

TELEFONOS DE MEXICO S A B DE C V

Form 20-F

June 27, 2008

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As filed with the Securities and Exchange Commission on June 27, 2008.

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007

Commission File Number: 001-32741

Teléfonos de México, S.A.B. de C.V.

(Exact name of registrant as specified in its charter)

Telephones of Mexico

(Translation of registrant's name into English)

United Mexican States

(Jurisdiction of incorporation or organization)

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

(Address of principal executive offices)

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(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	New York Stock Exchange
Series L Shares, without par value (L Share ADSs)	
Series L Shares, without par value (L Shares)	New York Stock Exchange
	(for listing purposes only)
American Depositary Shares, each representing 20	The NASDAQ Capital Market
Series A Shares, without par value (A Share ADSs)	
Series A Shares, without par value (A Share ADSs)	The NASDAQ Capital Market
	(for listing purposes only)
8.75% Senior Notes due 2016	New York Stock Exchange

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

None.

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

None

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

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

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

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 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.

Yes No

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

Large Accelerated filer Accelerated filer Non-accelerated filer

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

U.S. GAAP IFRS Other

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 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 No

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PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

SELECTED FINANCIAL DATA

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

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

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

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

Year ended December 31,
2007 2006 2005 2004 2003
(in millions of constant pesos as of December 31, 2007,

except per share data)

Income Statement Data:

Mexican FRS:⁽¹⁾

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

(see footnotes on following page)

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December 31,
2007 2006 2005 2004 2003
(in millions of constant pesos as of December 31, 2007, except

number of shares and ratios of earnings to fixed charges)

Balance Sheet Data:

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

Other Data:

	2007	2006	2005	2004	2003
Mexican FRS:⁽¹⁾					
Ratio of earnings to fixed charges ⁽⁵⁾	7.1	6.7	7.0	8.3	6.5
U.S. GAAP:⁽⁴⁾					
Ratio of earnings to fixed charges ⁽⁶⁾	7.1	6.0	6.0	7.4	6.9

- (1) Under Mexican FRS, the *Escisión* was deemed effective as of December 26, 2007, and therefore the businesses transferred to Telmex Internacional pursuant to the *Escisión* have been treated as discontinued operations for all periods. See *Item 4. Information on the Company The Escisión, Item 5. Operating and Financial Review and Prospect U.S. GAAP Reconciliation* and Note 2 to our audited consolidated financial statements.
- (2) We have not presented net income or dividends on a per ADS basis. Each L Share ADS represents 20 L Shares, and each A Share ADS represents 20 A Shares.
- (3) Nominal amounts. For information on dividends paid per share converted into U.S. dollars, see *Item 8. Financial Information Dividends*.
- (4) Under U.S. GAAP, the *Escisión* was deemed effective as of June 10, 2008, the date on which the Telmex Internacional share certificates were delivered to our shareholders, and therefore the businesses transferred to Telmex Internacional pursuant to the *Escisión* were treated as part of our continuing operations as of December 31, 2007. See *Item 4. Information on the Company The Escisión, Item 5. Operating and Financial Review and Prospect U.S. GAAP Reconciliation* and Note 18 to our audited consolidated financial statements.
- (5) Earnings for this purpose consist of earnings before provision for income tax and equity interest in net income of affiliates, plus fixed charges during the period. Fixed charges for this purpose consist of interest expense during the period. Fixed charges do not take into account gain or loss from monetary position or exchange gain or loss attributable to our indebtedness.
- (6) Earnings for this purpose consist of earnings before provision for income tax and equity interest in net income of affiliates, plus fixed charges and depreciation of capitalized interest and minus interest capitalized during the period. Fixed charges for this purpose consist of interest expense plus interest capitalized during the period. Fixed charges do not take into account gain or loss from monetary position or exchange gain or loss attributable to our indebtedness.

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

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

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

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

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

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RISK FACTORS

Risks Relating to Our Business Generally

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

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

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

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

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

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

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

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

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

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

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

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

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

The Escisión may affect our stock price

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

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

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

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

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

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

physical damage to our network;

natural disasters such as hurricanes, earthquakes, floods and storms, among others; and

disruptions beyond our control.

