

TELEFONOS DE MEXICO S A B DE C V

Form 20-F

June 27, 2008

[Table of Contents](#)

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

# SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

## FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007

Commission File Number: 001-32741

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

(Exact name of registrant as specified in its charter)

**Telephones of Mexico**

(Translation of registrant's name into English)

**United Mexican States**

(Jurisdiction of incorporation or organization)

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

(Address of principal executive offices)

**Anna Domínguez González**

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

**Parque Vía 190**

**Colonia Cuauhtémoc**

**06599 Mexico, D.F. Mexico**

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

**Fax: (52) 55 55 45 55 50**

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

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

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

**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



**Table of Contents****TABLE OF CONTENTS**

	<b>Page</b>
Item 1.	<u>Identity of Directors, Senior Management and Advisers</u>
Item 2.	<u>Offer Statistics and Expected Timetable</u>
Item 3.	<u>Key Information</u>
	<u>Selected Financial Data</u>
	<u>Exchange Rates</u>
	<u>Risk Factors</u>
	<u>Forward-Looking Statements</u>
Item 4.	<u>Information on the Company</u>
	<u>General</u>
	<u>Operations</u>
	<u>Capital Expenditures</u>
	<u>The Escisión</u>
	<u>Other Matters</u>
Item 4A.	<u>Unresolved Staff Comments</u>
Item 5.	<u>Operating and Financial Review and Prospects</u>
Item 6.	<u>Directors, Senior Management and Employees</u>
Item 7.	<u>Major Shareholders and Related Party Transactions</u>
	<u>Major Shareholders</u>
	<u>Related Party Transactions</u>
Item 8.	<u>Financial Information</u>
	<u>Consolidated Financial Statements</u>
	<u>Legal Proceedings</u>
	<u>Dividends</u>
Item 9.	<u>The Offer and Listing</u>
	<u>Trading Market</u>
	<u>Trading On The Mexican Stock Exchange</u>
Item 10.	<u>Additional Information</u>
	<u>Bylaws And Mexican Law</u>
	<u>Certain Contracts</u>
	<u>Exchange Controls</u>
	<u>Taxation</u>
	<u>Corporate Governance Practices</u>
	<u>Documents On Display</u>
Item 11.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>
	<u>Exchange Rate And Interest Rate Risks</u>
	<u>Sensitivity Analysis Disclosures</u>
Item 12.	<u>Description of Securities Other Than Equity Securities</u>
Item 13.	<u>Defaults, Dividend Arrearages and Delinquencies</u>
Item 14.	<u>Material Modifications to the Rights of Securities Holders and Use of Proceeds</u>
Item 15.	<u>Controls and Procedures</u>
Item 16A.	<u>Audit Committee Financial Expert</u>
Item 16B.	<u>Code of Ethics</u>
Item 16C.	<u>Principal Accountant Fees and Services</u>
Item 16D.	<u>Exemptions from the Listing Standards for Audit Committees</u>
Item 16E.	<u>Purchases of Equity Securities by the Issuer and Affiliated Purchasers</u>
Item 17.	<u>Financial Statements</u>
Item 18.	<u>Financial Statements</u>
Item 19.	<u>Exhibits</u>

**Table of Contents**

**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*.

**Table of Contents**

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:<sup>(1)</sup>

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 <sup>(2)</sup>	1.80	1.41	1.35	1.28	1.06
Majority net income per share from continuing operations Basic <sup>(2)</sup>	1.46	1.32	1.19	1.22	0.97
Majority net income per share from discontinued operations Basic <sup>(2)</sup>	0.34	0.09	0.16	0.06	0.09
Majority net income per share Diluted <sup>(3)</sup>	1.80	1.41	1.35	1.27	1.03
Majority net income per share from continuing operations Diluted <sup>(3)</sup>	1.46	1.32	1.19	1.21	0.94
Majority net income per share from discontinued operations Diluted <sup>(3)</sup>	0.34	0.09	0.16	0.06	0.09
Dividends paid per share <sup>(2)(3)</sup>	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: <sup>(4)</sup>					
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 <sup>(2)</sup>	1.79	1.37	1.28	1.32	1.02
Net income per share Diluted <sup>(3)</sup>	1.79	1.37	1.28	1.31	1.00
Dividends paid per share <sup>(2)(3)</sup>	0.440	0.403	0.370	0.333	0.303

(see footnotes on following page)

**Table of Contents**

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: <sup>(1)</sup>					
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: <sup>(4)</sup>					
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: <sup>(1)</sup>					
Ratio of earnings to fixed charges <sup>(5)</sup>	7.1	6.7	7.0	8.3	6.5
U.S. GAAP: <sup>(4)</sup>					
Ratio of earnings to fixed charges <sup>(6)</sup>	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.



