs.

If a partnership holds our shares or ADSs, the tax treatment of a partner will generally depend on the status of the partner and the activities of the partnership. Partners of a partnership holding our shares or ADSs should consult their own tax advisers.

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**Each U.S. holder should consult such holder s own tax adviser concerning the overall tax consequences to it of the ownership or disposition of shares or ADSs that may arise under foreign, state and local laws.**

***Treatment of ADSs***

In general, a U.S. holder of ADSs will be treated as the owner of the shares represented by those ADSs for U.S. federal income tax purposes. Deposits or withdrawals of shares by U.S. holders in exchange for ADSs will not result in the realization of gain or loss for U.S. federal income tax purposes. A U.S. holder s tax basis in such shares will be the same as its tax basis in such ADSs, and the holding period in such shares will be the same as the holding period for such ADSs. U.S. holders that withdraw any shares should consult their own tax advisers regarding the treatment of any foreign currency gain or loss on any pesos received in respect of such shares.

***Taxation of Distributions***

In this discussion, we use the term dividends to mean distributions paid out of our current or accumulated earnings and profits with respect to our shares or ADSs. In general, the gross amount of any dividends will be subject to U.S. federal income taxation. Dividends will be paid in pesos and will be includible in the income of a U.S. holder in a U.S. dollar amount calculated by reference to the exchange rate in effect on the day that they are received by the U.S. holder in the case of shares or by the depositary in the case of ADSs. U.S. holders should consult their own tax advisers regarding the treatment of foreign currency gain or loss, if any, on any pesos received by a U.S. holder or depositary that are converted into U.S. dollars on a date subsequent to receipt. Subject to certain exceptions for short-term and hedged positions, the U.S. dollar amount of dividends received by an individual prior to January 1, 2013 with respect to the ADSs, L Shares, A Shares and AA Shares will be subject to taxation at a maximum rate of 15% if the dividends are qualified dividends. Dividends paid on the ADSs, L Shares, A Shares and AA Shares will be treated as qualified dividends if (i) we are eligible for the benefits of a comprehensive income tax treaty with the United States that the Internal Revenue Service has approved for the purposes of the qualified dividend rules and (ii) we were not, in the year prior to the year in which the dividend was paid, and are not, in the year in which the dividend is paid, a passive foreign investment company, or PFIC. The Tax Treaty has been approved for the purposes of the qualified dividend rules. In addition, based on our audited consolidated financial statements and relevant market and shareholder data, we believe that we were not treated as a PFIC for U.S. federal income tax purposes with respect to our 2009 or 2010 taxable years. In addition, based on our audited consolidated financial statements and our current expectations regarding the value and nature of our assets, the sources and nature of our income and relevant market and shareholder data, we do not anticipate becoming a PFIC for our 2011 taxable year.

To the extent that the amount of any distribution exceeds our current and accumulated earnings and profits for a taxable year, as determined under United States federal income tax principles, the distribution will first be treated as a tax-free return of capital, causing a reduction in the adjusted basis of the shares or ADSs (thereby increasing the amount of gain, or decreasing the amount of loss, to be recognized by you on a subsequent disposition of the shares or ADSs), and the balance in excess of adjusted basis will be taxed as capital gain recognized on a sale or exchange. However, we do not expect to keep earnings and profits in accordance with United States federal income tax principles. Therefore, you should expect that a distribution will generally be treated as a dividend (as discussed above).

Dividends paid by us will not be eligible for the dividends-received deduction allowed to corporations under the U.S. Internal Revenue Code of 1986, as amended (the Code ).

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Distributions of additional shares or ADSs to U.S. holders with respect to their shares or ADSs that are made as part of a pro rata distribution to all of our shareholders generally will not be subject to U.S. federal income tax. The basis of any new shares or ADSs so received will be determined by allocating the U.S. holder s basis in the old shares or ADSs and the new shares or ADSs, respectively, based on the relative fair market values on the date of distribution. For U.S. tax purposes, any such tax-free share distribution generally would not result in foreign-source income to a U.S. holder. *You should consult your own tax advisors regarding the application of the foreign tax credit rules to your investment in the shares or ADSs.*

***Taxation of Dispositions***

A U.S. holder will recognize gain or loss on the sale or other disposition of the shares or ADSs in an amount equal to the difference between the U.S. holder s basis in such shares or ADSs (in U.S. dollars) and the amount realized on the disposition (in U.S. dollars, determined at the spot rate on the date of disposition or, for a cash basis U.S. holder (or an electing accrual basis U.S. holder), at the exchange rate in effect on the settlement date, if the amount realized is denominated in a foreign currency). Gain or loss realized by a U.S. holder on such sale or other disposition generally will be long-term capital gain or loss if, at the time of disposition, the shares or ADSs have been held for more than one year. The net amount of long-term capital gain recognized by an individual holder is taxed at a reduced rate. Such gain or loss generally will be treated as U.S. source gain or loss for U.S. foreign tax credit purposes.

Gain, if any, realized by a U.S. holder on the sale or other disposition of the shares or ADSs will be treated as U.S. source income for U.S. foreign tax credit purposes. Consequently, if a Mexican withholding tax is imposed on the sale or disposition of the shares or ADSs, a U.S. holder that does not receive significant foreign source income from other sources may not be able to derive effective U.S. foreign tax credit benefits in respect of these Mexican taxes. U.S. holders should consult their own tax advisers regarding the application of the foreign tax credit rules to their investment in, and disposition of, our shares or ADSs.

***Exchange of Shares***

A U.S. holder s exchange of A Shares for L Shares will not constitute a taxable event for U.S. federal income tax purposes. An exchanging U.S. holder will have a tax basis in the L Shares equal to the basis such holder had in the exchanged A Shares. An exchanging U.S. holder s holding period for the L Shares will include the holding period such U.S. holder had in the A Shares before such shares were exchanged.

A U.S. holder s exchange of L Shares for AA Shares, pursuant to the option to exchange in respect of such L Shares, will not constitute a taxable event for U.S. federal income tax purposes. An exchanging U.S. holder will have a tax basis in the AA Shares received equal to the basis such holder had in the exchanged L Shares. A U.S. holder s holding period for AA Shares received in such an exchange will include the holding period such U.S. holder had in the L Shares prior to such exchange. The AA Shares, however, may be owned only by holders that qualify as Mexican investors as defined in the Foreign Investment Law and our bylaws. See *Bylaws and Mexican Law Limitation on Share Ownership*.

***Information Reporting and Backup Withholding***

Dividends on, and proceeds from the sale or other disposition of, the shares or ADSs paid to a U.S. holder generally may be subject to the information reporting requirements of the Code and may be subject to backup withholding unless the holder:

- establishes that it is a corporation or other exempt holder; or

- provides an accurate taxpayer identification number on a properly completed Internal Revenue Service Form W-9 and certifies that it is not subject to backup withholding and otherwise complies with applicable requirements of the backup withholding rules.

The amount of any backup withholding from a payment to a holder will be allowed as a credit against the U.S. holder s U.S. federal income tax liability and may entitle such holder to a refund, provided that certain required information is furnished to the Internal Revenue Service.

***U.S. Tax Consequences for Non-U.S. holders***

***Distributions***. A holder or beneficial owner of shares or ADSs that is not a U.S. holder for U.S. federal income tax purposes (a non-U.S. holder ) generally will not be subject to U.S. federal income or withholding tax on dividends received on shares or ADSs, unless such income is effectively connected with the conduct by the holder of a U.S. trade or business.

***Dispositions***. A non-U.S. holder of shares or ADSs will not be subject to U.S. federal income or withholding tax on gain realized on the sale of shares or ADSs, unless:

- such gain is effectively connected with the conduct by the holder of a U.S. trade or business; or

- in the case of gain realized by an individual non-U.S. holder, the non-U.S. holder is present in the United States for 183 days or more in the taxable year of the sale and certain other conditions are met.

***Information reporting and backup withholding***. Although non-U.S. holders generally are exempt from backup withholding, a non-U.S. holder may be required to comply with certification and identification procedures in order to establish its exemption from information reporting and backup withholding.

## DOCUMENTS ON DISPLAY

We file reports, including annual reports on Form 20-F, and other information electronically with the SEC pursuant to the rules and regulations of the SEC that apply to foreign private issuers. You may read and copy any materials filed with the SEC at its Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Any filings we make are also available to the public over the Internet at the SEC s website at www.sec.gov and at our website at www.telmex.com. (This URL is intended to be an inactive textual reference only. It is not intended to be an active hyperlink to our website. The information on our website, which might be accessible through a hyperlink resulting from this URL, is not and shall not be deemed to be incorporated into this annual report.)

## Item 11. Quantitative and Qualitative Disclosures about Market Risk

## EXCHANGE RATE AND INTEREST RATE RISKS

We are exposed to exchange rate risk and interest rate risk related to our indebtedness. Exchange rate risk exists principally with respect to our indebtedness denominated in currencies other than Mexican pesos. As of December 31, 2010, indebtedness denominated in foreign currencies was P.44,075 million, of which P.40,853 million was denominated in U.S. dollars and P.3,222 million was denominated in other currency. Interest rate risk exists principally with respect to our indebtedness that bears interest at floating rates. We had P.46,149 million of indebtedness bearing interest at floating rates at December 31, 2010.

We use derivative financial instruments to minimize the impact of fluctuations in exchange rates and floating interest rates on our indebtedness. We regularly assess our exposure and monitor opportunities to manage these risks. See *Item 5. Operating and Financial Review and Prospects Hedging*.

## SENSITIVITY ANALYSIS DISCLOSURES

### Exchange Rates

The potential loss in fair value of financial instruments at December 31, 2010 that would have resulted from a hypothetical, instantaneous and unfavorable 10% change in currency exchange rates, taking into account our derivative transactions, would have been approximately P.112 million. Such a change in currency exchange rates would also have resulted in additional interest expense of approximately P.4 million per year, assuming no change in the principal amount of such indebtedness, reflecting the increased costs in pesos of servicing foreign currency indebtedness. This sensitivity analysis assumes an instantaneous unfavorable 10% change in exchange rates affecting the foreign currencies in which our indebtedness is denominated.

### Interest Rates

The potential loss in fair market value of financial instruments at December 31, 2010 that would have resulted from a hypothetical, instantaneous and unfavorable change of 100 basis points in the interest rate applicable to such financial instruments, taking into account our derivative transactions, would have been approximately P.1,448 million. This effect would be fully attributable to the impact of the interest rate change on fixed-rate financial assets and liabilities. A hypothetical, instantaneous and unfavorable change of 100 basis points in the interest rate applicable to floating-rate financial assets and liabilities held

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at December 31, 2010, taking into account our derivative transactions, would have resulted in additional interest expense of approximately P.389 million per year, assuming no change in the principal amount of such indebtedness. The above sensitivity analyses are based on the assumption of an unfavorable 100 basis point movement of the interest rates applicable to each homogeneous category of financial assets and liabilities. A homogeneous category is defined according to the currency in which financial assets and liabilities are denominated and assumes the same interest rate movement with each homogeneous category. As a result, interest rate risk sensitivity analysis may overstate the impact of interest rate fluctuations for such financial instruments, as consistently unfavorable.

## Item 12. Description of Securities Other Than Equity Securities

### Item 12A. Debt Securities

Not applicable.

### Item 12B. Warrants and Rights

Not applicable.

### Item 12C. Other Securities

Not applicable.

### Item 12D. American Depositary Shares

JPMorgan Chase Bank, N.A., or the Depositary, serves as the depositary for our ADSs. ADS holders are required to pay various fees to the Depositary, and the Depositary may refuse to provide any service for which a fee is assessed until the applicable fee has been paid.

ADS holders are required to pay the Depositary: (i) an annual fee of up to US$0.02 per ADS (or portion thereof) for administering the ADS program, and (ii) amounts in respect of expenses incurred by the Depositary or its agents on behalf of ADS holders, including expenses arising from compliance with applicable law, taxes or other governmental charges, facsimile transmission, or conversion of foreign currency into U.S. dollars. In both cases, the Depositary may decide in its sole discretion to seek payment by either billing holders or by deducting the fee from one or more cash dividends or other cash distributions.

ADS holders are also required to pay additional fees for certain services provided by the Depositary, as set forth in the table below.

| **Depositary service** | **Fee payable by ADS holders** |
|---|---|
| Issuance and delivery of ADRs, including in connection with share distributions, sales and stock splits | Up to US$5.00 per 100 ADSs (or portion thereof) |
| Distribution of dividends | US$0.02 or less per ADS |
| Withdrawal, cancellation or reduction of shares underlying ADSs | Up to US$5.00 per 100 ADSs (or portion thereof) |
| Transfers, combining or grouping of ADRs | US$1.50 per ADS |

**Payments by the Depositary**

The Depositary pays us an agreed amount, which includes reimbursements for certain expenses we incur in connection with the ADS program. These reimbursable expenses include legal and accounting fees, listing fees, investor relations expenses and fees payable to service providers for the distribution of material to ADR holders. For the year ended December 31, 2010, this amount was U.S.$3.9 million.

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## PART II

### Item 13. Defaults, Dividend Arrearages and Delinquencies

None.

### Item 14. Material Modifications to the Rights of Securities Holders and Use of Proceeds

None.

### Item 15. Controls and Procedures

**Disclosure Controls and Procedures**

We have evaluated, with the participation of our chief executive officer and chief financial officer, the effectiveness of our disclosure controls and procedures as of December 31, 2010. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon our evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the applicable rules and forms, and that it is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

**Management s Annual Report on Internal Control Over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Mexican Financial Reporting Standards, including the reconciliation to U.S. GAAP in accordance with Item 18 of Form 20-F. Our internal control over financial reporting includes those policies and procedures that:

(a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;

(b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with Mexican Financial Reporting Standards, including the reconciliation to U.S. GAAP in accordance with Item 18 of Form 20-F, and that receipts and expenditures of the company are being made only in accordance with authorizations of our management and directors; and

(c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company s assets that could have a material effect on the financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2010. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework and, with respect to the effectiveness of our information technology, the criteria set forth in the Control Objectives for Information and related Technology (COBIT).

Based on our assessment and those criteria, management believes that the company maintained effective internal control over financial reporting as of December 31, 2010.

Mancera, S.C., a member practice of Ernst & Young Global, the independent registered public accounting firm that has audited our financial statements, has issued an attestation report on our internal control over financial reporting, which appears below.

There has been no change in our internal control over financial reporting during 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting**

The Board of Directors and Stockholders

Teléfonos de México, S.A.B. de C.V.

We have audited Teléfonos de México, S.A.B. de C.V. and subsidiaries internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Teléfonos de México, S.A.B. de C.V. and subsidiaries management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management s Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States of America). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Mexican Financial Reporting Standards, including the reconciliation to U.S. GAAP in accordance with Item 18 of Form 20-F. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with Mexican Financial Reporting Standards, including the reconciliation to U.S. GAAP in accordance with Item 18 of Form 20-F, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Teléfonos de México, S.A.B. de C.V. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010 based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States of America), the consolidated balance sheets of Teléfonos de México, S.A.B. de C.V. and subsidiaries as of December 31, 2010 and 2009, the related consolidated statements of income, changes in stockholders equity and cash flows for each of the three years in the period ended

December 31, 2010 of Teléfonos de México, S.A.B. de C.V. and subsidiaries and our report dated May 11, 2011 expressed an unqualified opinion thereon.

Mancera, S.C.
A member practice of
Ernst & Young Global

/s/ C.P.C. David Sitt Cofradía
C.P.C. David Sitt Cofradía

Mexico City, Mexico

May 11, 2011

**Item 16A. Audit Committee Financial Expert**

Our Board of Directors has determined that Rafael Kalach M., the chairman of our audit committee and a member of our Board of Directors, qualifies as an audit committee financial expert. Rafael Kalach M. has a public accountant degree from the Universidad Nacional Autónoma de México. He has been a member of audit, finance and planning, and evaluation and compensation committees of various Mexican companies. Rafael Kalach M. qualifies as independent, as determined by our shareholders at their annual ordinary general meeting pursuant to the Mexican Securities Market Law and as defined under the rules of the New York Stock Exchange and the NASDAQ Stock Market, Inc. that are applicable to foreign private issuers. See *Item 6. Directors, Senior Management and Employees Audit Committee.*

**Item 16B. Code of Ethics**

We have adopted a code of ethics, as defined in Item 16B of Form 20-F. Our code of ethics applies to our chief executive officer, chief financial officer, principal accounting officer, persons performing similar functions and other personnel. Our code of ethics is available on our website at www.telmex.com. If we amend the provisions of our code of ethics that apply to our chief executive officer, our chief financial officer, our principal accounting officer and persons performing similar functions, or if we grant any waiver of such provisions, we will disclose such amendment or waiver on our website at the same address.

**Item 16C. Principal Accountant Fees and Services**
**Audit and Non-Audit Fees**

The following table sets forth the fees billed to us by our independent auditors, Mancera, S.C., a member practice of Ernst & Young Global, an independent registered public accounting firm, and by other member practices of Ernst & Young Global during the years ended December 31, 2010 and 2009:

| | Year ended December 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (thousands) | |
| Audit fees | P.38,501 | P.41,917 |
| Audit-related fees | 1,896 | 287 |
| Tax fees | 877 | 1,266 |
| Total fees | P.41,274 | P.43,470 |

Audit fees in the above table are the aggregate fees billed in connection with the audit of our annual financial statements, the review of our interim financial statements, statutory and regulatory audits, and fees related to compliance with the Sarbanes-Oxley Act of 2002.

Audit-related fees in the above table are fees billed for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements and are not reported under Audit fees, in particular fees billed for the review of information provided to Mexican regulatory authorities. The increase in 2010 was due to the issuance of a senior note.

Tax fees in the above table are fees billed for tax compliance, tax advice and tax planning services.

**Audit Committee Approval Policies and Procedures**

Our audit committee has established policies and procedures for the engagement of our independent auditors for services. Such policies and procedures outline services that require specific approval on a case-by-case basis and general services that have been approved in advance by the audit committee, which include statutory and regulatory audits, tax compliance and evaluation of the security of our information technology. Prior to providing any services that require specific pre-approval, our independent auditor, together with our chief financial officer, will jointly present to the audit committee a request for approval of audit services, in which such persons confirm that the request complies with applicable rules.

**Item 16D. Exemptions from the Listing Standards for Audit Committees**
Not applicable.

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**Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

The following table provides information on L Shares purchased by our company and affiliated purchasers in 2010:

| Year ended December 31, 2010 | Total Number of L Shares Purchased(1) | Weighted Average Price Paid per L Share | Total Number of L Shares Purchased as Part of the Share Repurchase Program(2) | Weighted Average Price Paid per L Share Purchased as Part of the Share Repurchase Program | Approximate Peso Value (in Thousands) of L Shares that May Yet Be Purchased Under the Share Repurchase Program(3) |
|---|---|---|---|---|---|
| **January 1-31** | 1,000,000 | P. 10.97 | 1,000,000 | P. 10.97 | P. 6,810,377 |
| **February 1-28** | | | | | 6,810,377 |
| **March 1-31** | 44,475,600 | 9.71 | | | 6,810,377 |
| **April 1-30** | 70,094,400 | 9.87 | | | 6,810,377 |
| **May 1-31** | 12,950,400 | 8.90 | | | 6,810,377 |
| **June 1-30** | 23,045,200 | 8.97 | | | 6,810,377 |
| **July 1-31** | | | | | 6,810,377 |
| **August 1-31** | | | | | 6,810,377 |
| **September 1-30** | | | | | 6,810,377 |
| **October 1-31** | 69,980,000 | 9.20 | | | 6,810,377 |
| **November 1-30** | 89,366,800 | 9.35 | | | 6,810,377 |
| **December 1-31** | 32,885,354 | 10.00 | 32,885,354 | 10.00 | 6,481,598 |
| **Total/Average** | 343,797,754 | 9.50 | 33,885,354 | 10.03 | |

(1) We do not repurchase our L Shares other than through the share repurchase program. An aggregate of 310 million L Shares were purchased by our affiliated purchasers in 2010. These shares were purchased in open-market transactions.

(2) We periodically repurchase our L Shares on the open market using funds authorized by our shareholders specifically for the repurchase of L Shares and A Shares by us at our discretion. On March 3, 2009, our shareholders authorized an additional P.10,000 million for the repurchase of L Shares and A Shares.

(3) This is the approximate peso amount available at the end of the period for purchases of both L Shares and A Shares pursuant to the share repurchase program.

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The following table provides information on A Shares purchased by our company and affiliated purchasers in 2010:

| Year ended December 31, 2010 | Total Number of A Shares Purchased[(1)] | Weighted Average Price Paid per A Share | Total Number of A Shares Purchased as Part of the Share Repurchase Program[(2)] | Weighted Average Price Paid per A Share Purchased as Part of the Share Repurchase Program | Approximate Peso Value (in Thousands) of A Shares that May Yet Be Purchased Under the Share Repurchase Program[(3)] |
|---|---|---|---|---|---|
| **January 1-31** | 6,900 | P. 11.00 | 6,900 | P. 11.00 | P. 6,810,377 |
| **February 1-28** | | | | | 6,810,377 |
| **March 1-31** | 46,600 | 9.68 | | | 6,810,377 |
| **April 1-30** | 90,200 | 9.76 | | | 6,810,377 |
| **May 1-31** | 77,800 | 9.04 | | | 6,810,377 |
| **June 1-30** | 85,809 | 9.07 | | | 6,810,377 |
| **July 1-31** | 93,600 | 9.01 | | | 6,810,377 |
| **August 1-31** | 3,300 | 9.34 | | | 6,810,377 |
| **September 1-30** | | | | | 6,810,377 |
| **October 1-31** | 37,000 | 9.35 | | | 6,810,377 |
| **November 1-30** | 235,700 | 9.65 | | | 6,810,377 |
| **December 1-31** | 55,406 | 9.88 | 6 | 10.39 | 6,481,598 |
| **Total/Average** | 732,315 | 9.46 | 6,906 | 11.00 | |

(1) We do not repurchase our A Shares other than through the share repurchase program. An aggregate of 725 thousand A Shares were purchased by our affiliated purchasers in 2010. These shares were purchased through open-market transactions.