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

Risks Relating to Our Controlling Shareholder and Capital Structure

We are controlled by one shareholder

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

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

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

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

We engage in transactions with entities that, like us, are controlled, directly or indirectly, by Carlos Slim Helú and members of his immediate family. These entities include (a) Telmex Internacional and certain of its subsidiaries, (b) Grupo Carso, S.A.B. de C.V., or Grupo Carso, and its subsidiaries, (c) Grupo Financiero Inbursa, S.A.B. de C.V., or Grupo Financiero Inbursa, and its subsidiaries, (d) América Móvil, S.A.B. de C.V., or América Móvil, and its subsidiaries, and (e) Carso Global Telecom. Our transactions with Telmex Internacional include Telmex Internacional's printing and distribution of our directories, Telmex Internacional's access to our customer database and our billing and collection system in connection with its directories business, and completion of international traffic in each other's countries of operation. Transactions with Grupo Carso include the purchase of network construction services and materials, and transactions with Grupo Financiero Inbursa include financial services and insurance. The largest component of our transactions with América Móvil in terms of amounts paid is interconnection between our respective networks in Mexico. We pay fees for consulting and management services to Carso Global Telecom and AT&T International (one of our principal shareholders), and have agreements with AT&T International that provide for the completion of calls in our respective countries of operation.

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

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

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

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

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

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

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You may not be entitled to preemptive rights

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

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

Our bylaws restrict the acquisition of shares in some circumstances

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

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

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

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

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

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Risks Relating to Developments in Mexico

Economic and political developments may adversely affect our business

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

Mexico has experienced adverse economic conditions in the past

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

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

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

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

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

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

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

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

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FORWARD-LOOKING STATEMENTS

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

projections of operating revenues, net income, net income per share, capital expenditures, dividends, capital structure or other financial items or ratios;

statements of our acquisition or divestiture plans;

statements about the impact of our acquisition of businesses;

statements of our plans, objectives or goals relating to competition, regulation and rates;

statements about competition in the business sectors in which we operate;

statements about our future financial performance or the economic performance of Mexico or other countries;

statements about currency exchange rates;

statements about the future impact of regulations; and

statements of assumptions underlying such statements.

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

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

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

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Item 4. Information on the Company

GENERAL

Overview

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

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

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

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

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

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

Table of Contents**History**

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

Significant Subsidiaries and Investees

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

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

Table of Contents**OPERATIONS**

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

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

Overview

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

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

(1) Includes incoming and outgoing traffic.

Local Service

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

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

Our charges for fixed-line local telephone service include (a) installation charges, (b) monthly line rental charges, (c) monthly measured service charges, (d) digital services and (e) charges for other services, such as the transfer of a line to another address and reconnection. Residential customers pay a fixed charge per local call in excess of a monthly allowance of 100 local calls, and commercial customers

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pay for every local call at the same fixed rate per call. The concession we hold to operate a public network for basic telephone services, or the Concession, permits but does not require us to base our charges on the duration of each call, with a monthly allowance of free calls or call minutes for residential customers. We currently do not charge by duration of invoiced calls in any region, except in the case of prepaid services.

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

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

Domestic Long Distance Service

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

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

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

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

International Long Distance Service

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

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

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

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

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

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

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

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

Interconnection

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

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

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Corporate Networks

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

Internet Access Services

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

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

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

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

Multiple Service Packages

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

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

Other Products and Services

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

Telmex Stores

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

Billing and Customer Service

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

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

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

Public Telephony and Prepaid Phone Cards

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

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

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

Operations in the United States

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

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

Network

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

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

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

Access Network

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

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

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

Core Network

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

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

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

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

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

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

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

IP Network

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

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

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

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

Competition

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

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

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

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

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

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

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

Regulation

Our business is subject to comprehensive regulation and oversight by the Communications Ministry and Cofetel. The Communications Ministry is part of the executive branch of the Mexican federal government, and Cofetel is an agency of the Communications Ministry. Regulation and oversight are governed by the Law of General Means of Communication (*Ley de 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 oversight by the Agency for Consumer Protection (*Procuraduría Federal del Consumidor*) and the Competition Commission (*Comisión Federal de Competencia*).

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

General

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

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Regulatory Oversight

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

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

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

Concessions

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

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

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

Audio and Television Services

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

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

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

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

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

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

Termination of the Concession

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

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

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

Failure to comply with the terms of the Concession;

Interruption of all or a material part of the services provided by us;

Transfer or assignment without Communications Ministry approval of the Concession, the rights provided under the Concession or any asset used to provide telephone service;

Violation of the prohibition against ownership of our shares by foreign states;

Violation of the prohibition against any material modification of the nature of our services without prior Communications Ministry approval; and

Breach of certain other obligations under the General Communications Law and the Federal Telecommunications Law.

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