**Table of Contents****EXCHANGE RATES**

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

<b>Period</b>	<b>High</b>	<b>Low</b>	<b>Average<sup>(1)</sup></b>	<b>Period End</b>
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.

**Table of Contents**

**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.

## **Table of Contents**

### ***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

## **Table of Contents**

*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.

## **Table of Contents**

### ***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.

## **Table of Contents**

### ***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.

## **Table of Contents**

### **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.

**Table of Contents**

**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.



## Table of Contents

### 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](http://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:

<b>Name of Company</b>	<b>Jurisdiction of establishment</b>	<b>Percentage of ownership and voting interest</b>	<b>Description</b>
<b>Subsidiaries</b>			
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
<b>Affiliated companies</b>			
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:

	<b>December 31,</b>				
	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
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) <sup>(1)</sup>	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

## **Table of Contents**

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

## **Table of Contents**

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.

## **Table of Contents**

### **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

## **Table of Contents**

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](http://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](http://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

## **Table of Contents**

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.



## **Table of Contents**

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.

## **Table of Contents**

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.

## **Table of Contents**

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.

## **Table of Contents**

### ***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.

## **Table of Contents**

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.

**Table of Contents**

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

Failure to comply with the terms of the Concession;

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

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

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

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

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

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

Material and continuing violation of any of the conditions set forth in the Concession;

Material failure to meet any of the service expansion requirements under the Concession;

Material failure to meet any of the requirements under the Concession for improvement in the quality of service;

Engagement in any telecommunications business not authorized under the Concession and requiring prior approval of the Communications Ministry;

Following notice and a cure period, failure without just cause to allow other concessionaires to interconnect their telephone networks to our telephone network; or

Our bankruptcy.

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

## Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

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

## **Table of Contents**

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

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

### ***Dominant Carrier Regulations***

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

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

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

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

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



## **Table of Contents**

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

### ***Competition***

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

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

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

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

## **Table of Contents**

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

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

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

## ***Rates***

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

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

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

**Table of Contents**

***Interconnection***

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

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

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

**Table of Contents****CAPITAL EXPENDITURES**

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

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

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

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

**THE ESCISIÓN**

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

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

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

**Table of Contents**

to improve the competitive position of each company; and

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

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

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

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

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

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

agreements relating to the implementation of the *Escisión*;

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

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

## **Table of Contents**

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

### **Telmex Internacional Shares and ADSs**

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

### **Adjustments Related to the *Escisión***

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

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

## **OTHER MATTERS**

### **Investments**

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

#### ***Portugal Telecom***

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

#### ***MCI, Inc.***

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

## **Table of Contents**

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

### **Plant, Property and Equipment**

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

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

### **The Telmex Foundation**

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

### **Item 4A. Unresolved Staff Comments**

None.

### **Item 5. Operating and Financial Review and Prospects**

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

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

### **Effect of Inflation Accounting**

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

## **Table of Contents**

### ***Recognition of effects of inflation***

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

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

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

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

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

### ***Re-expression in constant pesos***

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

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

### ***Cessation of inflation accounting under Mexican FRS***

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

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



## **Table of Contents**

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

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

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

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

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

### ***Effects of inflation accounting on U.S. GAAP reconciliation***

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

### **Changes in Mexican FRS**

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

### **Pro Forma Financial Information**

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

## **Table of Contents**

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

### **Overview**

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

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

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

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

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

**Table of Contents****Summary of Operating Income and Net Income**

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

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



**Table of Contents**

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

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

**Revenues**

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

**Local Service Revenues**

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

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

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

**Domestic Long Distance Revenues**

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

## **Table of Contents**

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

### ***International Long Distance Revenues***

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

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

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

### ***Revenues from Interconnection Service***

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

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

## **Table of Contents**

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

### ***Revenues from Corporate Networks***

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

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

### ***Revenues from Internet Access Service***

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

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

### ***Other Revenues***

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

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

## **Operating Costs and Expenses**

### ***Cost of Sales and Services***

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

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

## **Table of Contents**

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

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

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

### ***Transport and Interconnection Costs***

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

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

### ***Depreciation and Amortization***

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

### ***Operating Income***

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

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

### ***Employee Profit Sharing***

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



**Table of Contents****Other Income, Net**

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

**Comprehensive Financing Cost**

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

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

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

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

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

---

## **Table of Contents**

### **Income Tax**

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

### **Income from Continuing Operations**

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

### **Liquidity and Capital Resources**

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

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

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

**Table of Contents**

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

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

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

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

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

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

The major categories of indebtedness are as follows:

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

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

**Table of Contents**

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

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

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

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

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

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

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

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

**Hedging**

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

**Table of Contents**

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

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

**Off-Balance Sheet Arrangements**

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

**U.S. GAAP Reconciliation**

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

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

## **Table of Contents**

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

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

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

### **Use of Estimates in Certain Accounting Policies**

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

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

### ***Estimated Useful Lives of Plant, Property and Equipment***

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

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

### ***Employee Pensions and Seniority Premiums***

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

## **Table of Contents**

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

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

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

### ***Allowance for Doubtful Accounts***

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

### ***Revenues from Prepaid Telephone Cards***

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

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

## **Table of Contents**

### ***Impairment of Long-Lived Assets***

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

### **Item 6. Directors, Senior Management and Employees**

#### **Directors**

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

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

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

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



**Table of Contents**

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

**Table of Contents**

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

**Table of Contents**

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

**Table of Contents**

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

**Table of Contents**

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

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

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

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

**Executive Committee**

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

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

**Audit Committee**

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

**Table of Contents**

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

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

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

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

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

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

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

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

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

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

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

**Table of Contents**

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

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

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

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

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

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

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

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

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

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

**Corporate Practices Committee**

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

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

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

or to entities over which we have a significant influence;



**Table of Contents**

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

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

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

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

**Finance and Planning Committee**

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

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

**Table of Contents**

**Executive Officers**

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

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

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

**Compensation of Directors and Officers**

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

**Table of Contents**

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

**Employees**

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

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

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

**Item 7. Major Shareholders and Related Party Transactions****MAJOR SHAREHOLDERS**

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

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

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

**Table of Contents**

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

- (1) As of June 11, 2008, there were 8,115 million AA Shares outstanding, representing 95.0% of the total full voting shares (AA Shares and A Shares).
- (2) As of June 11, 2008, there were 424 million A Shares outstanding, representing 5.0% of the total full voting shares (AA Shares and A Shares).
- (3) As of June 11, 2008, there were 10,402 million L Shares outstanding.
- (4) Based on reports of beneficial ownership filed with the SEC, (i) JPMorgan Chase & Co. beneficially owned less than 5% of our L Shares as of March 31, 2008 and as of March 31, 2007, compared to 7.5% as of March 31, 2006, and (ii) Franklin Resources, Inc. beneficially owned less than 5% of our L Shares as of March 31, 2008, compared to 5.5% as of April 10, 2007.
- (5) AA Shares and A Shares.
- (6) Holders of AA Shares and A Shares are entitled to convert a portion of these Shares to L Shares, subject to the restrictions set forth in our bylaws. In accordance with Mexican law and our bylaws, AT&T holds its AA Shares through a Mexican trust, pursuant to the terms of which the trustee votes AT&T's AA Shares in the same way as Carso Global Telecom does, other than with respect to the election of the members of our Board of Directors and the Executive Committee. See *Item 10. Additional Information - Bylaws and Mexican Law*.
- (7) As of March 31, 2008. Derived from reports of beneficial ownership of our shares filed with the SEC. For comparability purposes, percent of class is calculated based on the number of L Shares outstanding on June 11, 2008.

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

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

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

At December 31, 2007, 55.1% of our outstanding L Shares were represented by L Share ADSs, each representing the right to receive 20 L Shares, and 99.1% of the holders of L Share ADSs (11,632 holders, including The Depository Trust Company, or DTC) had registered addresses

## Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

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

---

**Table of Contents**

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

A Shares;

L Shares not represented by ADSs; or

A Share ADSs that are held under the unsponsored A Share ADS programs, which pre-date the establishment of the sponsored program, and have not been exchanged for ADSs issued under such sponsored program. See *Item 9. The Offer and Listing Trading Market*. We purchase our shares on the Mexican Stock Exchange from time to time up to a specified maximum aggregate value authorized by the holders of AA Shares and A Shares and our Board of Directors. In 2007, we purchased 839.9 million L Shares and 2.8 million A Shares, representing 4.2% of the shares outstanding at the beginning of 2007, with an aggregate value of P.15,782.8 million (P.15,475.8 million historical).

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

**RELATED PARTY TRANSACTIONS**

**General**

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

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

Following the *Escisión* of our Latin American and yellow pages directory businesses, which was effected on December 26, 2007 (see *Item 4. Information on the Company The Escisión*), there has been

## Table of Contents

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

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

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

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

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

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

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

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

In June 2005, we sold our entire interest in Technology and Internet LLC to Grupo Condumex.

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

## **Table of Contents**

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

### **Transactions Relating to the *Escisión***

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

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

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

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

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

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

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

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

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

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



## **Table of Contents**

### **Transactions between Telmex and América Móvil**

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

### **International Long Distance Settlement with AT&T International**

We have agreements with AT&T International, one of our principal shareholders, that provide for AT&T International completing our international calls to the United States and for our completing AT&T International's calls from the United States. The rates of payment under these agreements are consistent with the rates agreed with other international carriers.