(2) We periodically repurchase our A Shares on the open market using funds authorized by our shareholders specifically for the repurchase of L Shares and A Shares by us at our discretion. On March 3, 2009, our shareholders authorized an additional P.10,000 million for the repurchase of L Shares and A Shares.

(3) This is the approximate peso amount available at the end of the period for purchases of both L Shares and A Shares pursuant to the share repurchase program.

**Item 16F. Change in Registrant s Certifying Accountant**

Not applicable.

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**Item 16G. Corporate Governance**

Pursuant to Section 303A.11 of the Listed Company Manual of the New York Stock Exchange (NYSE) and Rule 5615(a)(3) of the NASDAQ Stock Market, Inc. (NASDAQ) Marketplace Rules, we are required to provide a summary of the significant ways in which our corporate governance practices differ from those required for U.S. companies under the NYSE and NASDAQ listing standards.

The table below discloses the significant differences between our corporate governance practices and the NYSE and NASDAQ standards.

| NYSE Standards | NASDAQ Standards | Our Corporate Governance Practices |
|---|---|---|
| ***Director Independence***. *Majority of board of directors must be independent. §303A.01.* *Controlled companies, which would include our company if we were a U.S. issuer, are exempt from this requirement. A controlled company is one in which more than 50% of the voting power is held by an individual, group or another company, rather than the public. §303A.00.* | ***Director Independence***. *Majority of board of directors must be independent and directors deemed independent must be identified in a listed company s proxy statement (or annual report on Form 10-K or 20-F if the issuer does not file a proxy statement). Controlled companies, which would include our company if we were a U.S. issuer, are exempt from this requirement. A controlled company is one in which more than 50% of the voting power is held by an individual, group or another company, rather than the public. Rules 5605(b)(1), 5615(c)(1) and (c)(2).* | ***Director Independence***. Pursuant to the Mexican Securities Market Law and our bylaws, our shareholders are required to appoint a Board of Directors of no more than 21 members, 25% of whom must be independent. Certain directors are per se non-independent, including insiders, control persons, major suppliers and any relatives of such persons. In accordance with the Mexican Securities Market Law, our shareholders are required to make a determination as to the independence of our directors, though such determination may be challenged by the CNBV. There is no exemption from the independence requirement for controlled companies. |
| ***Executive Sessions***. *Non-management directors must meet at regularly scheduled executive sessions without management. Independent directors should meet alone in an executive session at least once a year. §303A.03.* | ***Executive Sessions***. *Independent directors must have regularly scheduled executive sessions at which only independent directors are present. Rule 5605(b)(2).* | ***Executive Sessions***. Our independent directors have not held executive sessions without management, and under our bylaws and applicable Mexican law, they are not required to do so. |
| ***Nominating/Corporate Governance Committee***. *Nominating/corporate governance committee composed entirely of independent directors is required. The committee must have a charter specifying the purpose, duties and evaluation procedures of the committee. §303A.04.* *Controlled companies are exempt from these requirements. §303A.00.* | ***Nominating Committee***. *Director nominees must be selected, or recommended for the board s selection, either by a nominating committee comprised solely of independent directors or by a majority of independent directors. Each listed company also must certify that it has adopted a formal charter or board resolution addressing the nominations process.* | ***Nominating Committee***. We currently do not have a nominating committee. We are not required to have a nominating committee. However, Mexican law requires us to have one or more committees that oversee the corporate governance function. |
| | | We have an executive committee, an audit committee and a corporate |

| NYSE Standards | NASDAQ Standards | Our Corporate Governance Practices |
|---|---|---|
| | *Controlled companies are exempt from this requirement. Rules 5605(e)(1)(A) and 5615(c)(2).* | practices committee, which together perform corporate governance functions.<br><br>As a controlled company, we would be exempt from this requirement if we were a U.S. issuer. |
| ***Compensation Committee**. Compensation committee composed entirely of independent directors is required, which must evaluate and approve executive officer compensation. The committee must have a charter specifying the purpose, duties and evaluation procedures of the committee. §303A.05. Controlled companies are exempt from this requirement. §303A.00.* | ***Compensation Committee**. CEO compensation must be determined, or recommended to the board for determination, either by a compensation committee comprised solely of independent directors or a majority of the independent directors and the CEO may not be present during voting or deliberations. Compensation of all other executive officers must be determined in the same manner, except that the CEO, and any other executive officers, may be present. Controlled companies are exempt from this requirement. Rules 5605(e)(1)(B) and 5615(c)(2).* | ***Compensation Committee***. We have a corporate practices committee, which assists our Board of Directors in evaluating and compensating our senior executives. The Mexican Securities Market Law requires that a majority of the members of the corporate practices committee of controlled listed companies be independent. All of the members of our corporate practices committee are independent.<br><br>As a controlled company, we would be exempt from this requirement if we were a U.S. issuer. |
| ***Audit Committee**. Audit committee satisfying the independence and other requirements of Rule 10A-3 under the Exchange Act and the more stringent requirements under the NYSE standards is required. §§303A.06, 303A.07.* | ***Audit Committee**. Audit committee satisfying the independence and other requirements of Rule 10A-3 under the Exchange Act and the more stringent requirements under the NASDAQ standards is required. Rule 5605(c)(1).* | ***Audit Committee***. We have an audit committee of three members. 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 Exchange Act. Our audit committee operates primarily pursuant to (1) a written charter approved by our Board of Directors and (2) Mexican law. For a detailed description of the duties of our audit committee, see *Item 6. Directors, Senior Management and Employees Audit Committee.* |
| ***Equity Compensation Plans**. Equity compensation plans and all material revisions thereto require shareholder approval, subject to limited exemptions. §§303A.08 and 312.03.* | ***Equity Compensation Plans**. Equity compensation plans or material amendments thereto require shareholder approval, subject to limited exemptions. Rule 5635(c).* | ***Equity Compensation Plans***. Shareholder approval is required under Mexican law for the adoption and amendment of an equity compensation plan. Such plans should provide for general application to all executives.<br><br>We do not have an equity |

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| NYSE Standards | NASDAQ Standards | Our Corporate Governance Practices |
|---|---|---|
| | | compensation plans. |
| ***Shareholder Approval for Issuance of Securities***. *Issuances of securities (1) that will result in a change of control of the issuer, (2) that are to a related party or someone closely related to a related party, (3) that have voting power equal to at least 20% of the outstanding common stock voting power before such issuance or (4) that will increase the number of shares of common stock by at least 20% of the number of outstanding shares before such issuance require shareholder approval. §§312.03(b)-(d).* | ***Shareholder Approval for Issuance of Securities***. *Issuances of securities (1) that will result in a change of control of the issuer, (2) in connection with certain acquisitions of the stock or assets of another company or (3) in connection with certain transactions other than public offerings require shareholder approval. Rules 5635(a), (b) and (d).* | ***Shareholder Approval for Issuance of Securities***. Mexican law and our bylaws require us to obtain shareholder approval of the issuance of new equity securities. |
| ***Code of Business Conduct and Ethics***. *Corporate governance guidelines and a code of business conduct and ethics is required, with disclosure of any waiver for directors or executive officers. The code must contain compliance standards and procedures that will facilitate the effective operation of the code. §303A.10.* | ***Code of Business Conduct and Ethics***. *Corporate governance guidelines and a code of business conduct and ethics is required, with disclosure of any waiver and the reasons for such waiver for directors or executive officers. The code must include an enforcement mechanism. Rule 5610.* | ***Code of Business Conduct and Ethics***. We have adopted a code of ethics, which has been accepted by all of our directors and executive officers and other personnel. A copy of our code of ethics is available on our website: www.telmex.com. |
| ***Conflicts of Interest***. *Determination of how to review and oversee related party transactions is left to the listed company. The audit committee or comparable body, however, could be considered the forum for such review and oversight. §303A.07. Certain issuances of common stock to a related party require shareholder approval. §312.03(b).* | ***Conflicts of Interest***. *Appropriate review of all related party transactions for potential conflict of interest situations and approval by an audit committee or another independent body of the board of directors of such transactions is required. Rule 5630.* | ***Conflicts of Interest***. 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 of 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 others customers and does not result from employee benefits of general character. |
| ***Solicitation of Proxies***. *Solicitation of proxies and provision of proxy materials is required for all meetings of shareholders. Copies of such proxy solicitations are to be provided to NYSE. §§402.01 and* | ***Solicitation of Proxies***. *Solicitation of proxies and provision of proxy materials is required for all meetings of shareholders. Copies of such proxy solicitations are to be provided to NASDAQ. Rule* | ***Solicitation of Proxies***. We are not required to distribute proxy materials to, or solicit the return of proxies from, our shareholders. In accordance with Mexican law and our bylaws, we inform shareholders of all meetings by public notice, |

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| NYSE Standards | NASDAQ Standards | Our Corporate Governance Practices |
|---|---|---|
| *402.04.* | *5620(b).* | which states the requirements for admission to the meeting and provides a mechanism by which shareholders can vote through a representative using a power of attorney. Under the new Mexican Securities Market Law, we have to make power of attorney forms available to shareholders at their request. Under the deposit agreement relating to our ADSs, holders of our ADSs receive notices of shareholders meetings and, where applicable, instructions on how to vote at the shareholders meeting through the depositary. |
| | ***Peer Review****. A listed company must be audited by an independent public accountant that is registered as a public accounting firm with the Public Company Accounting Oversight Board. Rule 5250(c)(3).* | ***Peer Review***. Under Mexican law we must be audited by an independent public accountant that satisfies quality control requirements as defined by the CNBV. |
| | | Mancera, S.C., a member practice of Ernst & Young Global, our independent auditor, is not subject to peer review as such term is defined in NASDAQ s Marketplace Rule 4350(k). |

# PART III

## Item 17. Financial Statements

Not applicable.

## Item 18. Financial Statements

See our consolidated financial statements beginning on page F-1, incorporated herein by reference.

## Item 19. Exhibits

Documents filed as exhibits to this annual report:

| | |
|---|---|
| 1.1 | Amended and restated bylaws (*estatutos sociales*) of Teléfonos de México, S.A.B. de C.V., dated December 26, 2007 (English translation) (incorporated by reference to the annual report on Form 20-F for the year ended December 31, 2008 (File No. 1-32741) filed on June 27, 2008). |
| 2.1 | Form of Amended and Restated L Share Deposit Agreement (incorporated by reference to the post-effective amendment to our registration statement on Form F-6 (File No. 333-125023) filed on September 28, 2006). |
| 2.2 | Form of Amended and Restated A Share Deposit Agreement (incorporated by reference to the post-effective amendment to our registration statement on Form F-6 (File No. 333-12936) filed on September 28, 2006). |
| 2.3 | Loan Agreement, dated as of August 11, 2006, among Teléfonos de México, S.A.B. de C.V., the lenders party thereto, Citibank, N.A., as administrative agent, ABN AMRO Bank N.V., BBVA Securities Inc., Citigroup Global Markets Inc., HSBC Securities (USA) Inc. and Calyon New York Branch, as joint bookrunners, ABN AMRO Bank N.V., as syndication agent, and Banco Bilbao Vizcaya Argentaria, S.A. and HSBC Securities (USA) Inc., as co-documentation agents (incorporated by reference to our annual report on Form 20-F for the year ended December 31, 2006 (File No. 1-32741) filed on July 16, 2007). |
| 3.1 | Agreement dated December 20, 2000 between Carso Global Telecom, S.A.B. de C.V. and SBC International, Inc. (AT&T International since 2006) (incorporated by reference to our annual report on Form 20-F for the year ended December 31, 2000 (File No. 1-10749) filed on May 4, 2001). |
| 3.2 | Amended Shareholders Agreement, by and among Carso Global Telecom, S.A.B. de C.V., formerly, Carso Global Telecom, S.A. de C.V., AT&T International, Inc. ( AT&T ), formerly SBC International, Inc., and Banco Inbursa, S.A. Institución de Banca Múltiple, Grupo Financiero Inbursa, División Fiduciaria acting as trustee under Trust F/10456, dated February 28, 2011, amending the Agreement filed as exhibit 3.1 hereto (incorporated by reference to the exhibit included in Amendment No. 4 to the Schedule 13G filed by AT&T and its parent, AT&T Inc. filed on March 1, 2011 in respect of their ownership in equity shares of Telmex). |

| | |
|---|---|
| 4.1 | Master Transition Agreement between Teléfonos de México, S.A.B. de C.V. and Telmex Internacional, S.A.B. de C.V., dated as of December 26, 2007 (English translation) (incorporated by reference to the registration statement on Form 20-F of Telmex Internacional, S.A.B. de C.V. (File No. 1-34086) filed on May 30, 2008). |
| 4.2 | Services Agreement dated January 1, 2010 between Teléfonos de México, S.A.B. de C.V. and Carso Global Telecom, S.A.B. de C.V. (English translation). |
| 4.3 | Management Services Agreement, dated January 2, 2001, between Teléfonos de México, S.A. de C.V. and AT&T Mexico, Inc. (incorporated by reference to our annual report on Form 20-F for the year ended December 31, 2003 (File No. 1-10749) filed on June 28, 2004). |
| 4.4 | Termination Agreement dated July 1, 2010 between Teléfonos de México, S.A.B. de C.V. and Carso Global Telecom, S.A.B. de C.V. (English translation). |
| 7.1 | Calculation of ratios of earnings to fixed charges. |
| 8.1 | List of significant subsidiaries of Teléfonos de México, S.A.B. de C.V. |
| 12.1 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 12.2 | Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 13.1 | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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The exhibits do not include any instrument defining the rights of holders of long-term debt of the registrant or of its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed when under such instrument the total amount of securities authorized does not exceed 10% of the total assets of the registrant and its subsidiaries on a consolidated basis. The registrant agrees to furnish a copy of any such instrument to the SEC upon its request.

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Teléfonos de México, S.A.B. de C.V.

We have audited the accompanying consolidated balance sheets of Teléfonos de México, S.A.B. de C.V. and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in stockholders equity and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States of America). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of Teléfonos de México, S.A.B. de C.V. and subsidiaries at December 31, 2010 and 2009, and the consolidated results of their operations and cash flows for each of the three years in the period ended December 31, 2010, in conformity with Mexican Financial Reporting Standards, which differ in certain respects from U.S. generally accepted accounting principles (see Note 18 to the consolidated financial statements).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States of America), Teléfonos de México, S.A.B. de C.V. and subsidiaries internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated May 11, 2011, expressed an unqualified opinion thereon.

Mancera, S.C.

A member practice of

Ernst & Young Global

/s/ C.P.C. David Sitt Cofradía
C.P.C. David Sitt Cofradía

Mexico City, Mexico

May 11, 2011

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**TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES**

**Consolidated Balance Sheets**

(In thousands of Mexican pesos, see Note 1 II.b)

| | December 31 | |
|---|---|---|
| | **2010** | 2009 |
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents (Note 2) | **P. 7,493,465** | P. 14,379,768 |
| Accounts receivable, net (Note 3) | **17,648,533** | 20,425,556 |
| Derivative financial instruments (Note 7) | **6,957,018** | 12,225,550 |
| Inventories for sale, net | **1,783,579** | 1,448,102 |
| Prepaid expenses and others | **3,121,994** | 3,303,275 |
| Total current assets | **37,004,589** | 51,782,251 |
| Plant, property and equipment, net (Note 4) | **99,421,332** | 106,047,642 |
| Licenses and trademarks, net (Note 5) | **1,307,517** | 918,341 |
| Equity investments (Note 6) | **1,392,042** | 1,775,380 |
| Net projected asset (Note 10) | **17,342,200** | 16,430,857 |
| Goodwill (Note 6) | **103,289** | |
| Deferred charges and prepaid expenses, net | **1,183,363** | 1,442,330 |
| Total assets | **P. 157,754,332** | P. 178,396,801 |
| **Liabilities and stockholders equity** | | |
| Current liabilities: | | |
| Short-term debt and current portion of long-term debt (Note 7) | **P. 11,951,532** | P. 19,768,894 |
| Accounts payable and accrued liabilities (Note 8) | **17,377,010** | 14,245,612 |
| Taxes payable | **2,443,268** | 2,211,626 |
| Deferred revenues (Note 9) | **917,377** | 1,104,175 |
| Total current liabilities | **32,689,187** | 37,330,307 |
| Long-term debt (Note 7) | **62,569,413** | 83,105,454 |
| Labor obligations (Note 10) | **3,516,686** | 4,113,513 |
| Deferred taxes (Note 15) | **14,132,763** | 15,060,058 |
| Deferred revenues (Note 9) | **622,351** | 466,696 |
| Total liabilities | **113,530,400** | 140,076,028 |
| Stockholders equity (Note 14): | | |
| Capital stock | **9,008,985** | 9,020,300 |
| Retained earnings: | | |
| Prior years | **19,135,353** | 7,907,079 |
| Current year | **15,384,162** | 20,468,689 |
| | **34,519,515** | 28,375,768 |
| Accumulated other comprehensive income items | **386,109** | 883,225 |
| Controlling interest | **43,914,609** | 38,279,293 |

| | | |
|---|---|---|
| Noncontrolling interest | **309,323** | 41,480 |
| Total stockholders equity | **44,223,932** | 38,320,773 |
| Total liabilities and stockholders equity | **P. 157,754,332** | P. 178,396,801 |

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

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**TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES**

**Consolidated Statements of Income**

(In thousands of Mexican pesos, except for earnings per share, see Note 1 II.b)

| | | Year ended December 31 | |
|---|---|---|---|
| | **2010** | 2009 | 2008 |
| **Operating revenues:** | | | |
| Local service | **P. 41,006,772** | P. 45,027,811 | P. 48,982,383 |
| Long distance service: | | | |
| Domestic | **12,264,837** | 14,142,688 | 15,741,771 |
| International | **5,646,278** | 6,662,102 | 8,793,262 |
| Interconnection service | **15,022,721** | 16,572,941 | 19,139,692 |
| Data | **32,878,968** | 30,817,715 | 25,387,672 |
| Other | **6,743,789** | 5,876,955 | 6,060,455 |
| | **113,563,365** | 119,100,212 | 124,105,235 |
| **Operating costs and expenses:** | | | |
| Cost of sales and services | **34,710,580** | 34,177,782 | 32,522,668 |
| Commercial, administrative and general expenses | **22,351,181** | 20,811,440 | 19,863,006 |
| Interconnection | **10,561,053** | 11,796,163 | 14,043,385 |
| Depreciation and amortization (Notes 4 and 5) (includes P.16,942,580 in 2010, P.17,152,939 in 2009 and P.16,961,597 in 2008, not included in cost of sales and services) | **17,523,330** | 17,950,768 | 17,933,207 |
| | **85,146,144** | 84,736,153 | 84,362,266 |
| **Operating income** | **28,417,221** | 34,364,059 | 39,742,969 |
| Other expenses, net (Note 1 II.s) | **78,337** | 1,349,680 | 679,592 |
| Financing cost: | | | |
| Interest income | **(583,761)** | (711,243) | (913,462) |
| Interest expense | **5,733,627** | 6,122,328 | 7,652,427 |
| Exchange (gain) loss, net | **(394,470)** | (1,096,531) | 2,493,729 |
| | **4,755,396** | 4,314,554 | 9,232,694 |
| Equity interest in net income (loss) of affiliates | **195,910** | 254,680 | (62,113) |
| Income before taxes on profits | **23,779,398** | 28,954,505 | 29,768,570 |
| Provision for income tax (Note 15) | **8,407,940** | 8,485,522 | 9,591,659 |
| **Net income** | **P. 15,371,458** | P. 20,468,983 | P. 20,176,911 |
| Distribution of net income: | | | |
| Controlling interest | **P. 15,384,162** | P. 20,468,689 | P. 20,176,936 |
| Noncontrolling interest | **(12,704)** | 294 | (25) |

| | | | | | | |
|---|---|---|---|---|---|---|
| | **P.** | **15,371,458** | P. | 20,468,983 | P. | 20,176,911 |
| Weighted average number of shares issued and outstanding (millions) | | **18,189** | | 18,383 | | 18,906 |
| **Earnings per share** | **P.** | **0.85** | P. | 1.11 | P. | 1.07 |

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

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**TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES**

**Consolidated Statements of Changes in Stockholders Equity**

for the years ended December 31, 2008, 2009 and 2010

(In thousands of Mexican pesos, see Note 1 II.b)

| | | | Retained earnings | | Accumulated other comprehensive | | | | Total |
|---|---|---|---|---|---|---|---|---|---|
| | Capital stock | Legal reserve | Unappropriated | Total | income items | Controlling interest | Noncontrolling interest | Comprehensive income | stockholders equity |
| Balance at December 31, 2007 | P. 9,402,561 | P. 1,880,513 | P. 109,659,551 | P. 111,540,064 | P. (78,822,851) | P. 42,119,774 | P. 39,034 | | P. 42,158,808 |
| Effect of adopting Mexican FRS B-10, net of deferred taxes | | | (79,419,845) | (79,419,845) | 79,419,845 | | | | |
| Cumulative effect adjustment for recognition of deferred employee profit sharing, net of deferred taxes | | | (4,136,583) | (4,136,583) | (53,552) | (4,190,135) | | | (4,190,135) |
| Cash dividends declared | | | (7,774,143) | (7,774,143) | | (7,774,143) | | | (7,774,143) |
| Cash purchase of Company s own shares | (263,929) | | (12,607,913) | (12,607,913) | | (12,871,842) | | | (12,871,842) |
| Comprehensive income: | | | | | | | | | |
| Net income for the year | | | 20,176,936 | 20,176,936 | | 20,176,936 | (25) | P. 20,176,911 | 20,176,911 |
| Other comprehensive income items: | | | | | | | | | |
| Changes in fair value of swaps, net of deferred taxes | | | | | 2,126,088 | 2,126,088 | | 2,126,088 | 2,126,088 |
| Deferred taxes | | | (403,860) | (403,860) | | (403,860) | 2,177 | (401,683) | (401,683) |
| Effect of translation of foreign entities | | | | | 147,095 | 147,095 | | 147,095 | 147,095 |
| Comprehensive income | | | | | | | | P. 22,048,411 | |
| Balance at December 31, 2008 | 9,138,632 | 1,880,513 | 25,494,143 | 27,374,656 | 2,816,625 | 39,329,913 | 41,186 | | 39,371,099 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Cash dividends declared | | | (15,447,559) | (15,447,559) | | (15,447,559) | | | (15,447,559) |
| Cash purchase of Company s own shares | (118,332) | | (3,976,988) | (3,976,988) | | (4,095,320) | | | (4,095,320) |
| Excess of purchase price over book value of entities acquired from companies under common control | | | (43,030) | (43,030) | | (43,030) | | | (43,030) |
| Comprehensive income: | | | | | | | | | |
| Net income for the year | | | 20,468,689 | 20,468,689 | | 20,468,689 | 294 | P. 20,468,983 | 20,468,983 |
| Other comprehensive income items: | | | | | | | | | |
| Changes in fair value of swaps, net of deferred taxes | | | | | (1,866,847) | (1,866,847) | | (1,866,847) | (1,866,847) |
| Effect of translation of foreign entities, net of deferred taxes | | | | | (66,553) | (66,553) | | (66,553) | (66,553) |
| Comprehensive income | | | | | | | | P. 18,535,583 | |
| Balance at December 31, 2009 | 9,020,300 | 1,880,513 | 26,495,255 | 28,375,768 | 883,225 | 38,279,293 | 41,480 | | 38,320,773 |
| Cash dividends declared | | | **(8,911,908)** | **(8,911,908)** | | **(8,911,908)** | | | **(8,911,908)** |
| Cash purchase of Company s own shares | **(11,315)** | | **(328,507)** | **(328,507)** | | **(339,822)** | | | **(339,822)** |
| Noncontrolling interest arising on a business combination | | | | | | | **280,547** | | **280,547** |
| Comprehensive income: | | | | | | | | | |
| Net income for the year | | | **15,384,162** | **15,384,162** | | **15,384,162** | **(12,704)** | **P. 15,371,458** | **15,371,458** |
| Other comprehensive income items: | | | | | | | | | |
| Changes in fair value of swaps, net of deferred taxes | | | | | **(536,933)** | **(536,933)** | | **(536,933)** | **(536,933)** |
| Effect of translation of foreign entities, net of deferred taxes | | | | | **39,817** | **39,817** | | **39,817** | **39,817** |
| Comprehensive income | | | | | | | | **P. 14,874,342** | |
| Balance at December 31, 2010 (Note 14) | **P. 9,008,985** | **P. 1,880,513** | **P. 32,639,002** | **P. 34,519,515** | **P. 386,109** | **P. 43,914,609** | **P. 309,323** | | **P. 44,223,932** |

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

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**TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows**

(In thousands of Mexican pesos, see Note 1 II.b)

| | Year ended December 31 | | |
|---|---|---|---|
| | **2010** | 2009 | 2008 |
| **Operating activities** | | | |
| Income before taxes on profits | **P. 23,779,398** | P. 28,954,505 | P. 29,768,570 |
| Add (deduct) items not requiring the use of cash: | | | |
| Depreciation | **17,392,411** | 17,828,006 | 17,815,050 |
| Amortization | **130,919** | 122,762 | 101,702 |
| Reserve for obsolete inventories for operation of the telephone plant | **9,462** | 69,669 | 14,675 |
| Equity interest in net income (loss) of affiliates | **(195,910)** | (254,680) | 62,113 |
| Gain on sale of affiliated company | **(322,500)** | | |
| Gain on valuation of marketable securities | | | (36,948) |
| Net periodic cost of labor obligations | **7,018,738** | 6,646,858 | 5,742,803 |
| Interest expense | **5,733,627** | 6,122,328 | 7,652,427 |
| Exchange (gain) loss, net | **(646,909)** | (1,232,671) | 3,322,871 |
| Other | **1,082** | | 2,531 |
| | **52,900,318** | 58,256,777 | 64,445,794 |
| Changes in operating assets and liabilities: | | | |
| Decrease (increase) in: | | | |
| Marketable securities | | | 760,420 |
| Accounts receivable | **820,670** | 335,214 | (1,514,850) |
| Inventories for sale | **(335,477)** | 370,658 | 276,804 |
| Prepaid expenses and others | **183,267** | (463,577) | (103,370) |
| Deferred charges | **284,446** | 24,537 | (130,599) |
| (Decrease) increase in: | | | |
| Labor obligations: | | | |
| Contributions to trust fund | **(289)** | (5,751,947) | (4,321,922) |
| Benefits paid to employees | **(6,445,654)** | (218,816) | (197,297) |
| Accounts payable and accrued liabilities | **(994,803)** | (2,924,775) | (2,961,080) |
| Taxes on profits paid | **(6,916,875)** | (10,200,635) | (10,924,849) |
| Taxes payable | **13,942** | 1,428,082 | (293,609) |
| Deferred revenues | **(33,149)** | (620,350) | 869,732 |
| Net cash flows provided by operating activities | **39,476,396** | 40,235,168 | 45,905,174 |
| **Investing activities** | | | |
| Acquisition of plant, property and equipment | **(9,270,448)** | (9,657,071) | (12,666,485) |
| Acquisition of licenses | **(6,620)** | (14,168) | (135,271) |
| Acquisition of long-term equity investments | **(285,181)** | (116,640) | |
| Sale of long-term equity investments | **669,387** | | 76,207 |
| Dividends received from affiliated companies | **126,000** | 28,751 | |
| Net cash flows used in investing activities | **(8,766,862)** | (9,759,128) | (12,725,549) |
| Cash surplus to be applied to financing activities | **30,709,534** | 30,476,040 | 33,179,625 |
| **Financing activities** | | | |

| | | | |
|---|---|---|---|
| New loans | **10,135,980** | 23,689,235 | 11,862,831 |
| Repayment of loans | **(35,727,693)** | (24,552,238) | (15,781,356) |
| Cash purchase of Company s own shares | **(339,822)** | (4,095,320) | (12,871,842) |
| Dividends paid | **(8,736,965)** | (15,093,082) | (7,609,477) |
| Derivative financial instruments | **826,850** | 2,019,050 | (2,291,873) |
| Interest paid | **(3,754,187)** | (4,200,480) | (5,049,097) |
| Net cash flows used in financing activities | **(37,595,837)** | (22,232,835) | (31,740,814) |
| Net (decrease) increase in cash and cash equivalents | **(6,886,303)** | 8,243,205 | 1,438,811 |
| Cash and cash equivalents at beginning of year | **14,379,768** | 6,136,563 | 4,697,752 |
| Cash and cash equivalents at end of year | **P. 7,493,465** | P. 14,379,768 | P. 6,136,563 |

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

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**TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2010, 2009 and 2008

(In thousands of Mexican pesos, see Note 1 II.b)

## 1. Description of the Business and Significant Accounting Policies

### I. Description of the Business

Teléfonos de México, S.A.B. de C.V. and its subsidiaries (collectively the Company or TELMEX ) provide telecommunications services, primarily in Mexico, including domestic and international long distance and local telephone services, data services, the interconnection of subscribers with cellular networks (calling party pays), as well as the interconnection of domestic long distance carriers , cellular telephone companies and local service carriers networks with the TELMEX local network. TELMEX also obtains revenues from the sale of telephone equipment and personal computers.

The amended Mexican government concession under which TELMEX operates was signed on August 10, 1990. The concession runs through the year 2026, but it may be renewed for an additional period of fifteen years. Among other significant aspects, the concession stipulates the requirements for providing telephony services and establishes the basis for regulating rates.

The rates to be charged for basic telephone services are subject to a cap determined by the Federal Telecommunications Commission (COFETEL). During the last ten years, TELMEX management decided not to raise its rates for basic services.

TELMEX has concessions in Mexico to operate radio spectrum wave frequency bands to provide fixed wireless telephone services and to operate radio spectrum wave frequency bands for point-to-point and point-to-multipoint microwave communications.

The foreign subsidiary has licenses for use of point-to-point and point-to-multipoint links in the U.S.A.

On May 11, 2010, América Móvil, S.A.B. de C.V. (América Móvil) launched two concurrent public exchange offers to acquire the outstanding shares of Carso Global Telecom, S.A.B. de C.V. (Carso Global Telecom) (TELMEX s controlling stockholder) and Telmex Internacional, S.A.B de C.V. (Telmex Internacional). Carso Global Telecom was the direct holder of 59.4% of the outstanding shares of TELMEX. On June 16, 2010, América Móvil completed the acquisition of 99.4% of the outstanding shares of Carso Global Telecom by means of a first public exchange offer, thus, América Móvil indirectly owned 59.1% of the outstanding shares of TELMEX by then. Upon completion of this transaction, TELMEX became a subsidiary of América Móvil. América Móvil launched an additional offer on November 19, 2010, which ended on December 17, 2010, increasing to 59.5% its indirect ownership of the outstanding shares of TELMEX.

On March 15, 2011, TELMEX s Audit Committee, Chief Executive Officer, General Counsel and Chief Financial Officer authorized the issuance of the accompanying consolidated financial statements and these notes as of December 31, 2010 and 2009 and for each of the three years in the period ended December 31, 2010, and Management evaluated subsequent events through May 11, 2011.

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(In thousands of Mexican pesos, see Note 1 II.b)

At December 31, 2010, 2009 and 2008, TELMEX s equity interest in its principal subsidiaries and affiliated companies is as follows:

| | | % equity interest at December 31 | | |
|---|---|---|---|---|
| **Company** | **Country** | **2010** | 2009 | 2008 |
| **Subsidiaries:** | | | | |
| Integración de Servicios TMX, S.A. de C.V. | Mexico | **100%** | 100% | 100% |
| Alquiladora de Casas, S.A. de C.V. | Mexico | **100%** | 100% | 100% |
| Cía. de Teléfonos y Bienes Raíces, S.A. de C.V. | Mexico | **100%** | 100% | 100% |
| Consorcio Red Uno, S.A. de C.V. | Mexico | **100%** | 100% | 100% |
| Teléfonos del Noroeste, S.A. de C.V. | Mexico | **100%** | 100% | 100% |
| Uninet, S.A. de C.V. | Mexico | **100%** | 100% | 100% |
| Telmex USA, L.L.C. | U.S.A. | **100%** | 100% | 100% |
| **Affiliated companies:** | | | | |
| Grupo Telvista, S.A. de C.V. | Mexico | **45%** | 45% | 45% |
| 2Wire, Inc. | U.S.A. | | 13% | 13% |

**II. Significant Accounting Policies and Practices**

The principal accounting policies and practices followed by the Company in the preparation of these consolidated financial statements, in conformity with Mexican Financial Reporting Standards, are described below:

**a) Consolidation and basis of translation of financial statements of foreign subsidiaries**

**i) Consolidation and equity method**

The consolidated financial statements include the accounts of Teléfonos de México, S.A.B. de C.V. and those of the subsidiaries over which the Company exercises control. All the companies operate in the telecommunications sector or provide services to companies operating in this sector.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which TELMEX obtains control, and continue to be consolidated until the date when such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as TELMEX, using consistent accounting policies.

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All intercompany balances and transactions have been eliminated in the consolidated financial statements. Noncontrolling interest refers to certain subsidiaries in which the Company does not hold 100% of the shares.

Equity investments in affiliated companies over which the Company exercises significant influence is accounted for using the equity method, which basically consists of recognizing TELMEX s proportional share in the net income or loss and the stockholders equity of the investee (see Note 6).

The results of operations of the subsidiaries and affiliates were included in TELMEX s financial statements as of the month following their acquisition.

**ii) Translation of financial statements of foreign subsidiary and affiliate**

Beginning January 1, 2008, the financial statements of the foreign subsidiary and affiliate are either consolidated or accounted for based on the equity method, as the case may be, once the financial statements have been adjusted to conform to Mexican Financial Reporting Standards in the corresponding local currency, and are then translated to the reporting currency. All the assets and liabilities of the foreign subsidiary are translated to Mexican pesos at the prevailing exchange rate at year-end. Stockholders equity accounts are translated at the prevailing exchange rate at the time capital contributions were made and earnings were generated. Revenues, costs and expenses are translated at the historical exchange rate. Translation differences are recorded in stockholders equity in the line item Effect of translation of foreign entities under Accumulated other comprehensive income items.

**b) Recognition of the effects of inflation on financial information**

Upon adoption of Mexican FRS B-10, *Effects of Inflation*, which became effective on January 1, 2008, the Company ceased to recognize the effects of inflation in its financial information because it currently operates in a non-inflationary economic environment .

The financial statements for the years ended December 31, 2010, 2009 and 2008 are expressed in nominal pesos, except for those non-monetary items that included inflation effects through December 31, 2007. Subsequent additions are recognized at historical cost.

Capital stock and retained earnings were re-expressed for inflation through December 31, 2007 based on the Mexican National Consumer Price Index (NCPI).

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Through December 31, 2007, the deficit from re-expression of stockholders equity consisted of the accumulated monetary position loss at the time the provisions of Bulletin B-10 were first applied, which was P. 13,924,729, and of the result from holding non-monetary assets, which represented the difference between re-expression by the specific indexation method and re-expression based on the NCPI. At December 31, 2007, this item was included in stockholders equity under the Accumulated other comprehensive income items caption. In conformity with Mexican FRS B-10, since it was not possible to identify the result from holding non-monetary assets with the items giving rise to them, the cumulative result from holding non-monetary assets, together with the initial effect from the adoption of Bulletin B-10, which amounted to P. (79,419,845), net of deferred taxes, were reclassified from accumulated other comprehensive income items to retained earnings in stockholders equity.

**c) Recognition of revenues**

Revenues are recognized at the time services are provided. Local service revenues are related to new-line installation charges, monthly service fees, measured usage charges based on the number of calls made, and other service charges to subscribers. Local service revenues also include measured usage charges for prepayment plans, based on the number of minutes.

Revenues from the sale of prepaid telephone service cards are recognized based on an estimate of the usage of time covered by the prepaid card. Revenues from the sale of equipment are recorded when the product is delivered to the customer.

Revenues from domestic and international long distance telephone services are determined on the basis of the duration of the calls and the type of service used, which are billed monthly based on the authorized rates. International long distance and interconnection service revenues also include the revenues earned under agreements with foreign carriers for the use of the Company s facilities in interconnecting international calls. These services are regulated by agreements with these operators, in which the rates to be paid are defined.

Data revenues include revenues from services related to data transmission through private and managed networks and revenues from Internet access.

**d) Use of estimates**

The preparation of financial statements in conformity with Mexican Financial Reporting Standards requires the use of estimates and assumptions in certain areas. Actual results could differ from these estimates. TELMEX based its assumptions and estimates on parameters available when the consolidated financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising beyond the control of TELMEX. Such changes are reflected in the estimates and assumptions and the related effect in the financial statements when they occur.

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(In thousands of Mexican pesos, see Note 1 II.b)

**e) Cash and cash equivalents**

Cash at banks earns interest at floating rates based on daily bank deposit rates. Cash equivalents are represented by short-term deposits made for varying periods of between one day and three months, depending on the immediate cash requirements of the Company, and earn interest at the respective short-term deposit rates. Such investments are stated at acquisition cost plus accrued interest, which is similar to their market value.

**f) Derivative financial instruments and hedging activities**

The Company is exposed to interest rate and foreign currency risks, which are mitigated through a controlled risk management program that includes the use of derivative financial instruments. The Company uses primarily cross-currency swaps and when necessary foreign currency forwards to offset the short-term risk of exchange rate fluctuations. In order to reduce the risks due to fluctuations in interest rates, the Company utilizes interest-rate swaps, through which it either pays or receives the difference between the net amount of either paying or receiving a fixed interest rate and the cash flow from receiving or paying a floating interest rate, based on a notional amount denominated in Mexican pesos or U.S. dollars. Most of these derivative financial instruments qualify and have been designated as cash flow hedges.

The Company s policy includes: i) formal documentation of all hedging relationships between the hedging instrument and the hedged position; ii) the objectives for risk management; and iii) the strategy for conducting hedging transactions. This process takes into account the relationship between the cash flow of the derivatives with the cash flows of the corresponding assets and liabilities recognized in the balance sheet.

The effectiveness of the Company s derivatives used for hedging purposes is evaluated prior to their designation as hedges, as well as during the hedging period, which is performed at least quarterly based on recognized statistical techniques. Whenever it is determined that a derivative is not highly effective as a hedge or that the derivative ceases to be a highly effective hedge, the Company ceases to apply hedge accounting for the derivative on a prospective basis. During the years ended December 31, 2010, 2009 and 2008, there were no gains or losses recognized due to changes in the accounting treatment for hedges.

Derivative financial instruments are recognized in the balance sheet at their fair values, which are obtained from the financial institutions with which the Company has entered into the related agreements. The Company s policy is to verify such fair values against valuations provided by an independent valuation agent contracted by the Company. The effective portion of the cash flow hedge s gain or loss is recognized in Accumulated other comprehensive income items in stockholders equity, while the ineffective portion is recognized in current year earnings. Changes in the fair value of derivatives that do not qualify as hedges are immediately recognized in earnings.

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The change in fair value recognized in earnings related to derivatives that are accounted for as hedges is presented in the same income statement caption as the gain or loss of the hedged item.

**g) Allowance for doubtful accounts**

The allowance for doubtful accounts is determined based on the Company s historical experience, the aging of the balances and general economic trends, as well as an evaluation of accounts receivable in litigation seeking recovery. The allowance for doubtful accounts primarily covers the balances of accounts receivable greater than 90 days old.

The risk of uncollectibility of accounts receivable from related parties is evaluated annually based on an examination of each related party s financial situation and the markets in which they operate.

**h) Inventories**

Inventories for sale are valued at average cost. The carrying value of inventories is not in excess of their net realizable value.

**i) Plant, property and equipment**

Through December 31, 1996, plant, property and equipment and construction in progress were re-expressed based on the acquisition date and cost, applying the factors derived from the specific indexes determined by the Company and validated by an independent appraiser.

From January 1, 1997 through December 31, 2007, plant, property and equipment and construction in progress acquired abroad were re-expressed based on the rate of inflation of the respective country of origin and the prevailing exchange rate at the balance sheet date (specific indexation factors). Plant, property and equipment of domestic origin were re-expressed based on the NCPI.

Telephone plant and equipment are depreciated using the straight-line method based on the estimated useful lives of the related assets (see Note 4 b).

The carrying value of plant, property, plant and equipment is reviewed whenever there are indicators of impairment in the carrying value of such assets. Whenever an asset s recovery value, which is the greater of the asset s selling price and its value in use (the present value of future cash flows) is less than the asset s net carrying amount, the difference is recognized as an impairment loss. For the years ended December 31, 2010, 2009 and 2008, there were no indicators of impairment in the value of the Company s plant, property and equipment.

An item of plant, property and equipment and any significant part initially recognized is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement when the asset is derecognized.

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The assets residual values, useful lives and methods of depreciation are reviewed at each financial year end and adjusted prospectively, if appropriate.

The Company has not capitalized any financing costs since it has no significant qualifying assets with prolonged acquisition periods.

*Reclassification of comparative information*

TELMEX has reclassified the caption inventories for operation of the telephone plant, net as part of the caption plant, property and equipment, net. The Company concluded that this classification better reflects the underlying nature of the asset.

Inventories for the operation of the telephone plant are valued at average cost, and through December 31, 2007 were re-expressed on the basis of specific indexes. The carrying value of inventories is similar to replacement value, which is not in excess of their market value.

**j) Leases**

When the risks and benefits inherent to the ownership of the leased asset remain mostly with the lessor, they are classified as operating leases and rent expense is charged to results of operations when incurred.

Lease agreements are recognized as capital leases if (i) the ownership of the leased asset is transferred to the lessee upon termination of the lease; (ii) the agreement includes an option to purchase the asset at a reduced price; (iii) the term of the lease is substantially the same as the remaining useful life of the leased asset; or (iv) the present value of minimum lease payments is substantially the same as the market value of the leased asset, net of any future benefit or residual value.

**k) Licenses and trademarks**

TELMEX records licenses at acquisition cost and, through December 31, 2007, re-expressed them based on the inflation rate of the country in which the license was acquired. The amortization period is based on the terms of the licenses, which range from 5 to 20 years. Trademarks are recorded at their estimated fair values at the date of acquisition, as determined by independent appraisers, and are amortized using the straight-line method over a sixteen-year period (see Note 5).

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**l) Business combinations and goodwill**

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at fair value at the acquisition date and the amount of any noncontrolling interest in the acquiree. For each business combination, the acquirer measures the noncontrolling interest in the acquiree either at fair value or at the proportionate share of the acquiree s identifiable net assets. Acquisition-related costs incurred are expensed and included in administrative expenses.

The subsequent acquisition of noncontrolling interest is considered a transaction between entities under common control and any difference between the purchase price and the carrying value of net assets acquired is recognized as an equity transaction.

Goodwill is initially measured as the excess of the acquisition price and the amount recognized for noncontrolling interest, as measured at their fair value, over the net identifiable assets acquired and liabilities assumed.

**m) Accrued liabilities**

Accrued liabilities are recognized whenever (i) the Company has current obligations (legal or assumed) resulting from a past event, (ii) when it is probable the obligation will give rise to a future cash disbursement for its settlement and (iii) the amount of the obligation can be reasonably estimated.

When the effect of the time value of money is significant, the amount of the liability is determined as the present value of the expected future disbursements to settle the obligation. The discount rate applied is determined on a pre-tax basis and reflects current market conditions at the balance sheet date and, where appropriate, the risks specific to the liability. When discounting is used, an increase in the liability is recognized as a finance expense.

Contingent liabilities are recognized only when it is probable they will give rise to a future cash disbursement for their settlement. Also, commitments are only recognized when they will generate a loss.

**n) Labor obligations**

The cost of pension, seniority premium and termination benefits (severance) are recognized periodically during the years of service of personnel, based on actuarial computations made by independent actuaries using the projected unit-credit method (see Note 10).

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Actuarial (losses) gains are being amortized over a period of 11 years, which is the estimated average remaining working lifetime of Company employees.

Beginning January 1, 2008, the Company adopted Mexican FRS D-3 *Employee Benefits*, which replaced Mexican accounting Bulletin D-3, *Labor Obligations*. As a result of the MFRS D-3 adoption, the transition liability for labor obligations and prior service costs at December 31, 2007 are being amortized over a maximum period of 5 years. Prior to December 31, 2007, such amounts were being amortized over the estimated average remaining working lifetime of Company employees (12 years) (see Note 10).

**o) Employee profit sharing**

Current-year and deferred employee profit sharing expense is presented as an ordinary expense in the income statement.

Beginning January 1, 2008, in connection with the adoption of Mexican FRS D-3, the Company recognizes deferred employee profit sharing using the asset and liability method. Under this method, deferred profit sharing is computed by applying the 10% rate to all temporary differences between the values of all assets and liabilities for financial and tax reporting purposes. The Company periodically evaluates the possibility of recovering deferred employee profit sharing assets and, if necessary, creates a valuation allowance for those assets that do not have a high probability of being realized (see Note 10).

**p) Exchange differences**

Transactions in foreign currency are recorded at the prevailing exchange rate on the day of the related transactions. Foreign currency denominated monetary assets and liabilities are valued at the prevailing exchange rate at the balance sheet date. Exchange differences from the transaction date to the time foreign currency denominated monetary assets and liabilities are settled, as well as those arising from the translation of foreign currency denominated balances at the balance sheet date are charged or credited to results of operations.

See Note 11 for the Company s consolidated foreign currency position at the end of each year and the exchange rates used to translate foreign currency denominated balances.

**q) Comprehensive income**

Comprehensive income consists of current year net income, the effect of translation of the financial statements of foreign entities, the changes in the fair value of cash flow hedges and the effect of deferred taxes and deferred employee profit sharing related to these items.

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**r) Taxes on profits**

*Current income tax*

Current income tax assets and liabilities for the current period are measured at the amount expected to be recovered from or paid to the tax authorities. The tax rates and tax laws used to compute the amount are those that are enacted at the reporting date.

*Deferred tax*

Deferred taxes on profits are recognized using the asset and liability method. Under this method, deferred taxes on profits are recognized on all differences between the financial reporting and tax values of assets and liabilities, applying the enacted income tax rate effective as of the balance sheet date, or the enacted rate at the balance sheet date that will be in effect when the deferred tax assets and liabilities are expected to be recovered or settled.

The Company periodically evaluates the possibility of recovering deferred tax assets and, if necessary, creates a valuation allowance for those assets that do not have a high probability of being realized.

**s) Statement of income presentation**

Costs and expenses shown in the Company s income statement are presented on a combined basis between their nature and function, in accordance with industry practice since such classification allows for an appropriate evaluation of gross profit and operating margin.

The Operating income caption is shown in the income statement since it is an important indicator used for evaluating the Company s operating results.

An analysis of the Other expenses, net caption for the years ended December 31, 2010, 2009 and 2008 is as follows:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Employee profit sharing, current | **P. 1,998,105** | P. 2,217,482 | P. 2,548,762 |
| Other income (Note 10) | **(1,919,768)** | (867,802) | (1,869,170) |
| Other expenses, net | **P. 78,337** | P. 1,349,680 | P. 679,592 |

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**t) Statement of cash flows**

Effective January 1, 2008, the Company adopted Mexican FRS B-2 *Statement of cash flows.* The statement of cash flows shows the entity s cash inflows and outflows during the period. Also, the statement of cash flows presents first income before taxes on profits, followed by cash flows from operating activities, then cash flows from investing activities and finally cash flows from financing activities.

The statements of cash flows for the years ended December 31, 2010, 2009 and 2008 were prepared using the indirect method.

**u) Earnings per share**

Earnings per share are determined by dividing the controlling interest in net income by the weighted-average number of shares outstanding during the year. In determining the weighted-average number of shares outstanding during the year, shares repurchased by the Company have been excluded.

**v) Concentration of risk**

The main risks associated with the Company s financial instruments are cash flow risk, liquidity risk, market risk and credit risk. The Company performs sensitivity analyses to measure potential losses in its operating results based on a theoretical increase of 100 basis points in interest rates and a 10% change in exchange rates. The Board of Directors approves the risk management policies that are proposed by the Company s management.

Credit risk represents the potential loss from the failure of counterparties to completely comply with their contractual obligations. The Company is also exposed to market risks related to fluctuations in interest rates and exchange rates. In order to reduce the risks related to fluctuations in interest rates and exchange rates, the Company uses derivative financial instruments as hedges against its debt obligations.

Financial instruments which potentially subject the Company to concentrations of credit risk are cash and cash equivalents, trade accounts receivable, debt and derivative financial instruments. Pension fund assets are subject to market risk. The Company s policy is designed to not restrict its exposure to any one financial institution; therefore, the Company s financial instruments are maintained in different financial institutions located in different geographical areas.

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The credit risk in accounts receivable is diversified, because the Company has a broad customer base that is geographically dispersed. The Company continuously evaluates the credit conditions of its customers and does not require collateral to guarantee collection of its accounts receivable. In the event the collection of accounts receivable deteriorates significantly, the Company s results of operations could be adversely affected.

**w) Segments**

Segment information is presented based on information used by the Company in its decision-making processes (see Note 16).

Local and long distance segment information differs from the information presented in the consolidated financial statements due to:

Segment information only includes those companies that are directly involved in rendering local and long distance telephone services in Mexico.

Local service includes: revenues from basic rent, measured service, installation charges, equipment sales and interconnection.

Long distance service includes: revenues from basic services of domestic and international long distance services; it does not include revenues from rural and public telephony and data services.

The services being disclosed include the corresponding attributes for interconnection, billing, collecting, co-location and leased lines.

Interconnection with cellular operators includes revenues from calling party pays.

**x) Reclassifications**

Certain captions shown in the 2009 financial statements as originally issued have been reclassified for uniformity of presentation with the 2010 financial statements.

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(In thousands of Mexican pesos, see Note 1 II.b)

| | | As originally reported 2009 | Reclassifications | As reclassified 2009 |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets: | | | | |
| Accounts receivable, net | (1) | P. 21,113,323 | P. (687,767) | P. 20,425,556 |
| Derivative financial instruments | (2) | 11,496,359 | 729,191 | 12,225,550 |
| Inventories for sale, net | (3) | 1,543,648 | (95,546) | 1,448,102 |
| Plant, property and equipment, net | (3) | 104,304,749 | 1,742,893 | 106,047,642 |
| Inventories for operation of telephone plant, net | (3) | 1,647,347 | (1,647,347) | |
| **Liabilities** | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued liabilities | (1, 2) | 14,204,188 | 41,424 | 14,245,612 |
| **Statement of income** | | | | |
| Operating costs and expenses: | | | | |
| Cost of sales and services | (4) | 34,158,977 | 18,805 | 34,177,782 |
| Commercial, administrative and general expenses | (4) | 20,830,245 | (18,805) | 20,811,440 |

(1) Reclassification to accounts receivable, net.
(2) Reclassification of derivative financial instruments.
(3) Reclassification of inventories for operation of telephone plant.
(4) Reclassification of administrative expenses.

**y) New accounting pronouncements**

Following is a discussion of the new accounting pronouncements issued by the Mexican Financial Reporting Standards Research and Development Board (*Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera, A.C.* or CINIF ) that became effective on January 1, 2010 and that affected TELMEX s accounting policies:

**Mexican FRS C-1, *Cash and Cash equivalents***

In November 2009, the CINIF issued Mexican FRS C-1, which became effective for fiscal years beginning on or after January 1, 2010. Mexican FRS C-1 replaces Mexican accounting Bulletin C-1, *Cash*. The main changes compared to Mexican accounting Bulletin are the presentation of restricted cash and the substitution of the term short-term demand investments with the new term liquid demand investments , which, among other characteristics, must be readily convertible to cash and have maturities of no more than three months.

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The adoption of this accounting standard must be made retrospectively. The adoption of the requirements of this standard had no effect on the Company s financial position or on its results of operations.

**Interpretation to Mexican FRS 19, *Changes derived from the adoption of International Financial Reporting Standards***

In August 2010, the CINIF issued Interpretation to Mexican FRS 19, which became effective for financial statements issued on or after September 30, 2010. This interpretation establishes the disclosures that must be made in the notes to the financial statements prepared under Mexican Financial Reporting Standards prior to the adoption of International Financial Reporting Standards.

The National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores or CNBV ) requires securities issuers registered with the National Securities Registry to prepare and disclose their financial information in conformity with International Financial Reporting Standards (IFRS) beginning on January 1, 2012, allowing early adoption. As a result of this requirement, the Company plans to adopt IFRS as the basis for preparing its financial information beginning on January 1, 2011.

Based on an analysis performed to identify the accounting effects upon adoption, the items which the Company has identified will have a significant impact on its financial statements are labor obligations, deferred taxes, stockholders equity and inflation effects. The Company is in the process of quantifying the impact on its financial statements.

**2. Cash and Cash Equivalents**

Cash and cash equivalents consist of the following at December 31, 2010 and 2009:

| | **2010** | 2009 |
|---|---|---|
| Cash and bank accounts | **P. 817,630** | P. 1,010,973 |
| Cash equivalents | **6,675,835** | 13,368,795 |
| Total | **P. 7,493,465** | P. 14,379,768 |

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(In thousands of Mexican pesos, see Note 1 II.b)

**3. Accounts Receivable**

An analysis of accounts receivable at December 31, 2010 and 2009 is as follows:

| | **2010** | 2009 |
|---|---|---|
| Customers | **P. 19,589,206** | P. 19,112,062 |
| Recoverable taxes | **623,876** | 2,728,510 |
| Related parties (Note 13) | **892,786** | 894,535 |
| Net settlement receivables | **181,856** | 417,152 |
| Other | **1,396,115** | 1,582,178 |
| | **22,683,839** | 24,734,437 |
| Less: | | |
| Allowance for doubtful accounts | **5,035,306** | 4,308,881 |
| Total | **P. 17,648,533** | P. 20,425,556 |

An analysis of activity in the allowance for doubtful accounts for the years ended December 31, 2010, 2009 and 2008 is as follows:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Beginning balance at January 1 | **P. 4,308,881** | P. 2,522,842 | P. 1,725,969 |
| Increase charged to expenses | **2,218,564** | 2,986,891 | 1,690,160 |
| Write-offs | **(1,492,139)** | (1,200,852) | (893,287) |
| Ending balance at December 31 | **P. 5,035,306** | P. 4,308,881 | P. 2,522,842 |

**4. Plant, Property and Equipment**

a) An analysis of plant, property and equipment at December 31, 2010 and 2009 is as follows:

| | **2010** | 2009 |
|---|---|---|
| Telephone plant and equipment | **P. 320,261,936** | P. 315,548,924 |
| Land and buildings | **37,496,994** | 37,128,186 |
| Computer equipment and other assets | **52,446,218** | 49,952,667 |
| | **410,205,148** | 402,629,777 |
| Less: | | |

| | | |
|---|---|---|
| Accumulated depreciation | **313,020,620** | 298,734,102 |
| Net | **97,184,528** | 103,895,675 |
| Construction in progress and advances to equipment suppliers | **244,469** | 409,074 |
| Inventories for operation of the telephone plant, net | **1,992,335** | 1,742,893 |
| Total | **P. 99,421,332** | P. 106,047,642 |

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Construction in progress refers mainly to projects related to telephone plant, which are scheduled to be completed and transferred to the plant mostly during the first half of 2011.

b) Depreciation of the telephone plant and equipment is calculated at annual rates ranging from 3.3% to 20.0%. The rest of the Company s assets, excluding land, are depreciated at rates ranging from 10% to 33.3%. Depreciation charged to operating costs and expenses was P.17,392,411 in 2010, P.17,828,006 in 2009 and P.17,815,050 in 2008.

**5. Licenses and Trademarks**

An analysis of licenses and trademarks at December 31, 2010 and 2009 is as follows:

| | **2010** | 2009 |
|---|---|---|
| Licenses, net | **P. 850,809** | P. 918,341 |
| Trademarks, net | **456,708** | |
| Total | **P. 1,307,517** | P. 918,341 |

An analysis of licenses cost and their amortization at December 31, 2010 and 2009 is as follows:

| | **2010** | 2009 |
|---|---|---|
| Investment | **P. 1,824,790** | P. 1,777,464 |
| Less: | | |
| Accumulated amortization | **973,981** | 859,123 |
| Net | **P. 850,809** | P. 918,341 |

An analysis of the changes in 2010, 2009 and 2008 is as follows:

| | **Balance at January 1, 2010** | **Translation effect** | **Effect of acquired companies** | **Investment and amortization for the year** | **Balance at December 31, 2010** |
|---|---|---|---|---|---|
| Investment | **P. 1,777,464** | **P. 19,281** | **P. 21,425** | **P. 6,620** | **P. 1,824,790** |
| Accumulated amortization | **859,123** | **2,447** | | **112,411** | **973,981** |
| Net | **P. 918,341** | **P. 16,834** | **P. 21,425** | **P. (105,791)** | **P. 850,809** |

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| | Balance at January 1, 2009 | Investment and amortization for the year | Balance at December 31, 2009 |
|---|---|---|---|
| Investment | P. 1,763,296 | P. 14,168 | P. 1,777,464 |
| Accumulated amortization | 738,269 | 120,854 | 859,123 |
| Net | P. 1,025,027 | P. (106,686) | P. 918,341 |

| | Balance at January 1, 2008 | Investment and amortization for the year | Traslation effect | Balance at December 31, 2008 |
|---|---|---|---|---|
| Investment | P. 1,627,992 | P. 135,271 | P. 33 | P. 1,763,296 |
| Accumulated amortization | 636,531 | 101,703 | 35 | 738,269 |
| Net | P. 991,461 | P. 33,568 | P. (2) | P. 1,025,027 |

**Trademarks**

At December 31, 2010, the Company has well-known trademarks of certain acquired companies, which were recognized at their fair value, based on appraisals performed by independent experts.

An analysis of trademarks and their amortization at December 31, 2010 is as follows:

| | **2010** |
|---|---|
| Investment | **P. 473,310** |
| Accumulated amortization | **16,602** |
| Net | **P. 456,708** |

The amortization expense of other deferred charges was P.1,906, P.1,908 and P.16,454 for the years ended December 31, 2010, 2009 and 2008, respectively.

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(In thousands of Mexican pesos, see Note 1 II.b)

## 6. Investments

### I. Equity investments

An analysis of equity investments in affiliates and other companies at December 31, 2010 and 2009, and a brief description of each, is as follows:

| | **2010** | 2009 |
|---|---|---|
| **Equity investments in:** | | |
| Grupo Telvista, S.A. de C.V. | **P. 784,875** | P. 907,973 |
| 2Wire, Inc. | | 301,035 |
| Other affiliates | **607,167** | 566,372 |
| | **P. 1,392,042** | P. 1,775,380 |

***Grupo Telvista***

TELMEX holds 45% of the capital stock of Grupo Telvista, S.A. de C.V. (Grupo Telvista) which, through its subsidiaries, provides telemarketing services in Mexico and the U.S.A. For the year ended December 31, 2010, TELMEX s equity interest in the net income of Grupo Telvista gave rise to a credit to results of operations of P.24,022 (credits of P.195,498 in 2009 and P.154,795 in 2008) and a charge to stockholders equity of P.21,120 (charge of P.13,867 in 2009 and credit of P.69,128 in 2008). In September 2010, TELMEX received a dividend of P.126,000.

***2Wire***

On October 20, 2010, TELMEX sold to Pace, Plc its 13% equity interest in 2Wire, Inc. (2Wire) for P. 744,231. Such sale gave rise to a gain of P.322,500 recorded in other income. For the year ended December 31, 2010, TELMEX s equity interest in the results of 2Wire gave rise to a credit to results of operations of P.120,697 (credit of P.25,035 in 2009 and charge of P.266,568 in 2008).

**Other affiliates**

For the year ended December 31, 2010, equity interest in other affiliates represented a net credit to results of operations of P.51,191 (net credits of P.34,147 in 2009 and P.49,660 in 2008) and a charge to stockholders equity of P.10,396 (charge of P.4,427 in 2009 and credit of P.37,718 in 2008).

### II. Investment in subsidiary

**Scitum**

On May 24, 2010, TELMEX acquired for P.296,334 a 51.5% equity interest in Scitum, S.A. de C.V. (Scitum), which offers services in the design, implementation and management of infrastructures of security of information in Mexico.

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The allocation of the acquisition price over fair value of the net assets acquired at the acquisition date is as follows:

| | **May 2010** |
|---|---|
| Current assets | P. 142,736 |
| Fixed assets | 41,389 |
| Deferred assets | 22,991 |
| Trademarks | 473,310 |
| Less: | |
| Current liabilities | 78,934 |
| Long-term liabilities | 128,972 |
| Fair value of net assets acquired | 472,520 |
| Acquisition price at 100% | 575,809 |
| Goodwill arising on acquisition | P. 103,289 |

Goodwill includes P.50,350 which corresponds to the noncontrolling interest.

From the date of acquisition, Scitum has contributed P.230,453 to operating revenues and P.(61,389) to net income of the Company.

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(In thousands of Mexican pesos, see Note 1 II.b)

**7. Debt**

Short-term and long-term debt consist of the following:

| | Weighted average interest rate at December 31 | | Maturities from | Balance at December 31 | |
|---|---|---|---|---|---|
| | **2010** | 2009 | **2011 through** | **2010** | 2009 |
| *Debt denominated in foreign currency:* | | | | | |
| Senior notes | **5.5%** | 5.2% | 2019 | **P. 16,044,459** | P. 29,361,181 |
| Bank loans | **0.8%** | 0.7% | 2018 | **21,665,623** | 40,074,814 |
| Others | **0.6%** | 2.0% | 2022 | **6,364,863** | 238,353 |
| Total debt denominated in foreign currency | | | | **44,074,945** | 69,674,348 |
| *Debt denominated in Mexican pesos:* | | | | | |
| Senior notes | **8.8%** | 8.8% | 2016 | **4,500,000** | 4,500,000 |
| Domestic senior notes | **6.3%** | 6.3% | 2037 | **25,900,000** | 25,900,000 |
| Bank loans | **5.5%** | 4.8% | 2011 | **46,000** | 2,800,000 |
| Total debt denominated in Mexican pesos | | | | **30,446,000** | 33,200,000 |
| Total debt | | | | **74,520,945** | 102,874,348 |
| Less short-term debt and current portion of long-term debt | | | | **11,951,532** | 19,768,894 |
| Long-term debt | | | | **P. 62,569,413** | P. 83,105,454 |

The above-mentioned rates are subject to market variances and do not include the effect of the Company s agreement to reimburse certain lenders for Mexican withholding taxes. The Company s weighted-average cost of debt at December 31, 2010 (including interest expense, interest rate swaps, fees and withholding taxes, and excluding exchange rate variances) was approximately 6.6% (5.9% in 2009).

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Short-term debt and current portion of long-term debt consist of the following:

| | Balance at December 31 | |
|---|---|---|
| | **2010** | 2009 |
| ***Short-term debt:*** | | |
| Bank loans | **P. 46,000** | |
| Others | **6,178,550** | |
| | **6,224,550** | |
| ***Current portion of long-term debt:*** | | |
| Senior notes | | P. 12,405,765 |
| Domestic Senior notes | **4,500,000** | |
| Bank loans | **1,226,982** | 7,363,129 |
| | **5,726,982** | 19,768,894 |
| Total | **P. 11,951,532** | P. 19,768,894 |

***Senior notes:***

a) In November 2008, TELMEX repaid a bond of P.13,151,147 (U.S.$1,000 million, nominal amount) that was issued in November 2003 and bore an annual interest of 4.5%, payable semiannually. For the year ended December 31, 2008, interest expense on the bond was P. 442,078.

b) In the first quarter of 2005, TELMEX issued bonds in the amount of P.21,892,381(1) (U.S.$1,750 million) divided into two issuances of P.11,870,243(1) and P.10,022,138(1) (U.S.$950 million and U.S.$800 million, respectively), the first maturing in January 2010 and bearing an annual interest of 4.75%, and the second maturing in 2015 and bearing an annual interest of 5.5%. Interest is payable semiannually.

On January 27, 2010, TELMEX repaid the first issuance for P.12,294,140 (U.S.$950 million). For the year ended December 31, 2010, interest expense on these bonds was P.628,617 (P.1,274,163 in 2009 and P.1,025,848 in 2008).

c) On January 26, 2006, TELMEX issued abroad a bond denominated in Mexican pesos in the amount of P.4,500,000 (nominal amount), which matures in 2016 and bears an annual interest of 8.75%. For the year ended December 31, 2010, interest expense on the bond was P.406,656 (P.407,708 in 2009 and P.409,655 in 2008).

d) On November 12, 2009, TELMEX issued a bond in the amount of P.6,615,400 (U.S.$500 million, nominal amount), which matures in 2019 and bears an annual interest of 5.5%, payable semiannually. For the year ended December 31, 2010, interest expense on the bond was P.367,648 (P.49,823 in 2009)

[1] Amounts re-expressed in constant pesos as of December 31, 2007.

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On February 2, 2011, América Móvil launched a private offer to exchange any and all outstanding senior notes of TELMEX with maturity in 2015 and 2019, for new senior notes of América Móvil. The offer expired on March 3, 2011. As a result of the offer, on March 8, 2011, U.S.$243.6 million of senior notes due in 2015 and U.S.$122.6 million of senior notes due in 2019 were exchanged for América Móvil senior notes. On March 10, 2011, TELMEX paid América Móvil U.S.$394.0 million, which includes a premium of U.S.$27.8 million, to extinguish the exchanged senior notes. The consideration paid by TELMEX was based on the same market conditions under which the TELMEX senior notes were exchanged by América Móvil.

***Syndicated loans:***

In 2004, the Company entered into a syndicated loan, which was restructured in 2005 and 2006 to improve the credit conditions and increase the total loan amount to P.34,531,521[(1)] (U.S.$3,000 million), split into three tranches. Tranche A for P.14,963,659[(1)] (U.S.$1,300 million) with a three-year maturity. Tranche B for P.11,510,507[(1)] (U.S.$1,000 million) with a five-year maturity. Tranche C for P.8,057,355[(1)] (U.S.$700 million) with a seven-year maturity. In August 2009, TELMEX prepaid the total amount of tranche A, which was scheduled to mature in October 2009. In November 2010, TELMEX prepaid the total amount of tranche B, which was scheduled to mature in October 2011. The balance of tranche C at December 31, 2010 is included under banks loans (debt denominated in foreign currency), and is scheduled to mature in October 2013.

On June 30, 2006, TELMEX entered into a syndicated loan agreement in the amount of P.5,986,554[(1)] (U.S.$500 million), split into two tranches in equal amounts of P.2,993,277[(1)] (U.S.$250 million), with maturities of four years and six years, respectively. In March 2010, TELMEX prepaid the total amount of the first tranche, for which the original maturity was scheduled for June 2010.

(1) Amounts re-expressed in constant pesos as of December 31, 2007.

Substantially all of the bank loans bear interest equal to the London Inter-Bank Offered Rate (LIBOR) plus a specified margin. For the year ended December 31, 2010, interest expense on these loans was P.162,539 (P.556,305 in 2009 and P.1,425,514 in 2008).

***Others:***

On November 12, 2010, TELMEX entered into two loan agreements with América Móvil, the first one in the amount of P.2,454,280 (U.S.$200 million) maturing in December 2010, and the second in the amount of P.6,135,700 (U.S.$500 million), maturing in October 2011. These loans bear interest equal to the LIBOR plus a specified margin (25 basis points). The first loan was repaid on its maturity. In 2010, interest expense on this loan was P.6,048.

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***Domestic senior notes ( Certificados Bursátiles ):***

On December 19, 2007, TELMEX obtained authorization from the CNBV for a program to issue long-term domestic senior notes in a total amount of P.10,000,000 (nominal amount). In April 2008, domestic senior notes in the amount of P.1,600,000 were issued. In July 2009, TELMEX placed domestic senior notes in two issuances for a total amount of P.8,000,000.

On September 18, 2009, TELMEX obtained authorization from the CNBV for a dual program to issue short and long-term domestic senior notes in a total amount of P.15,000,000 (nominal amount). In November 2009, TELMEX placed long-term domestic senior notes in two issuances for a total amount of P.6,000,000.

Some domestic senior notes bear fixed-rate interest, while others bear interest equal to the Mexican interbank equilibrium interest rate ( TIIE ) plus a specified margin. For the year ended December 31, 2010, interest expense on long-term domestic senior notes was P.1,663,516 (P.1,194,213 in 2009 and P.1,004,242 in 2008).

***Restrictions:***

The above-mentioned debt is subject to certain restrictions with respect to maintaining certain financial ratios, as well as restrictions on selling a significant portion of groups of assets, among others. At December 31, 2010, the Company was in compliance with all these requirements.

A portion of the debt is also subject to early maturity or repurchase at the option of the holders in the event of a change in control of the Company, as so defined in each instrument. The definition of change in control varies from instrument to instrument; however, no change in control shall be considered to have occurred as long as Carso Global Telecom or its current stockholders continue to hold the majority of the Company s voting shares.

***Foreign currency debt:***

An analysis of the foreign currency denominated debt at December 31, 2010 is as follows:

| | Foreign currency (in thousands) | Exchange rate at December 31, 2010 (in units) | Equivalent in Mexican pesos |
|---|---|---|---|
| U.S. dollar | 3,306,054 | P. 12.3571 | P. 40,853,235 |
| Japanese yen | 19,891,200 | 0.1526 | 3,035,397 |
| Euro | 11,242 | 16.5733 | 186,313 |
| Total | | | P. 44,074,945 |

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Long-term debt maturities at December 31, 2010 are as follows:

| **Years** | **Amount** |
|---|---|
| 2012 | P. 11,936,560 |
| 2013 | 11,153,036 |
| 2014 | 8,331,893 |
| 2015 | 10,673,067 |
| 2016 and thereafter | 20,474,857 |
| Total | P. 62,569,413 |

**Derivative financial instruments and hedging activities:**

At December 31, 2010 and 2009, the derivative financial instruments held by the Company are as follows:

| | **2010** | | 2009 | |
|---|---|---|---|---|
| **Instrument** | **Notional** | **Fair value asset (liability)** | Notional | Fair value asset (liability) |
| | **(in millions)** | | (in millions) | |
| Cross currency swaps | **U.S.$ 3,487** | **P. 6,957** | U.S.$ 4,178 | P. 12,226 |
| Forwards dollar-peso (Note 8) | **U.S.$ 40** | **(21)** | U.S.$ 245 | (120) |
| Interest-rate swaps in pesos (Note 8) | **P. 16,649** | **(1,540)** | P. 23,752 | (729) |
| Cross currency coupon swaps | | | U.S.$ 50 | |
| Total | | **P. 5,396** | | P. 11,377 |

To reduce the risks related to fluctuations in exchange and interest rates, the Company uses derivative financial instruments as hedges associated with its debt. The derivative financial instruments principally used by the Company are as follows:

*Cross currency swaps*

At December 31, 2010, the Company had cross currency swaps that hedge foreign currency denominated liabilities of P.43,091,161 (U.S.$3,487 million) (P.54,557,723 or U.S.$4,178 million in 2009). These cross currency swaps hedge the exchange rate and interest rate risks associated with bonds that mature in 2015 and 2019 in the total amount of U.S.$1,310 million and bank loans that mature from 2011 to 2018 of U.S.$2,177 million. These agreements allow TELMEX to fix the parity of such debt at a weighted-average exchange rate of P.10.7645 per U.S. dollar, as well as to set a fixed interest rate of 8.57% for the bond maturing in 2015 and a floating rate equal to the average 28-day TIIE less a specified margin for the bond maturing in 2019 and for the bank loans.

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The change in the fair value of these cross currency swaps that offset the exchange gain on the foreign-currency denominated debt for the year ended December 31, 2010 was a net charge of P.2,108,445 (charge of P.5,682,263 in 2009 and P.16,281,874 in 2008).

*Forwards dollar-peso*

At December 31, 2010, the Company had short term foreign currency forwards with a notional amount of P.494,284 (U.S.$40 million) (P.3,199,382 or U.S.$245 million in 2009). For the year ended December 31, 2010, the Company recognized a net charge of P.97,295 (charges of P.520,733 in 2009 and P.1,690,380 in 2008) as part of the net exchange gain, due to changes in the fair value of these forwards.

*Interest-rate swaps*

At December 31, 2010, the Company had interest-rate swaps for an aggregate notional amount of P.16,649,250 (P.23,752,125 in 2009) to hedge the floating interest rate risk of its debt in Mexican pesos, fixing such rate at an average of 8.48%.

At December 31, 2010, the Company had no cross currency coupon swap contracts outstanding. At December 31, 2009 the Company had cross currency coupon swaps that covered interest payments flows of P.652,935 (U.S.$50 million).

For the year ended December 31, 2010, the Company recognized a net expense for these swaps in interest expense of P.1,687,679 (P.1,941,649 in 2009 and P.2,282,554 in 2008).

The ineffective portion of the cash flow hedges was a net expense of P.506,815 for the year ended December 31, 2010 (P.115,190 in 2009 and P.157,224 in 2008), recognized in interest expense.

The Company s derivatives are acquired in over-the counter markets, mostly from the same financial institutions with which it has contracted its debt.

Several of the Company s agreements under which it has negotiated its derivative financial instruments require margin calls when the fair value of the derivatives exceeds the Company s existing credit lines of P.5,251,768 (U.S.$425 million). At December 31, 2010, 61% of the Company s outstanding derivatives correspond to these types of agreements; however, no margin calls had been required at such date.

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## 8. Accounts Payable and Accrued Liabilities

An analysis of accounts payable and accrued liabilities is as follows:

| | December 31 | |
|---|---|---|
| | **2010** | 2009 |
| Suppliers | **P. 4,426,398** | P. 2,081,727 |
| Employee benefits | **3,017,073** | 2,804,324 |
| Derivative financial instruments (Note 7) | **1,561,294** | 848,910 |
| Related parties (Note 13) | **1,314,356** | 1,602,128 |
| Vacation accrual | **1,333,231** | 1,284,578 |
| Accrual for other contractual employee benefits | **1,104,135** | 1,230,645 |
| Dividend pending payment | **1,123,388** | 1,106,119 |
| Sundry creditors | **956,722** | 750,440 |
| Interest payable | **625,986** | 936,516 |
| Other | **1,914,427** | 1,600,225 |
| | **P. 17,377,010** | P. 14,245,612 |

The activity in the main accruals for the years ended December 31, 2010, 2009 and 2008 is as follows:

**Vacation accrual:**

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Beginning balance at January 1 | **P. 1,284,578** | P. 1,287,747 | P. 1,256,783 |
| Increase charged to expenses | **1,701,334** | 1,619,979 | 1,656,930 |
| Payments | **(1,652,681)** | (1,623,148) | (1,625,966) |
| Ending balance at December 31 | **P. 1,333,231** | P. 1,284,578 | P. 1,287,747 |

**Accrual for other contractual employee benefits:**

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Beginning balance at January 1 | **P. 1,230,645** | P. 1,310,570 | P. 1,151,700 |
| Increase charged to expenses | **3,528,045** | 3,725,372 | 3,588,400 |
| Payments | **(3,654,555)** | (3,805,297) | (3,429,530) |
| Ending balance at December 31 | **P. 1,104,135** | P. 1,230,645 | P. 1,310,570 |

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## 9. Deferred Revenues

Deferred revenues consist of the following at December 31, 2010 and 2009:

| | **2010** | 2009 |
|---|---|---|
| **Short-term:** | | |
| Advance billings | **P. 891,108** | P. 1,009,603 |
| Advances from customers | **26,269** | 94,572 |
| | **917,377** | 1,104,175 |
| **Long-term:** | | |
| Advance billings | **622,351** | 466,696 |
| Total | **P. 1,539,728** | P. 1,570,871 |

## 10. Labor Obligations

### a) Pensions plans and seniority premiums

The majority of the Company s employees are covered under defined benefits pension plans and seniority premiums. Pension benefits and seniority premiums are determined on the basis of compensation of employees in their final year of employment, their seniority, and their age at the time of retirement.

TELMEX has set up an irrevocable trust fund to finance these labor obligations and has adopted the policy of making contributions to such fund, which are deductible for Mexican corporate income tax and employee profit sharing purposes. The most important information related to labor obligations is as follows:

Analysis of net periodic cost:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Labor cost | **P. 4,850,844** | P. 4,431,755 | P. 4,333,194 |
| Finance cost on defined benefit obligation | **17,751,583** | 15,861,542 | 14,344,072 |
| Projected return on plan assets | **(19,632,161)** | (17,524,795) | (15,571,525) |
| Amortization of past services and transition liability | **69,533** | 69,526 | 1,344,971 |
| Amortization of variances in actuarial assumptions (1) | **2,488,132** | 2,183,763 | 201,412 |
| Net periodic cost | **P. 5,527,931** | P. 5,021,791 | P. 4,652,124 |

(1) Includes P.99,125 in 2008 for the amortization of the initial balance of the actuarial loss, which is presented in the statement of income under the caption Other expenses, net, in conformity with Mexican FRS D-3.

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Analysis of the defined benefit obligation:

| | **2010** | 2009 |
|---|---|---|
| Present value of labor obligations: | | |
| Vested benefit obligation | **P. 120,520,269** | P. 105,002,007 |
| Non-vested benefit obligation and effect of salary projection | **96,406,898** | 92,330,826 |
| Defined benefit obligation at end of year | **P. 216,927,167** | P. 197,332,833 |

Analysis of changes in the defined benefit obligation:

| | **2010** | 2009 |
|---|---|---|
| Defined benefit obligation at beginning of year | **P. 197,332,833** | P. 176,182,835 |
| Labor cost | **4,850,844** | 4,431,755 |
| Finance cost on defined benefit obligation | **17,751,583** | 15,861,542 |
| Actuarial loss | **7,608,718** | 10,200,996 |
| Benefits paid to employees | **(6,438,985)** | (215,298) |
| Payments from trust fund | **(4,177,826)** | (9,128,997) |
| Defined benefit obligation at end of year | **P. 216,927,167** | P. 197,332,833 |

Analysis of changes in plan assets:

| | **2010** | 2009 |
|---|---|---|
| Established fund at beginning of year | **P. 163,995,375** | P. 145,475,893 |
| Projected return on plan assets | **19,632,161** | 17,524,795 |
| Actuarial gain | **1,130,129** | 4,371,737 |
| Contributions to trust fund | **289** | 5,751,947 |
| Payments from trust fund | **(4,177,826)** | (9,128,997) |
| Established fund at end of year | **P. 180,580,128** | P. 163,995,375 |

Analysis of the net projected asset:

| | **2010** | 2009 |
|---|---|---|

| | | |
|---|---|---|
| Insufficiency of plan assets for defined benefit obligation | **P. (36,347,039)** | P. (33,337,458) |
| Unamortized actuarial loss | **53,506,227** | 49,515,770 |
| Transition liability | **86,987** | 121,815 |
| Past service cost and changes to plan | **96,025** | 130,730 |
| Net projected asset | **P. 17,342,200** | P. 16,430,857 |

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In 2010, the net actuarial loss of P.6,478,589 resulted from (i) the effect of a favorable actuarial variance of P.1,130,129 due to the behavior of the plan assets resulting from an increase in the value of investments in shares of companies and in fixed-yield investments due to variances in reference rates, and (ii) an actuarial loss of P.7,608,718, attributable principally to the fact that the number of employees who retired was greater than the number estimated at the beginning of the year, and the salary and pension benefits of the retired employees were higher than estimated at the beginning of the year.

In 2009, the net actuarial loss of P.5,829,259 resulted from (i) the effect of a favorable actuarial variance of P.4,371,737 due to the behavior of the plan assets resulting from an increase in the value of investments in shares of companies and in fixed-yield investments due to variances in reference rates, and (ii) an actuarial loss of P.10,200,996, attributable principally to the fact that the number of employees who retired was greater than the number estimated at the beginning of the year, and the salary and pension benefits of the retired employees were higher than estimated at the beginning of the year.

At December 31, 2010, 2009 and 2008, the rates used in the actuarial study are as follows:

| | **Nominal rates %** |
|---|---|
| Discount of labor obligations: | |
| Long-term average | 9.2 |
| Increase in salaries: | |
| Long-term average | 4.5 |

At December 31, 2010, 46.4% (45.9% in 2009) of plan assets were invested in fixed-yield securities and the remaining 53.6% (54.1% in 2009) in variable-yield securities.

**b) Termination benefits**

The most important information related to the liability for termination benefits is as follows:

Analysis of net periodic cost:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Labor cost | **P. 13,134** | P. 12,630 | P. 15,188 |
| Finance cost on defined benefit obligation | **13,508** | 12,498 | 14,599 |
| Amortization of variances in assumptions (1) | **(15,537)** | (9,867) | (87,699) |
| Net periodic cost (gain) | **P. 11,105** | P. 15,261 | P. (57,912) |

(1) Includes P. 36,206 in 2008 for the amortization of the initial balance of the actuarial gain, which is presented in the statement of income under the caption Other expenses, net, in conformity with Mexican FRS D-3.

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The activity in the termination pay liability is as follows:

| | 2010 | 2009 |
|---|---|---|
| Balance at beginning of year | **P. 159,377** | P. 147,634 |
| Net periodic cost (gain) | **11,105** | 15,261 |
| Payments | **(6,669)** | (3,518) |
| Balance at end of year | **P. 163,813** | P. 159,377 |

**c) Employee profit sharing**

TELMEX is obligated to pay profit sharing to its employees in Mexico, in addition to their contractual compensation and benefits. For the years ended December 31, 2010, 2009 and 2008, employee profit sharing was based on 10% of the Company s taxable income, excluding certain inflation effects and the re-expression of depreciation expense.

The cumulative effect of deferred employee profit sharing at the beginning of 2008 resulting from the adoption of Mexican FRS D-3 was P.5,820,412 and was charged to stockholders equity. The deferred employee profit sharing gave rise to a credit to stockholders equity for deferred income tax of P.1,630,277. Accordingly, the net effect of the adoption of Mexican FRS D-3 was a charge to stockholders equity of P.4,190,135. For the year ended December 31, 2010, the deferred employee profit sharing provision represented a credit to results of operations of P.518,403 (P.607,676 in 2009 and P.1,400,171 in 2008), which was recognized in the statement of income under the caption Other expenses, net.

At December 31, 2010 and 2009, the Company recognized deferred employee profit sharing on the following temporary items:

| | 2010 | 2009 |
|---|---|---|
| **Deferred employee profit sharing assets:** | | |
| Allowance for bad debts and slow-moving inventories | **P. 434,813** | P. 310,287 |
| Advance billings | **146,480** | 147,750 |
| Accrued liabilities | **405,470** | 515,522 |
| Exchange loss on debt | **397,925** | 347,123 |
| Derivative financial instruments | **31,756** | |
| | **1,416,444** | 1,320,682 |
| **Deferred employee profit sharing liabilities:** | | |
| Fixed assets | **(2,959,631)** | (3,437,606) |
| Inventories | **(5,420)** | (4,881) |
| Licenses | **(38,889)** | (44,852) |
| Labor obligations | **(1,707,402)** | (1,609,552) |

| | | |
|---|---|---|
| Prepaid expenses | **(57,975)** | (86,043) |
| Derivative financial instruments | | (91,884) |
| | **(4,769,317)** | (5,274,818) |
| Deferred employee profit sharing liability, net | **P. (3,352,873)** | P. (3,954,136) |

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## 11. Foreign Currency Position

At December 31, 2010 and 2009, the Company had the following foreign currency denominated assets and liabilities:

| | Foreign currency in millions | | | |
|---|---|---|---|---|
| | **2010** | **Exchange rate at December 31, 2010** | 2009 | Exchange rate at December 31, 2009 |
| **Assets:** | | | | |
| U.S. dollar | **139** | **P. 12.36** | 669 | P. 13.06 |
| **Liabilities:** | | | | |
| U.S. dollar | **3,553** | **12.36** | 5,205 | 13.06 |
| Japanese yen | **19,904** | **0.15** | 19,891 | 0.14 |
| Euro | **11** | **16.57** | 13 | 18.74 |

At May 10, 2011, the applicable exchange rates are as follows:

| **Foreign currency** | **Exchange rate** |
|---|---|
| U.S. dollar | P. 11.61 |
| Japanese yen | 0.14 |
| Euro | 16.63 |

## 12. Commitments and Contingencies

**Commitments**

At December 31, 2010, TELMEX has non-cancelable commitments for the purchase of equipment of P.5,346,417 (P.3,372,975 in 2009), which include P.1,579,895 (P.977,637 in 2009) of non-cancelable commitments with related parties. Payments made under the related purchase agreements aggregated to P.2,832,019 in 2010 (P.2,858,996 in 2009 and P.3,173,710 in 2008).

**Contingencies**

a) In November 2005, COFETEL issued the guidelines for making changes to local service areas. In April 2006, Teléfonos de México, S.A.B. de C.V. filed a motion for an administrative review of COFETEL s guidelines for modifying the local service areas. Such motion was denied by the Communications Ministry (*Secretaría de Comunicaciones y Transportes*, or SCT) and is currently in litigation before the Third Regional Metropolitan Chamber of the Federal Tax and Administrative Court.

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In March 2007, COFETEL ordered the consolidation of a package of 70 local service areas and a package of 2 local service areas while, in September 2008 it ordered the consolidation of another package of 125 local service areas and in December 2008, it ordered the consolidation of one local service area, each with its own schedule. Teléfonos de México, S.A.B. de C.V. has challenged COFETEL s orders through the corresponding legal procedures.

In November 2009, in compliance with the ruling issued by the Full Circuit Court in Administrative Matters, the court declared the resolutions issued by COFETEL to be null and void.

If the validity of COFETEL s ruling is eventually recognized, COFETEL may be able to re-initiate proceedings to require the consolidation of the local service areas.

Should the consolidation requirement ever become effective, there could be an adverse effect on the Company s long-distance revenues.

The Company believes, based on the advice of external lawyers who are handling this matter, that although the Company s arguments are well-founded, there is no certainty that Teléfonos de México, S.A.B. de C.V. will obtain favorable results.

b) Since 2007, the Federal Commission of Economic Competition (COFECO) initiated eight investigations to evaluate if Teléfonos de México, S.A.B. de C.V. has substantial power and engages in monopolistic practices in certain markets.

Final resolutions in four of these investigations have been issued, in which COFECO has determined that Teléfonos de México, S.A.B. de C.V. has substantial power in the following areas: (i) termination of public commuted traffic; (ii) origination of public commuted traffic; (iii) local transit services; and (iv) leasing of lines or circuits. Teléfonos de México, S.A.B. de C.V. has expressed its disagreement with the proceedings, objected to the findings and submitted evidence against the resolutions.

In the four markets in question, COFECO has already confirmed its resolutions and Teléfonos de México, S.A.B. de C.V. filed the applicable motions for appeal, which COFECO denied. Teléfonos de México, S.A.B. de C.V. has filed relief (*amparo*) proceedings against the COFECO s rejection of the motions for appeal, and the rulings on these relief proceedings are currently still pending. If the disputed resolutions are determined to be final, COFETEL, after completing the applicable procedure, may establish specific obligations for the Company regarding tariffs, quality of services and information in such markets, such as additional information and service quality disclosure requirements. The exact nature of these regulations and their impact on the business cannot be known in advance, but they will likely reduce the Company s flexibility and its ability to adopt competitive market policies. It is also impossible to predict how long the Company will have to adopt the new regulations and whether it will actually be able to do so.

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In the four remaining investigations, COFECO is attempting to determine if TELMEX engaged in the alleged monopolistic practices in the following markets: (i) the broad-band internet market for domestic residential customers; and (ii) the local and national long-distance dedicated links wholesale leasing services market. These investigations are currently in the submission of evidence stage. For the inter-urban transport for commuted long-distance traffic services market and the fixed-network interconnection services market, COFECO has already issued and delivered Probable Fault Notices. Teléfonos de México, S.A.B. de C.V. promptly responded to these notices and contested the findings objecting to its considerations. There is no certainty as to the outcome of these investigations and notices and they may be unfavorable, which could result in regulations, restrictions or monetary fines being imposed on the Company.

The Company believes, based on the advice of external lawyers who are handling this matter, that although the Company s arguments are well-founded, there is no certainty that Teléfonos de México, S.A.B. de C.V. will obtain favorable results.

c) The Mexican Social Security Institute (IMSS) audited Teléfonos de México, S.A.B. de C.V. for the 1997-2001 period. At the conclusion of the audit, IMSS determined that Teléfonos de México, S.A.B. de C.V. owed a total of approximately P.330,000 (historical amount) in taxes, fines, surcharges and re-expression for inflation at July 2, 2003. Teléfonos de México, S.A.B. de C.V. filed an appeal to nullify these findings and related assessment with the Federal Court of Justice for Tax and Administrative Matters. In accordance with Mexican law, by means of a trust fund established with a banking institution, the Company guaranteed payment of the tax assessment in the amount of P.568,869 through July 19, 2010. The Regional Metropolitan Chamber court nullified the ruling; however, IMSS filed a motion for appeal. In October 2009, the court handling the appeal ruled in favor of the Company. Therefore, the ruling issued on the nullity of the fee settlement schedules became final. Consequently, Teléfonos de México, S.A.B. de C.V. initiated proceedings to dissolve the trust fund guaranteeing the payment of the amounts sought by IMSS. The trust was dissolved on January 22, 2010, which was the date on which Teléfonos de México, S.A.B. de C.V. recognized the income from canceling this contingency as other income.

As a result, since the tax liabilities have been annulled and the amount pledged in guaranty was returned to Teléfonos de México, S.A.B. de C.V. on January 22, 2010, this matter is considered closed.

d) In accordance with Mexican law, Teléfonos de México, S.A.B. de C.V. shall be severally liable for all of the obligations transferred to Telmex Internacional, S.A.B. de C.V. as a result of the split-up, for a three-year period, with respect to the terms of the split-up agreement approved by the shareholders of Teléfonos de México, S.A.B. de C.V. on December 21, 2007. This responsibility, however, does not apply to obligations with those creditors who have given their express consent relieving Teléfonos de México, S.A.B. de C.V. from these liabilities and approving the split-up.

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e) On February 10, 2009, COFETEL published the Fundamental Technical Interconnection and Interoperability Plan in the *Official Gazette*. Such plan could have a negative impact on Teléfonos de México, S.A.B. de C.V. and on the telecommunications sector in general, since it establishes additional obligations to concessionaries.

Teléfonos de México, S.A.B. de C.V. has legally challenged the plan through a number of available channels and has presented its evidence as to the illegality and unconstitutionality of the plan.

The Company believes, based on the advice of external lawyers who are handling this matter, that although the Company s arguments are well-founded, there is no certainty that Teléfonos de México, S.A.B. de C.V. will obtain favorable results.

**13. Related Parties**

a) An analysis of balances due from/to related parties at December 31, 2010 and 2009 is provided below. All the companies are considered affiliates since TELMEX s primary stockholders are also either direct or indirect stockholders of the related parties:

| | December 31 | |
|---|---|---|
| | **2010** | 2009 |
| **Accounts receivable:** | | |
| Alestra, S. de R.L. de C.V. | **P.490,773** | P.454,762 |
| Sercotel, S.A. de C.V. | **165,824** | 193,316 |
| Anuncios en Directorios, S.A. de C.V. | **44,319** | 27,662 |
| AT&T Inc. | **25,897** | 87,885 |
| Telmex Colombia, S.A. | **25,162** | |
| Sears Roebuck de México, S.A. de C.V. | **16,874** | 14,231 |
| Sanborn Hermanos, S.A. | **15,495** | 6,397 |
| Fundación Telmex, A.C. | **13,018** | 1,052 |
| Controladora de Servicios de Telecomunicaciones, S.A. de C.V. | **5,647** | 18,235 |
| Banco Inbursa, S.A. | **1,315** | 4,256 |
| Sección Amarilla USA, L.L.C. | | 54 |
| Others | **88,462** | 86,685 |
| | **P.892,786** | P.894,535 |

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| | December 31 | |
|---|---|---|
| | **2010** | 2009 |
| **Accounts payable:** | | |
| RadioMóvil Dipsa, S.A. de C.V. | **P. 501,699** | P. 1,027,048 |
| Operadora Cicsa, S.A. de C.V. | **134,040** | 5,940 |
| Inversora Bursátil, S.A. | **131,813** | 127,472 |
| Eidon Services, S.A. de C.V. | **106,186** | |
| PC Industrial, S.A. de C.V. | **98,735** | 29,614 |
| Grupo Financiero Inbursa, S.A.B. de C.V. | **59,723** | 50,695 |
| Microm, S.A. de C.V. | **52,008** | 65,349 |
| Conductores Mexicanos Eléctricos y de Telecomunicaciones, S.A. de C.V. | **42,812** | 34,161 |
| Acer Computec México, S.A. de C.V. | **34,739** | |
| Sinergía Soluciones Integrales de Energía, S.A. de C.V. | **13,121** | 23,629 |
| Carso Infraestructura y Construcción, S.A.B de C.V. | **293** | 25,459 |
| Eidon Software, S.A. de C.V. | | 103,738 |
| Others | **139,187** | 109,023 |
| | **P. 1,314,356** | P. 1,602,128 |
| **Short-term debt:** | | |
| América Móvil, S.A.B. de C.V. | **P. 6,178,550** | |

b) For the years ended December 31, 2010, 2009 and 2008, the Company had the following transactions with related parties:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| ***Investment and expenses:*** | | | |
| Construction services, purchase of materials, inventories and fixed assets (1) | **P. 2,948,738** | P. 2,163,205 | P. 3,958,756 |
| Insurance premiums, fees for administrative and operating services, security trading and others (2) | **2,877,506** | 3,318,218 | 3,389,572 |
| Calling Party Pays interconnection fees and other telecommunication services (3) | **7,069,638** | 7,944,362 | 9,959,288 |
| Cost of termination of international calls (6) | **730,292** | 715,780 | 685,100 |
| ***Revenues:*** | | | |
| Sale of materials and other services (4) | **1,830,032** | 1,879,051 | 2,091,927 |
| Sale of long distance and other telecommunications services (5) | **4,866,957** | 5,727,833 | 6,211,439 |
| Revenues from termination of international calls (6) | **709,844** | 1,074,419 | 2,428,631 |

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(1) Includes P.2,720,123 in 2010 (P.1,591,531 in 2009 and P.2,190,819 in 2008) for network construction services and purchase of construction materials from subsidiaries of Grupo Carso, S.A.B. de C.V. (Carso Group), which is an entity under common control with Carso Global Telecom. Also includes P.97,204 in 2010 (P.453,348 in 2009 and P.1,652,662 in 2008) for the purchase of equipment for broadband platform services from 2Wire.

(2) Includes P.343,810 in 2010 (P.571,338 in 2009 and P.563,331 in 2008) for network maintenance services from subsidiaries of Carso Group; P.632,059 in 2010 (P.714,242 in 2009 and P.632,970 in 2008) for software services received from affiliates; P.327,674 in 2010 (P.327,500 in 2009 and P.805,703 in 2008) for the production and distribution of white pages telephone directories and advertising in the yellow pages with subsidiaries of Telmex Internacional; P.518,680 in 2010 (P.482,598 in 2009 and P.392,170 in 2008) for insurance premiums with Seguros Inbursa, S.A. (Seguros), which, in turn, places most of this amount in reinsurance with third parties; P.196,417 in 2010 (P.208,942 in 2009 and P.222,963 in 2008) for telemarketing services with Grupo Telvista; P.1,816 in 2010 (P.40,602 in 2009 and P.71,668 in 2008) for security trading fees with Inversora Bursátil, S.A. (Inversora); and P.159,083 in 2010 (P.335,975 in 2009 and P.243,999 in 2008) for fees paid for administrative and operating services to AT&T Mexico, Inc. and Carso Global Telecom. Telmex Internacional, Seguros, Grupo Telvista and Inversora are entities under common control with Carso Global Telecom. AT&T Inc. is a noncontrolling stockholder of the Company.

(3) Includes P.7,068,477 in 2010 (P.7,944,083 in 2009 and P.9,959,018 in 2008) for interconnection expenses under the Calling Party Pays program for outgoing calls from fixed line telephones to cellular telephones paid to subsidiaries of América Móvil.

(4) Includes P.33,206 in 2010 (P.47,462 in 2009 and P.84,654 in 2008) for the sale of materials and other services rendered to subsidiaries of Carso Group; P.235,742 in 2010 (P.230,397 in 2009 and P.206,634 in 2008) for billing and collection services rendered to subsidiaries of Grupo Financiero Inbursa, S.A.B. de C.V. (Inbursa); P.301,440 in 2010 (P.301,440 in 2009 and P.753,600 in 2008) for the use and updating of the telephone directory customer database, as well as P.317,945 in 2010 (P.373,648 in 2009 and P.411,956 in 2008) for billing, collection, administrative services and others rendered to subsidiaries of Telmex Internacional; and P.562,852 (P.494,785 in 2009 and P.451,686 in 2008) for property leases and other services rendered to subsidiaries of América Móvil. Inbursa is an entity under common control with Carso Global Telecom.

(5) Includes P.3,767,925 in 2010 (P.4,397,574 in 2009 and P.5,072,839 in 2008) for revenues invoiced to a subsidiary of América Móvil for the rental of private circuits and long distance services.

(6) Includes costs and revenues with companies of AT&T Inc. and with subsidiaries of América Móvil and Telmex Internacional.

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c) An analysis of employee benefits granted to the Company s key management or directors is as follows:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Short and long-term direct benefits | **P. 45,461** | P. 51,371 | P. 41,636 |
| Post-retirement benefits | **4,831** | 3,154 | 3,060 |
| Total | **P. 50,292** | P. 54,525 | P. 44,696 |

**14. Stockholders Equity**

a) At December 31, 2010, capital stock is represented by 18,158 million shares issued and outstanding with no par value, representing the Company s fixed capital (18,192 million in 2009). An analysis is as follows:

| | **2010** | 2009 |
|---|---|---|
| 7,840 million Series AA common shares (8,115 million in 2009) | **P. 5,380,966** | P. 5,569,721 |
| 383 million Series A common shares (395 million in 2009) | **308,440** | 317,792 |
| 9,935 million Series L shares with limited voting rights (9,682 in 2009) | **3,319,579** | 3,132,787 |
| Total | **P. 9,008,985** | P. 9,020,300 |

At December 31, 2010 and 2009, the historical value of the Company s capital stock was P.78,398 and P.78,545, respectively.

An analysis of the changes in 2010, 2009 and 2008 is as follows:

| | **Capital stock(1)** | | | | | |
|---|---|---|---|---|---|---|
| | **Series AA** | | **Series A** | | **Series L** | |
| | **Number** | **Amount** | **Number** | **Amount** | **Number** | **Amount** |
| Balance at December 31, 2007 | 8,115 | P. 5,569,721 | 430 | P. 345,936 | 10,815 | P. 3,486,904 |
| Cash purchase of Company s own shares | | | (9) | (6,934) | (796) | (256,995) |
| Conversion of shares | | | (14) | (11,268) | 14 | 11,268 |
| Balance at December 31, 2008 | 8,115 | 5,569,721 | 407 | 327,734 | 10,033 | 3,241,177 |
| Cash purchase of Company s own shares | | | (2) | (1,551) | (361) | (116,781) |
| Conversion of shares | | | (10) | (8,391) | 10 | 8,391 |
| Balance at December 31, 2009 | 8,115 | 5,569,721 | 395 | 317,792 | 9,682 | 3,132,787 |
| Cash purchase of Company s own shares | | | | **(5)** | **(34)** | **(11,310)** |

| | | | | | | |
|---|---|---|---|---|---|---|
| Conversion of shares | **(275)** | **(188,755)** | **(12)** | **(9,347)** | **287** | **198,102** |
| Balance at December 31, 2010 | **7,840** | **P. 5,380,966** | **383** | **P. 308,440** | **9,935** | **P. 3,319,579** |

(1) Number of shares in millions

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The Company s capital stock must be represented by (i) no less than 20% of Series AA common shares, which may be subscribed and acquired only by Mexican investors, and at all times must represent at least 51% of the common shares of total capital stock; (ii) Series A common shares, which may be freely subscribed, that must not exceed more than 19.6% of capital stock and no more than 49% of the common shares of total capital stock; (iii) both Series AA and A shares combined may not represent more than 51% of capital stock; and (iv) Series L shares, which have limited voting rights and may be freely subscribed, in a percentage when combined with the Series A shares may not exceed 80% of capital stock.

Each share of the Series AA or Series A may be exchanged at the option of the holder for one share of Series L , provided that the Series AA shares may never represent less than 20% of our outstanding capital stock or less than 51% of our combined Series AA and A shares.

**Voting rights**

Each ordinary share of the Series AA and A entitles the holder to one vote at the general stockholders meetings. Each Series L share entitles the holder to one vote at all stockholders meetings in which holders of Series L shares are authorized to vote. In accordance with the Eighth Clause of the Company s bylaws, holders of Series L shares only have the right to vote to designate two directors on the Board of Directors and their corresponding alternate directors, and on the following matters:

- The transformation of TELMEX from one type of entity to another;
- Any merger in which TELMEX is not the surviving entity or any merger with an entity whose principal corporate purposes are different from those of TELMEX (when TELMEX is the surviving entity); and
- Cancellation of the registration of the TELMEX s shares in the securities or special sections of the Mexican National Securities Registry and in any foreign stock exchanges in which they are registered.

In order for the resolutions adopted in extraordinary stockholders meetings related to any of the matters on which the Series L shares are entitled to vote to be validated, the approval by a majority vote of the Series AA and Series A stockholders will be required.

Under Mexican law, the stockholders of any Series of shares are also entitled to vote as one class on any proposal that could adversely affect the rights of the stockholders of that particular series and the Company s stockholders (including the Series L stockholders), which individually or collectively represent 20% or more of all capital stock could judicially oppose any stockholders resolution with respect to those resolutions for which such stockholders have the right to vote. The determination of whether a matter requires the vote

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by the holders of Series L under such basis would initially be made by the board of directors or by any other party that calls a stockholders meeting to decide on the resolution. A negative decision would be subject to judicial challenge by any affected stockholder, and a court would ultimately determine the necessity for a class vote. There are no other procedures for determining whether a proposal requires a class vote, and Mexican law does not provide extensive guidance on the criteria to be applied in making such a determination.

b) In 1994, the Company initiated a program to purchase its own shares. The cost of the repurchased shares, in the amount that exceeds the portion of capital stock corresponding to the repurchased shares, is charged to retained earnings.

At a regular stockholders meeting held on March 3, 2009, the stockholders approved an increase of P.10,000,000 in the total authorized nominal amount for the repurchase of the Company s own shares. The remainder of the previously authorized amount was P.340,868, bringing the total maximum amount to be used for this purpose to P.10,340,868.

At a regular stockholders meeting held on April 27, 2007, the stockholders approved an increase of P.15,000,000 (historical) to the total authorized nominal amount for the repurchase of the Company s own shares. The remaining amount was P.8,046,597, bringing the total maximum amount to be used for this purpose to P.23,046,597 (historical).

In 2010, the Company acquired 33.9 million Series L shares for P.339,746 and 6,906 Series A shares for P.76.

In 2009, the Company acquired 361.2 million Series L shares for P.4,073,625 and 1.9 million Series A shares for P.21,695.

In 2008, the Company acquired 796.7 million Series L shares for P.12,764,130 and 8.6 million Series A shares for P.107,712.

At December 31, 2010, 2009 and 2008, the Company had 14,074 million (14,032 million Series L and 42 million Series A ), 14,040 million (13,998 million Series L and 42 million Series A ) and 13,677 million (13,637 million Series L and 40 million Series A ) treasury shares, respectively.

c) In conformity with the Mexican Corporations Act, at least 5% of net income of the year must be appropriated to increase the legal reserve. This practice must be continued each year until the legal reserve reaches at least 20% of capital stock.

d) At December 31, 2010, Accumulated other comprehensive income items include P.211,741 for the effective portion of the fair value of swaps designated as cash flow hedges and P.174,368 for the effect of translation of foreign entities, net of deferred taxes (P.748,675 and P.134,550 in 2009, respectively).

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e) At a regular meeting held on April 29, 2010, the stockholders agreed to declare a cash dividend of P.0.50 per outstanding share, to be paid in four installments of P.0.1250 each in June, September and December 2010 and in March 2011. In March 2010, the Company paid the fourth installment of P.0.1150 per outstanding share, which was authorized at the regular meeting held on April 28, 2009.

At a regular meeting held on April 28, 2009, the stockholders agreed to declare a cash dividend of P.0.46 per outstanding share, to be paid in four installments of P.0.1150 each in June, September and December 2009 and in March 2010. In March 2009, the Company paid the fourth installment of P.0.10 per outstanding share, which was authorized at the regular meeting held on April 25, 2008. At a regular meeting held on December 1, 2009, the stockholders agreed to declare an extraordinary cash dividend of P.0.40 per outstanding share, paid in a single payment beginning on December 17, 2009.

At a regular meeting held on April 25, 2008, the stockholders agreed to declare a cash dividend of P.0.40 per outstanding share, to be paid in four installments of P.0.10 each in June, September and December 2008 and in March 2009. In March 2008, the Company paid the fourth installment of P.0.1125 per outstanding share, which was authorized at the regular meeting held on April 27, 2007.

The cash dividends paid in 2010, 2009 and 2008 were P.8,736,965, P.15,093,082 and P.7,609,477, respectively.

**15. Income Tax and Flat-Rate Business Tax**

a) Through December 31, 2009 the corporate income tax rate was 28%. Under the Mexican Tax Reform Law approved on December 7, 2009, the corporate income tax rate was increased from 28% to 30% for the period from January 1, 2010 through December 31, 2012, and will be scaled back to 29% in 2013, and to 28% in 2014 and future years.

b) On October 1, 2007, the Flat-Rate Business Tax (FRBT) Law was published and became effective as of January 1, 2008.

Beginning January 1, 2008, the FRBT is computed by applying the applicable rate to income determined on the basis of cash flows, which is determined by deducting authorized deductions from all income collected from those activities that are subject to the tax. As established under the Law, certain FRBT credits also may be deducted from the FRBT payable. Under the Law s transitory provisions, the FRBT rate is 16.5% in 2008, 17% in 2009 and 17.5% in 2010 and succeeding years.

When the FRBT base is negative because deductions exceed taxable income, there is no FRBT payable. The amount of the negative base multiplied by the FRBT rate results in a FRBT credit, which in 2008 and 2009 could be applied against income tax for the same year or, if applicable, may be applied against FRBT payable in the next ten years.

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FRBT creditable concepts result mainly from the negative FRBT base to be amortized, salary and social security contribution credits, and credits arising from the deduction of certain assets, such as inventories and fixed assets, during the transition period as of the date on which the FRBT became effective.

FRBT is payable only to the extent it exceeds income tax for the same period. To determine FRBT payable, income tax paid in a given period is first subtracted from the FRBT of the same period.

For the years ended December 31, 2010, 2009 and 2008, the Company had no FRBT payable and, based on its tax projections, estimates that it will not be subject to the payment of FRBT in subsequent years.

c) An analysis of the income tax provision is as follows:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Current year income tax | **P. 9,269,487** | P. 9,560,860 | P. 10,606,003 |
| Deferred tax | **(861,547)** | (1,075,338) | (1,014,344) |
| Total | **P. 8,407,940** | P. 8,485,522 | P. 9,591,659 |

A reconciliation of the statutory income tax rate to the effective rate recognized for financial reporting purposes is as follows:

| | **2010 %** | 2009 % | 2008 % |
|---|---|---|---|
| Statutory income tax rate | **30.0** | 28.0 | 28.0 |
| Depreciation | **(1.1)** | (0.9) | (3.9) |
| Social security benefits | **1.6** | 1.2 | 1.1 |
| Monetary gain | **4.2** | 2.6 | 6.0 |
| Tax benefits | | (0.2) | |
| Other | **0.7** | (1.4) | 1.0 |
| Effective income tax rate | **35.4** | 29.3 | 32.2 |

At December 31, 2010 and 2009, the Company recognized deferred income taxes on the following temporary differences:

| | **2010** | 2009 |
|---|---|---|
| **Deferred tax assets:** | | |
| Allowance for bad debts and slow-moving inventories | **P. 1,233,739** | P. 877,847 |
| Tax loss carryforwards | **112,731** | 87,365 |

| | | |
|---|---|---|
| Advance billings | **381,538** | 435,521 |
| Accrued liabilities | **1,201,475** | 1,492,471 |
| Employee profit sharing | **1,499,763** | 1,728,654 |
| Derivative financial instruments | **82,708** | |
| | **4,511,954** | 4,621,858 |

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| | **2010** | 2009 |
|---|---|---|
| **Deferred tax liabilities:** | | |
| Fixed assets | **(13,257,546)** | (14,357,100) |
| Inventories | **(15,174)** | (13,667) |
| Licenses and trademarks | **(231,365)** | (118,903) |
| Labor obligations | **(4,809,996)** | (4,566,155) |
| Prepaid expenses | **(262,086)** | (300,552) |
| Derivative financial instruments | | (272,538) |
| Effect of translation of foreign entities | **(68,550)** | (53,001) |
| | **(18,644,717)** | (19,681,916) |
| Deferred tax liability, net | **P. (14,132,763)** | P. (15,060,058) |

d) At December 31, 2010, the balance of the re-expressed contributed capital account (CUCA) and the net tax profit account (CUFIN) was P.12,108,643 and P.17,315,061, respectively. These amounts correspond to Teléfonos de México, S.A.B. de C.V. on an individual basis.

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**16. Segments**

TELMEX primarily operates in two segments: local and long distance telephone service. The local telephone service segment corresponds principally to local fixed-line wired service, including interconnection service. The long distance service segment includes domestic and international service. Other segments include long distance calls made from public and rural telephones, data services and other services. Additional information related to the Company s operations is provided in Note 1. The following summary shows the most important segment information, which has been prepared on a consistent basis:

| | (Amounts in millions of Mexican pesos) | | | | |
|---|---|---|---|---|---|
| | **Local service** | **Long distance** | **Other segments** | **Adjustments** | **Consolidated total** |
| **December 31, 2010** | | | | | |
| **Revenues:** | | | | | |
| **External revenues** | **P. 60,489** | **P. 20,056** | **P. 33,018** | | **P. 113,563** |
| **Intersegment revenues** | **11,338** | | **885** | **P. (12,223)** | |
| **Depreciation and amortization** | **9,335** | **1,698** | **6,490** | | **17,523** |
| **Operating income** | **14,301** | **1,609** | **12,507** | | **28,417** |
| **Segment assets** | **261,594** | **35,214** | **115,634** | | **412,442** |
| December 31, 2009 | | | | | |
| Revenues: | | | | | |
| External revenues | P. 65,158 | P. 22,543 | P. 31,399 | | P. 119,100 |
| Intersegment revenues | 11,722 | | 929 | P. (12,651) | |
| Depreciation and amortization | 9,818 | 1,788 | 6,345 | | 17,951 |
| Operating income | 17,846 | 2,537 | 13,981 | | 34,364 |
| Segment assets | 260,597 | 35,094 | 109,091 | | 404,782 |
| December 31, 2008 | | | | | |
| Revenues: | | | | | |
| External revenues | P. 70,801 | P. 27,454 | P. 25,850 | | P. 124,105 |
| Intersegment revenues | 10,600 | | 993 | P. (11,593) | |
| Depreciation and amortization | 11,260 | 2,211 | 4,462 | | 17,933 |
| Operating income | 19,552 | 6,169 | 14,022 | | 39,743 |
| Segment assets | 284,502 | 53,932 | 63,321 | | 401,755 |

Inter-segmental transactions are reported based on terms offered to third parties. Employee profit sharing, other expenses, financing cost, equity interest in net income of affiliates and the income tax provision are not allocated to each segment, because they are handled at the corporate level.

Segment assets include plant, property and equipment (excluding accumulated depreciation), construction in progress and advances to equipment suppliers, and inventories for operation of the telephone plant.

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## 17. Subsequent Event

At an extraordinary meeting held on April 4, 2011, the stockholders approved a corporate restructuring, through the creation of a subsidiary company that will provide telecommunications and interconnection services in rural areas, where fixed telephony competitors do not invest. The subsidiary will be named Telmex Social.

The restructuring is subject, if needed, to the approval of the Communications Ministry (*Secretaría de Comunicaciones y Transportes*, or SCT), as well as the authorization and confirmation of the rest of the corresponding authorities and governmental entities.

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## 18. Differences between Mexican FRS and U.S. GAAP

The Company s consolidated financial statements are prepared in accordance with Mexican Financial Reporting Standards ( Mexican FRS ), which differ in certain respects from accounting principles generally accepted in the United States ( U.S. GAAP ).

As described in Note 1 II b, effective January 1, 2008, the Company ceased to recognize the effects of inflation on its financial statements as required by Mexican FRS B-10. However, as required by such standard, the financial statement amounts that were previously reported remained unchanged, and the inflation adjustments previously recognized have been maintained in their corresponding caption. This new standard requires that the re-expressed amounts of non-monetary assets as reported at December 31, 2007 become the carrying amounts for those assets effective January 1, 2008. The carrying amounts affected the 2008, 2009 and 2010 net income and will also affect net income in future periods. For example, depreciation expense after the adoption of Mexican FRS B-10 is based on carrying amounts of fixed assets that include inflation adjustments recorded prior to the adoption of Mexican FRS B-10.

The Mexican and U.S. GAAP amounts included in this Note, as they relate to the years ended December 31, 2010, 2009 and 2008, are presented in the carrying amounts as required by Mexican FRS B-10, and the effects of inflation that were recorded prior to 2008 have not been reversed in the reconciliations to U.S. GAAP.

The principal differences between Mexican FRS and U.S. GAAP, as they relate to the Company, are described below together with an explanation, where appropriate, of the method used to determine the adjustments that affect net income, stockholders equity and resources provided by operating and financing activities.

***Cash flow information***

As described in Note 1, the Company adopted Mexican FRS B-2, *Statement of cash flows,* on January 1, 2008. Accordingly, the cash flow statements as prepared under Mexican FRS for the years ended December 31, 2010, 2009 and 2008, comply with IAS 7, *Statement of Cash Flows*, as issued by the International Accounting Standards Board; therefore, no reconciliation was needed.

Noncash transactions related to investment in plant, property and equipment for the years ended December 31, 2010, 2009 and 2008 were P. 2,194,859, P. 801,187 and P. 2,147,017, respectively.

***Capitalized interest:***

Under U.S. GAAP, interest on borrowings incurred during the construction period must be considered as an additional cost of constructed assets to be capitalized in plant, property and equipment and depreciated over the lives of the related assets. The amount of the capitalized financing cost for U.S. GAAP purposes was determined by applying the weighted-average rate of interest of financing.

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Starting January 1, 2007, although the Company adopted the policy of capitalizing the comprehensive cost of financing on assets under construction, as a result of the adoption of Mexican FRS D-6, the Company did not capitalize any comprehensive cost of financing since the Company has not had any significant qualifying assets with prolonged construction periods. For the years ended December 31, 2010, 2009 and 2008, the Company did not capitalize any interest under U.S. GAAP. The reconciling items show the depreciation of capitalized interest in prior years.

***Valuation of inventories for operation of the telephone plant and plant, property and equipment:***

As previously discussed in Note 1.II.i, through December 31, 2007, the re-expression of plant, property and equipment was based on the rate of inflation in the respective country of origin. This method is not acceptable for U.S. GAAP purposes; consequently, the difference between this method and the re-expression of inventories for operation of the telephone plant and plant, property and equipment based on the NCPI was taken to the U.S. GAAP reconciliations subsequently presented.

As a result of this comparison, inventories for operation of the telephone plant, plant, property and equipment and stockholders equity as of December 31, 2010 increased by P. 900,193 (P. 1,331,167 in 2009), and the depreciation expense for 2010 increased by P. 430,974 (P. 402,963 and P. 787,067 in 2009 and 2008, respectively).

***Deferred income tax and deferred employee profit sharing:***

As mentioned in Note 1.II.r, under Mexican FRS, deferred income tax is determined on all differences in balance sheets accounts for financial and tax reporting purposes, using the enacted income tax rate at the balance sheet date, which is basically in conformity with ASC Topic 740, *Income taxes,* except for the treatment of deferred taxes on the effect of translation of foreign entities.

The deferred tax adjustment included in the net income and stockholders equity reconciliations, also includes the effect of deferred taxes on all U.S. GAAP adjustments reflected in the reconciliation between Mexican FRS and U.S. GAAP.

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The differences in the recognition of deferred income tax and deferred employee profit sharing (for purposes of this note, collectively referred to as deferred taxes ) between Mexican FRS and U.S. GAAP for purposes of the income statement were as follows:

| | |
|---|---|
| 2008 | P. (153,150) |
| 2009 | 198,339 |
| **2010** | **266,601** |

The yearly changes in the accumulated amount for deferred taxes applied to equity as a result of the difference between the indexed cost and the specific indexation factor valuation of fixed assets and inventories, primarily for operation of the telephone plant from 2008 through 2010 are the following:

| | |
|---|---|
| 2008 | P. 320,831 |
| 2009 | (145,116) |
| **2010** | **5,976** |

The yearly changes in the accumulated amount for deferred taxes applied to equity as a result of ASC Topic 715, *Compensation - Retirement Benefits,* from 2008 through 2010 are the following:

| | |
|---|---|
| 2008 | P. 10,174,718 |
| 2009 | 1,193,289 |
| **2010** | **1,383,431** |

The related accumulated amounts at December 31, 2010 and 2009 that increased equity were P. 18,993,116 and P. 17,609,685, respectively.

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Significant components of deferred taxes under U.S. GAAP at December 31, 2010 and 2009 are as follows:

| | **2010** | | | 2009 | | |
|---|---|---|---|---|---|---|
| | **Income tax** | **Employee profit sharing** | **Total** | Income tax | Employee profit sharing | Total |
| Deferred assets: | | | | | | |
| Allowances for bad debts and slow-moving inventories | **P. 1,233,739** | **P. 434,813** | **P. 1,668,552** | P. 877,847 | P. 310,287 | P. 1,188,134 |
| Tax loss carryforwards | **112,731** | | **112,731** | 87,365 | | 87,365 |
| Advance billings | **381,538** | **146,480** | **528,018** | 435,521 | 147,750 | 583,271 |
| Accrued liabilities | **1,201,475** | **405,470** | **1,606,945** | 1,492,471 | 515,522 | 2,007,993 |
| Employee profit sharing | **46,451** | | **46,451** | 403,550 | | 403,550 |
| Labor obligations | **10,214,231** | **3,647,926** | **13,862,157** | 9,370,573 | 3,346,606 | 12,717,179 |
| Exchange loss on debt | | **397,925** | **397,925** | | 347,123 | 347,123 |
| Derivative financial instruments | **82,708** | **31,756** | **114,464** | | | |
| Total deferred assets | **13,272,873** | **5,064,370** | **18,337,243** | 12,667,327 | 4,667,288 | 17,334,615 |
| Deferred liabilities: | | | | | | |
| Fixed assets | **(13,491,450)** | **(3,065,309)** | **(16,556,759)** | (14,746,460) | (3,574,360) | (18,320,820) |
| Inventories | **(15,174)** | **(5,420)** | **(20,594)** | (13,667) | (4,881) | (18,548) |
| Capitalized interest or net financing cost | **(165,896)** | **(59,249)** | **(225,145)** | (231,667) | (82,738) | (314,405) |
| Licenses and trademarks | **(231,365)** | **(38,889)** | **(270,254)** | (115,533) | (44,852) | (160,385) |
| Prepaid expenses | **(262,086)** | **(57,975)** | **(320,061)** | (315,546) | (90,195) | (405,741) |
| Derivative financial instruments | | | | (272,538) | (91,884) | (364,422) |
| Total deferred liabilities | **(14,165,971)** | **(3,226,842)** | **(17,392,813)** | (15,695,411) | (3,888,910) | (19,584,321) |
| Net deferred (liabilities) assets | **P. (893,098)** | **P. 1,837,528** | **P. 944,430** | P. (3,028,084) | P. 778,378 | P. (2,249,706) |

For Mexican FRS purposes, as discussed in Note 15, the net deferred income tax liabilities recognized amounted to P. 14,132,763 and P. 15,060,058 at December 31, 2010 and 2009, respectively. Also as discussed in Note 10.c, for Mexican FRS purposes the net deferred employee profit sharing liabilities recognized amounted to P.3,352,873 and P.3,954,136 at December 31, 2010 and 2009.

Under U.S. GAAP deferred tax assets and liabilities are classified as current or noncurrent, based on the classification of the asset or liability that originated it. A deferred tax asset or liability that is not related to an asset or liability for financial reporting purposes, including deferred tax assets related to carryforwards, is classified in accordance to its expected reversal date. For a particular tax-paying component and within a particular tax jurisdiction, (a) all current deferred tax assets and liabilities are offset and presented as a single amount and (b) all noncurrent deferred tax assets and liabilities are offset and presented as a single amount. However, deferred tax assets and liabilities attributable to different tax-paying components of the enterprise or to different tax jurisdictions are not offset.

Under Mexican FRS deferred tax assets and liabilities are classified as noncurrent and are presented in one net amount in the balance sheet. The consolidated amounts of deferred taxes are not offset if they do not belong to the same taxable entity and to the same taxation authority.

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***Income taxes on unremitted foreign earnings***

Under US GAAP, deferred tax consequences on unremitted foreign earnings that are considered to be permanently invested are not recognized. Therefore, the Company has eliminated the deferred tax consequences on the effect of translation of its foreign operations in the reconciliation of stockholders equity between Mexican FRS and US GAAP. In the event that the Company repatriated these earnings, incremental taxes may be incurred. The Company has determined that it is not practicable to determine the amount of these incremental taxes.

***Employee benefit obligation:***

In 2010, 2009 and 2008, pension and seniority premium plans expense under U.S. GAAP totaled P. 5,518,651, P. 5,207,736 and P. 3,812,903, respectively. The components of these employee benefit obligations calculated in accordance with the provisions of ASC 715, consist of the following:

| | December 31, | | |
|---|---|---|---|
| | **2010** | 2009 | 2008 |
| Labor cost | **P. 4,850,844** | P. 4,431,755 | P. 4,333,194 |
| Financial cost on defined benefit obligation | **17,751,583** | 15,861,542 | 14,344,072 |
| Expected return on plan assets | **(19,632,161)** | (17,524,795) | (15,571,525) |
| Amortization of unrecognized net transition obligation and prior service cost | **34,768** | 34,766 | 624,355 |
| Amortization of unrecognized losses | **2,513,617** | 2,404,468 | 82,807 |
| Net periodic cost under U.S. GAAP | **5,518,651** | 5,207,736 | 3,812,903 |
| Net periodic cost under Mexican FRS | **5,527,931** | 5,021,791 | 4,652,124 |
| Cost increase (reduction) under U.S. GAAP | **P. (9,280)** | P. 185,945 | P. (839,221) |

The amounts reconciled in net income, represent the effect generated by the assumptions used during the first application on the adoption of the pension and seniority premium accounting rules when they became effective for U.S. GAAP and Mexican FRS purposes, which were in different years.

In determining the various economic assumptions used in the computation, the Company estimates specific rates for each of the next 11 years and assumes a constant ultimate rate for each year thereafter. Each economic assumption is evaluated annually and revised as necessary. Assumptions used in the computation of the net cost under U.S. GAAP for each of the years presented in the above table are equal to those used in the determination of employee benefit obligations disclosed in Note 10. The expected rates of annual return on plan assets used for the computation of the net cost under Mexican FRS and U.S. GAAP, for each of the years presented in the above table were 12% (nominal), 12% (nominal) and 10% (nominal) for 2010, 2009 and 2008, respectively.

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(In thousands of Mexican pesos, see Note 1 II.b)

*Plan assets:*

The weighted average asset actual allocation of plan assets by asset category is as follows:

| | **Percentage of plan assets at December 31,** | |
|---|---|---|
| | **2010** | 2009 |
| Debt securities: | | |
| Mexican Government | **39.8%** | 40.4% |
| Mexican companies | **6.6%** | 5.5% |
| Equity securities: | | |
| Mexican companies | **49.4%** | 46.9% |
| U.S. companies | **4.2%** | 5.8% |
| Cash | **0.0%** | 1.4% |
| Total | **100.0%** | 100.0% |

The asset allocation of plan assets at December 31, 2010 and 2009 and the target allocation for 2011 by asset category are as follows:

| | Target allocation 2011 | **Actual allocation 2010** | Actual allocation 2009 |
|---|---|---|---|
| Fixed-income securities | 40-50% | **46.4%** | 45.9% |
| Variable-income securities | 50-60% | **53.6%** | 54.1% |

The target asset allocations reflect the Company s investment strategy of maximizing the rate of return on plan assets and the resulting funded status, within an appropriate level of risk.

As of December 31, 2010, equity securities held by the plan included 179.2 million shares of TELMEX (242.5 million shares in 2009) and 1,483.9 million shares of América Móvil and related parties (1,741.7 million shares in 2009), with a fair value of P. 1,794,171 (P. 2,653,441 in 2009) and P. 73,811,918 (P. 66,182,240 in 2009), respectively. In 2010, the plan purchased 379.8 million shares of América Móvil and related parties (20.8 million shares in 2009) and sold 637.6 million shares of América Móvil and related parties (241.2 million shares in 2009). In 2009, the plan purchased 2.8 million shares of TELMEX and in 2010 sold 63.3 million shares of TELMEX (16.1 million shares in 2009). Dividends received by the plan in 2010 were P. 511,990 (P. 925,224 in 2009) from TELMEX and related parties.

As of December 31, 2010, securities held by the plan also included P. 1,562,280 (notional amount) of TELMEX debt securities (P. 943,080 in 2009) and P. 6,729,443 (notional amount) of related parties debt securities (P. 2,296,338 in 2009), with a fair value of P. 1,574,245 (P. 943,049 in 2009) and P. 6,867,608 (P. 2,345,667 in 2009), respectively. In 2010, the plan purchased P. 693,086,313 (P. 975,694,551 in 2009) and sold P. 688,977,807 (P. 992,728,118 in 2009) of related parties debt securities, and purchased P. 28,471,073 (P. 19,488,270 in 2009) and sold P. 27,857,697 (P. 18,963,254 in 2009) of TELMEX debt securities. Interest income recognized by the plan in 2010 was P. 38,068 (P. 16,559 in 2009) on TELMEX debt securities and P. 58,022 (P. 44,877 in 2009) on related parties debt securities.

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The table below presents the fair value hierarchy of our plan assets as of December 31, 2010.

There are three broad levels to the fair value hierarchy of inputs to fair value (Level 1 being the highest priority and Level 3 being the lowest priority):

Level 1: Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets;

Level 2: Inputs other than quoted prices included in Level 1 that are observable for the asset or liability either directly or indirectly; and

Level 3: Unobservable inputs (e.g., a reporting entity s own data).

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Debt securities: | | | | |
| Mexican Government | P. 71,806,217 | | | P. 71,806,217 |
| Mexican companies | 11,928,900 | | | 11,928,900 |
| Equity securities: | | | | |
| Mexican companies | 89,134,299 | | | 89,134,299 |
| U.S. companies | 7,696,386 | | | 7,696,386 |
| Cash and cash equivalents | 14,326 | | | 14,326 |
| Established fund | P. 180,580,128 | | | P. 180,580,128 |

Expected cash flows for the pension and seniority premiums plans are as follows:

| | |
|---|---|
| Expected benefit payments: | |
| 2011 | P. 11,708,919 |
| 2012 | 12,230,400 |
| 2013 | 13,059,529 |
| 2014 | 13,824,309 |
| 2015 | 14,548,627 |
| 2016-2020 | 89,325,937 |
| Total | P. 154,697,721 |

The investment policies of plan assets are the following:

Tax rules issued by the Ministry of Finance and Public Credit:
Asset investments of the pension fund must be made through an irrevocable trust set up with a financial credit institution authorized to operate in Mexico.

To invest at least 30% of assets in Mexican government securities registered in the National Registry of Securities and Intermediaries ( *Registro Nacional de Valores e Intermediarios* ) or in shares of investment funds in debt instruments ( *sociedades de inversión* ).

The remaining 70% (maximum) will be invested in securities approved by the National Banking and Securities Commission (CNBV).

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Trading:
The fund invests in securities approved by CNBV with high trading, liquidity and credit quality.

Plan assets structure:
Ensure that the composition of assets comprising the pension fund generates sufficient resources and liquidity to cover growth of pension obligations.

The Company s policy that defines long-term interest rates to discount the obligations of the pension plan is based on the historical returns of short-term interest rates for the last 20 years in Mexico. As part of the policy s criteria, interest rates used in the projection are those available at the beginning of the year.

The unrecognized net transition obligation under ASC 715 of P. 7,074 924 at January 1, 1997, was amortized over the average future working lifetime of the employee group, being 2008 the last year of the amortization period. The portion of the unrecognized net actuarial (loss) gain that exceeds 10% of the greater of defined benefit obligation or plan assets will also be recognized over 11 years.

ASC 715 requires (1) recognition on the balance sheet of an asset for a defined benefit plan s overfunded status or a liability for a plan s underfunded status, (2) measurement of a defined benefit plan s assets and its obligations that determine its funded status as of the end of the employer s fiscal year, and (3) recognition of the changes in the funded status of a defined benefit postretirement plan as a component of accumulated other comprehensive income in the year the changes occur.

The components of the plan s funded status that are reflected in the consolidated condensed balance sheet under U.S. GAAP as of December 31, 2010 and 2009 are as follows:

| | **2010** | 2009 |
|---|---|---|
| Fair value of plan assets | **P. 180,580,128** | P. 163,995,375 |
| Defined benefit obligation | **216,927,167** | 197,332,833 |
| Under funded status | **P. (36,347,039)** | P. (33,337,458) |

Amounts recognized in accumulated other comprehensive income under U.S. GAAP consist of the following:

| | **2010** | 2009 |
|---|---|---|
| Unrecognized actuarial loss | **P. 53,861,665** | P. 49,896,696 |
| Unrecognized prior service cost and changes in the plan | **96,051** | 130,819 |
| Total | **P. 53,957,716** | P. 50,027,515 |

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(In thousands of Mexican pesos, see Note 1 II.b)

Through December 31, 2007, for Mexican FRS reporting purposes, labor obligations were accounted for under rules similar to ASC 715 other than assumptions used during its first application, thereby constituting a difference with U.S. GAAP. Effective January 1, 2008, labor obligations are reported based on Mexican FRS D-3, *Employee benefits*, which requires the recognition on the balance sheet of a net projected liability or a net projected asset (see Note 10), in which unamortized items are included in the determination of the net projected liability or net projected asset, whereas under U.S. GAAP unamortized items are presented in accumulated other comprehensive income.

***Effects of inflation accounting on U.S. GAAP adjustments:***

Effective January 1, 2008, and as a result of adopting Mexican FRS B-10, *Effects of inflation*, the Company ceased recognizing the effects of inflation in its financial statements and considered the re-expressed amounts of all non-monetary items as its carrying basis as of January 1, 2008. The Company has not reconciled the inflation adjustments still included in its non-monetary items, with one exception for the adjustments in the valuation of inventories for operation of the telephone plant, plant, property and equipment and depreciation expense, previously mentioned in this Note.

***Penalties and interest:***

Under Mexican FRS penalties and interest on income tax settlements are presented as other income (expense), net; whereas under U.S. GAAP, such gains are presented in interest income (expense). The Company did not have any penalties or interest on tax settlements in 2010, 2009 and 2008.

***Accounting for uncertainty in income taxes:***

In accordance with ASC 740, TELMEX establishes reserves to remove some or all of the tax benefit of any of its tax positions at the time it determines that it becomes uncertain based upon one of the following conditions: (1) the tax position is not more likely than not to be sustained, (2) the tax position is more likely than not to be sustained, but for a lesser amount, or (3) the tax position is more likely than not to be sustained, but not in the financial period in which the tax position was originally taken.

For purposes of evaluating whether or not a tax position is uncertain, (1) the Company presumes the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information, (2) the technical merits of a tax position are derived from authorities such as legislation and statutes, legislative intent, regulations, rulings and case law and their applicability to the facts and circumstances of the tax position, and (3) each tax position is evaluated without consideration of the possibility of offset or aggregation with other tax positions taken.

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A number of years may elapse before a particular uncertain tax position is audited and finally resolved or when a tax assessment is raised. The number of years subject to tax assessments varies depending on the tax jurisdiction and is generally five years for the countries in which the Company principally operates. The tax benefit that has been previously reserved because of a failure to meet the more likely than not recognition threshold would be recognized in our income tax expense in the first period when the uncertainty disappears under any one of the following conditions: (1) the tax position is more likely than not to be sustained, (2) the tax position, amount, and/or timing is ultimately settled through negotiation or litigation, or (3) the statute of limitations for the relevant taxing authority to examine and challenge the tax position has expired.

As of December 31, 2010 and 2009, there are no uncertain tax positions not more likely than not to be sustained.

***Fair value measurements:***

ASC Topic 820, *Fair Value Measurement and Disclosures* establishes a framework for measuring fair value providing a consistent definition of fair value that focuses on exit price and prioritizes, within a measurement of fair value, the use of market based inputs over company specific inputs. ASC 820 expands the disclosure requirements and establishes a three-level hierarchy for fair value measurements on the observable inputs to the valuation of an asset or liability at the measurement date. ASC 820 requires companies to consider their own nonperformance risk when measuring liabilities carried at fair value, including derivative instruments. ASC 820 was effective on January 1, 2008 for all financial assets and liabilities and for non-financial assets and liabilities recognized or disclosed at fair value on a recurring basis (at least annually). For all other assets and liabilities, this statement was effective on January 1, 2009. The adoption of ASC 820 did not have a material impact on the Company s consolidated financial statements.

ASC Topic 825, *Financial Instruments* allows entities to voluntarily choose to measure certain financial assets and liabilities at fair value (fair value option). The fair value option may be elected on an instrument by instrument basis and is irrevocable, unless a new election date occurs. If the fair value option is elected for an instrument, ASC 825 specifies that the unrealized gains and losses for that instrument be reported in earnings at each subsequent reporting date. ASC 825 was effective for TELMEX on January 1, 2008. The Company did not elect to adopt fair value option to any of its outstanding instruments; therefore, it did not have any impact on its consolidated financial statements.

The Company is exposed to counterparty credit risk on all derivative financial instruments. Because the amounts are recorded at fair value, the full amount of the Company s exposure is the carrying value of these instruments. Credit risk is monitored through established approval procedures, including setting concentration limits by counterparty. The Company only enters into derivative transactions with well-established financial institutions; accordingly, the Company believes such risk is minimal.

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The following table provides a summary of significant assets and liabilities at December 31, 2010 and 2009 that are measured at fair value on a recurring basis:

| | Fair Value Measurement | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| **December 31, 2010** | | | | |
| **Assets** | | | | |
| Derivative financial instruments | | P. 6,957,018 | | P. 6,957,018 |
| **Liabilities** | | | | |
| Derivative financial instruments | | 1,561,294 | | 1,561,294 |
| **December 31, 2009** | | | | |
| **Assets** | | | | |
| Derivative financial instruments | | P. 12,225,550 | | P. 12,225,550 |
| **Liabilities** | | | | |
| Derivative financial instruments | | 848,910 | | 848,910 |

*Valuation Methods:*

*Derivatives:* The fair value of derivative financial instruments is based on quoted market prices supported by confirmations from the financial institutions with which the Company has entered into the related agreements. The Company s policy is to verify such fair values against valuations provided by an independent valuation agent contracted by the Company. This valuation agent applying technical models uses the present value of expected cash flows based on observable market interest rate curves (cross currency mid swaps, interest rate swap discount and LIBOR) commensurate with the term of each instrument. For currency derivatives, the Company s approach is to use forward contract employing market observable inputs, such as spot currency rates and time value. Since the Company primarily uses observable inputs in its valuation of its derivative assets and liabilities, they are considered Level 2.

In accordance with ASC 825*,* under U.S. GAAP it is necessary to provide information about the fair value of certain financial instruments for which it is practicable to estimate that value. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities approximate fair values due to the short-term maturity of these instruments.

The fair value of total debt is estimated using discounted cash flow analyses based on current borrowing rates offered to the Company for debt of the same remaining maturities and the market value for the senior notes at December 31, 2010 and 2009. The Company primarily uses observable inputs in the valuation of its debt, which are considered Level 2; also the Company uses quoted prices in active markets in the valuation of its senior notes and domestic senior notes, which are considered Level 1. As of December 31, 2010, the carrying value of total debt is P. 74,520,945 (P. 102,874,348 at December 31, 2009) and the fair value is P. 75,807,540 (P. 101,060,180 at December 31, 2009).

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***Related parties***

At December 31, 2009, *Recoverable taxes* in Note 3 includes P. 1,123,429 with Carso Global Telecom related with the tax consolidation, which correspond to the balance of monthly payments on account of the consolidated annual tax.

**A summary of the most significant new pronouncements in U.S. GAAP that became effective in 2010 is as follows:**

***Amendments to ASC Topic 855, Subsequent Events***

In February 2010, the Financial Accounting Standards Board (FASB) issued ASU No. 2010-09, *Subsequent Events* (ASC 855), *Amendments to Certain Recognition and Disclosure Requirements*. This update addresses certain implementation issues related to an entity s requirement to perform and disclose subsequent-events procedures, and removes the requirement that public companies disclose the date of their financial statements in both issued and revised financial statements. According to the FASB, the revised statements include those that have been changed to correct an error or conform to a retrospective application of U.S. GAAP. The adoption of this ASU had no impact on the Company s consolidated financial statements.

***ASU 2010-11, Derivatives and Hedging (Topic 815): Scope Exception Related to Embedded Credit Derivatives***

In March 2010, the FASB issued ASU No.2010-11, which is included in FASB ASC Topic 815. This update clarifies the type of embedded credit derivative that is exempt from embedded derivative bifurcation requirements. Only an embedded credit derivative that is related to the subordination of one financial instrument to another qualifies for the exemption. This guidance became effective for the Company s annual reporting period beginning January 1, 2010. The adoption of this guidance had no impact on the Company s consolidated financial statements.

***ASU 2010-21, Accounting for Technical Amendments to Various SEC Rules and Schedules***

In August 2010, the FASB issued ASU No. 2010-21, *Accounting for Technical Amendments to Various SEC Rules and Schedules Amendments to SEC Paragraphs Pursuant to Release No. 33-9026; Technical Amendments to Rules, Forms, Schedules and Codification of Financial Reporting Policies* and ASU 2010-22, *Accounting for Various Topics Technical Corrections to SEC Paragraphs - An announcement made by the staff of the U.S. Securities and Exchange Commission.* Both amendments have been adopted by the Company and had no effect on the financial position, results of operations or cash flows of the Company.

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**Summary:**

Net income and total stockholders equity, adjusted to take into account the material differences between Mexican FRS and U.S. GAAP, excluding the U.S. GAAP difference related to the split-up of Telmex Internacional, are as follows:

| | Year ended December 31, | | |
|---|---|---|---|
| | **2010** | 2009 | 2008 |
| Income from continuing operations as reported under Mexican FRS | **P. 15,371,458** | P. 20,468,983 | P. 20,176,911 |
| U.S. GAAP adjustments: | | | |
| Depreciation of capitalized interest | **(234,897)** | (259,894) | (293,358) |
| Deferred income tax under U.S. GAAP included in this reconciliation | **200,873** | 132,084 | (155,707) |
| Deferred employee profit sharing under U.S. GAAP included in this reconciliation | **65,728** | 66,255 | 2,557 |
| Pension and seniority premium plan cost | **9,280** | (185,945) | 839,221 |
| Difference between the re-expression of depreciation expense based on specific indexation factors and on the basis of the NCPI | **(430,974)** | (402,963) | (787,067) |
| Total U.S. GAAP adjustments, net | **(389,990)** | (650,463) | (394,354) |
| Net income under U.S. GAAP | **P. 14,981,468** | P. 19,818,520 | P. 19,782,557 |

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(In thousands of Mexican pesos, see Note 1 II.b)

| | **Year ended December 31** | |
|---|---|---|
| | **2010** | 2009 |
| Total stockholders equity under Mexican FRS | **P. 44,223,932** | P. 38,320,773 |
| U.S. GAAP adjustments, net of effects of inflation on monetary items: | | |
| Capitalized interest or net financing cost | **12,783,898** | 12,783,898 |
| Accumulated depreciation of capitalized interest or net financing cost | **(12,202,054)** | (11,967,158) |
| Deferred income tax on U.S.GAAP adjustments included in this reconciliation | **13,639,636** | 12,461,438 |
| Deferred income tax on effect of translation of foreign entities | **68,550** | 53,001 |
| Deferred employee profit sharing on U.S. GAAP adjustments included in this reconciliation | **5,395,074** | 4,929,217 |
| Deferred taxes on the difference between the indexed cost and specific indexation factor valuation of fixed assets and inventories | **(673,197)** | (679,173) |
| Pension and seniority premium plan cost | **268,483** | 259,203 |
| Difference between the re-expression of fixed assets and inventories based on specific indexation factors and on the basis of the NCPI | **900,193** | 1,331,167 |
| Labor obligations (ASC 715) | **(53,957,716)** | (50,027,515) |
| Total U.S. GAAP adjustments, net | **(33,777,133)** | (30,855,922) |
| Total stockholders equity under U.S. GAAP | **P. 10,446,799** | P. 7,464,851 |

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***Condensed financial information under U.S. GAAP***

The following table presents consolidated condensed income statements for the years ended December 31, 2010, 2009 and 2008, prepared under U.S. GAAP, and including the differences and reclassifications as compared to Mexican FRS described in this Note, but excluding the U.S. GAAP difference related to the split-up of Telmex Internacional:

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Operating revenues | **P. 113,563,365** | P. 119,100,212 | P. 124,105,235 |
| Operating costs and expenses | **86,618,562** | 87,128,506 | 85,749,504 |
| Operating income | **26,944,803** | 31,971,706 | 38,355,731 |
| Other income, net | **803,218** | 260,126 | 468,999 |
| Financing cost | **(4,755,396)** | (4,314,554) | (9,232,694) |
| Equity interest in net income (loss) of affiliates | **195,910** | 254,680 | (62,113) |
| Income before income tax | **23,188,535** | 28,171,958 | 29,529,923 |
| Income tax | **8,207,067** | 8,353,438 | 9,747,366 |
| Net income | **14,981,468** | 19,818,520 | 19,782,557 |
| Plus (less) net income attributable to noncontrolling interest | **12,704** | (294) | 25 |
| Net income attributable to TELMEX | **P. 14,994,172** | P. 19,818,226 | P. 19,782,582 |
| Weighted average number of shares issued and outstanding (in millions): | **18,189** | 18,383 | 18,906 |
| Earnings per share (in pesos) | **P. 0.82** | P. 1.08 | P. 1.05 |

*Reclassifications under U.S. GAAP*

In the consolidated condensed income statements, the Company reclassified: a) the employee profit sharing from 2010, 2009 and 2008 for P.1,479,702, P. 1,543,551 and P. 1,146,034, respectively, from the Other income, net caption to the Operating cost and expenses caption; and b) P. 598,147 related to ruling in favor of dissolving the trust fund in 2010, which was established for the IMSS contingency, from Other income, net caption to the Operating costs and expenses caption.

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The following table presents consolidated condensed balance sheets at December 31, 2010 and 2009, prepared under U.S. GAAP, and including the differences and reclassifications as compared to Mexican FRS described in this note:

| | **2010** | 2009 |
|---|---|---|
| **Assets** | | |
| Current assets | **P. 40,462,796** | P. 55,162,471 |
| Plant, property and equipment, net | **100,903,369** | 108,195,540 |
| Goodwill | **103,289** | |
| Equity investments | **1,392,042** | 1,775,380 |
| Other non-current assets | **2,490,880** | 2,360,671 |
| Total assets | **P. 145,352,376** | P. 167,494,062 |
| **Liabilities and stockholders equity** | | |
| Short-term debt and current portion of long-term debt | **P. 11,951,532** | P. 19,768,894 |
| Other current liabilities | **20,737,655** | 17,561,413 |
| Total current liabilities | **32,689,187** | 37,330,307 |
| Long-term debt | **62,569,413** | 83,105,454 |
| Labor obligations | **36,510,848** | 33,496,828 |
| Deferred taxes | **2,513,778** | 5,629,926 |
| Deferred credits | **622,351** | 466,696 |
| Total liabilities | **134,905,577** | 160,029,211 |
| Controlling interest | **10,137,476** | 7,423,371 |
| Non controlling interest | **309,323** | 41,480 |
| Total stockholders equity | **10,446,799** | 7,464,851 |
| Total liabilities and stockholders equity | **P. 145,352,376** | P. 167,494,062 |

*Reclassifications under U.S. GAAP*

In the consolidated condensed balance sheets, the Company reclassified from 2010 and 2009, P.3,458,208 and P. 3,380,220, respectively, from the long-term Deferred taxes liability caption to the Current assets caption.

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(In thousands of Mexican pesos, see Note 1 II.b)

***Condensed financial information under U.S. GAAP***

The shares of Telmex Internacional were authorized and issued pursuant to the TELMEX s stockholders meeting on December 21, 2007 approving the split-up. The establishment of Telmex Internacional became effective on December 26, 2007, following the recording of the stockholders resolution before a Mexican public notary, the registration in the Mexican Public Registry of Commerce and the publication in the *Diario Oficial* (Official Gazette); however the delivery of the share certificates occurred at the completion of the registration processes with the Mexican and U.S. Stock Exchanges on June 10, 2008.

Until the date of the exchange and delivery of the share certificates, the shares of Telmex Internacional traded together with the shares of TELMEX on the Mexican and U.S. Stock Exchanges. For Mexican FRS purposes, the entities transferred to Telmex Internacional have been treated as discontinued operations and distributed as of its effective date; however, since the share certificates of Telmex Internacional were not distributed to its stockholders as of December 31, 2007, the split-up entities could not be considered distributed to its stockholders for U.S. GAAP purposes as of December 31, 2007. Therefore, under U.S. GAAP the split-up entities could not be treated as distributed or discontinued operations until the shares were actually delivered to Telmex Internacional s stockholders.

In order to comply with U.S. GAAP, condensed financial information under U.S. GAAP for the three years ended December 31, 2010 is as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2010** | 2009 | 2008 |
| Operating revenues | **P. 113,563,365** | P. 119,100,212 | P. 124,105,235 |
| Operating costs and expenses | **86,618,562** | 87,128,506 | 85,749,504 |
| Operating income | **26,944,803** | 31,971,706 | 38,355,731 |
| Other income, net | **803,218** | 260,126 | 468,999 |
| Financing cost | **(4,755,396)** | (4,314,554) | (9,232,694) |
| Equity interest in net income (loss) of affiliates | **195,910** | 254,680 | (62,113) |
| Income before income tax | **23,188,535** | 28,171,958 | 29,529,923 |
| Income tax | **8,207,067** | 8,353,438 | 9,747,366 |
| Income from continuing operations | **14,981,468** | 19,818,520 | 19,782,557 |
| Income from discontinued operations, net of income tax | | | 2,172,831 |
| Net income | **14,981,468** | 19,818,520 | 21,955,388 |
| Plus (less) net income attributable to noncontrolling interest | **12,704** | (294) | 52,870 |
| Net income attributable to TELMEX | **P. 14,994,172** | P. 19,818,226 | P. 22,008,258 |
| Net income attributable to TELMEX s stockholders: | | | |
| Income from continuing operations | **P. 14,994,172** | P. 19,818,226 | P. 19,782,582 |
| Discontinued operations, net of income tax | | | 2,225,676 |

| | | | |
|---|---|---|---|
| Net income | **P. 14,994,172** | P. 19,818,226 | P. 22,008,258 |

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**TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2010, 2009 and 2008

(In thousands of Mexican pesos, see Note 1 II.b)

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Weighted average number of shares issued and outstanding (in millions): | **18,189** | 18,383 | 18,906 |
| Earnings per share (in pesos) | **P. 0.82** | P. 1.08 | P. 1.16 |
| Earnings per share (in pesos) from continuing operations | **P. 0.82** | P. 1.08 | P. 1.05 |
| Earnings per share (in pesos) from discontinued operations | **P.** | P. | P. 0.11 |

**TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2010, 2009 and 2008

(In thousands of Mexican pesos, see Note 1 II.b)

| | **Total Stockholders equity** |
|---|---|
| Balance at December 31, 2007 | P. 122,414,589 |
| Cash dividends declared | (7,774,143) |
| Cash purchase of Company s own shares | (12,871,842) |
| Comprehensive income: | |
| Net income for the year | 21,955,388 |
| Other comprehensive income: | |
| Deferred taxes allocated to equity | (11,347) |
| Changes in fair value of swaps, net of deferred taxes | 2,126,088 |
| Effect of translation of foreign entities, net | 2,050,829 |
| Effect of ASC 715, net of deferred taxes | (18,873,531) |
| Decrease due to the split-up of Telmex Internacional | (97,706,655) |
| Balance at December 31, 2008 | 11,309,376 |
| Cash dividends declared | (15,447,559) |
| Cash purchase of Company s own shares | (4,095,320) |
| Excess of purchase price over book value of entities acquired from companies under common control | (43,030) |
| Comprehensive income: | |
| Net income for the year | 19,818,520 |
| Other comprehensive income items: | |
| Changes in fair value of swaps, net of deferred taxes | (1,866,847) |
| Effect of translation of foreign entities, net | (13,552) |
| Effect of ASC 715, net of deferred taxes | (2,196,737) |
| Balance at December 31, 2009 | 7,464,851 |
| Cash dividends declared | **(8,911,908)** |
| Cash purchase of Company s own shares | **(339,822)** |
| Noncontrolling interest arising on a business combination | **280,547** |
| Comprehensive income: | |
| Net income for the year | **14,981,468** |
| Other comprehensive income items: | |
| Changes in fair value of swaps, net of deferred taxes | **(536,933)** |
| Effect of translation of foreign entities, net | **55,366** |
| Effect of ASC 715, net of deferred taxes | **(2,546,770)** |
| Balance at December 31, 2010 | **P. 10,446,799** |

| | **2010** | 2009 | 2008 |
|---|---|---|---|
| Comprehensive income for the year | **P. 11,953,131** | P. 15,741,384 | P. 7,247,427 |

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## SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Dated: May 11, 2011

Teléfonos de México, S.A.B. de C.V.

By: /s/ Adolfo Cerezo Pérez
Name: Adolfo Cerezo Pérez
Title: Chief Financial Officer