### **Item 8. Financial Information**

#### **CONSOLIDATED FINANCIAL STATEMENTS**

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

#### **LEGAL PROCEEDINGS**

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

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

**Table of Contents****DIVIDENDS**

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

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

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

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

**Table of Contents****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 Depository, as depository for the L Share ADSs. The L Share ADSs are traded on the New York Stock Exchange and listed on the Frankfurt Stock Exchange, and the L Shares are traded on the Mexican Stock Exchange and listed on the *Mercado de Valores Latinoamericano* (Latibex) in Madrid, Spain.

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

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

	Mexican Stock Exchange (pesos per L Share)		New York Stock Exchange (U.S. dollars per L Share ADS)	
	High	Low	High	Low
<b>Annual highs and lows</b>				
2007	P. 23.29	P. 14.32	U.S.\$ 43.26	U.S.\$ 25.89
2006	15.97	10.01	29.35	17.61
2005	13.27	8.92	24.79	16.49
2004	10.81	8.66	19.27	15.06
2003	9.53	7.48	17.25	14.42
<b>Quarterly highs and lows</b>				
2008:				
First quarter	P. 20.43	P. 16.96	U.S.\$ 38.39	U.S.\$ 30.88
2007				
First quarter	18.63	14.32	33.83	25.89
Second quarter	23.29	18.45	43.26	33.37
Third quarter	22.32	17.07	41.37	30.10
Fourth quarter	21.35	17.16	39.43	32.48
2006:				
First quarter	13.90	11.47	26.07	21.76
Second quarter	12.81	10.01	23.35	17.61
Third quarter	14.22	11.20	25.79	20.26
Fourth quarter	15.97	13.45	29.35	24.05
<b>Monthly highs and lows</b>				
2007				
December	P. 21.35	P. 18.76	U.S.\$ 39.43	U.S.\$ 34.45
2008				
January	20.30	16.96	37.33	30.88
February	20.10	17.33	37.40	32.03
March	20.43	17.51	38.39	32.50
April	21.00	18.34	39.71	34.86
May	22.19	18.90	42.94	35.47

**Table of Contents**

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 restated in constant currency units, but have been adjusted to give effect to the two-for-one stock split that occurred in May 2005. Following the *Escisión* and until June 10, 2008, the A Shares and A Share ADSs of Telmex and Telmex Internacional traded together. On June 11, 2008, the closing price of the A Shares on the Mexican Stock Exchange was P.12.60, and the closing price of the A Share ADSs on NASDAQ was U.S.\$24.09.

	Mexican Stock Exchange (pesos per A Share)		NASDAQ (U.S. dollars per A Share ADS)	
	High	Low	High	Low
<b>Annual highs and lows</b>				
2007	P. 22.65	P. 14.30	U.S.\$ 43.14	U.S.\$ 25.71
2006	15.79	10.30	29.07	17.04
2005	13.25	8.97	24.50	16.40
2004	10.80	8.62	19.25	15.01
2003	9.50	7.48	17.25	14.26
<b>Quarterly highs and lows</b>				
2008:				
First quarter	P. 20.20	P. 17.60	U.S.\$ 38.06	U.S.\$ 30.01
2007:				
First quarter	18.40	14.30	33.81	25.71
Second quarter	22.65	18.60	43.14	33.08
Third quarter	22.10	17.50	41.25	30.06
Fourth quarter	21.21	17.30	39.20	31.04
2006:				
First quarter	13.80	11.50	26.52	21.36
Second quarter	12.66	10.30	23.49	17.04
Third quarter	14.14	11.40	25.81	20.34
Fourth quarter	15.79	13.70	29.07	24.25
<b>Monthly highs and lows</b>				
2007:				
December	P. 21.21	P. 18.50	U.S.\$ 39.20	U.S.\$ 34.57
2008:				
January	20.20	17.60	37.16	30.01
February	19.80	17.80	37.16	32.00
March	20.15	18.00	38.06	32.20
April	20.99	18.76	39.69	34.49
May	22.15	18.97	42.99	34.85

**Table of Contents**

**TRADING ON THE MEXICAN STOCK EXCHANGE**

The Mexican Stock Exchange (*Bolsa Mexicana de Valores, S.A. de C.V.*), located in Mexico City, is the only stock exchange in Mexico. Founded in 1907, it is organized as a corporation whose shares are held by 26 brokerage firms, which are exclusively authorized to trade on the Mexican Stock Exchange. Trading on the Mexican Stock Exchange takes place principally through automated systems, which are open between the hours of 8:30 a.m. and 3:00 p.m., Mexico City time, each business day. 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 depository that acts as a clearinghouse for Mexican Stock Exchange transactions.

## **Table of Contents**

### **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 and Officers of Registrant*.

#### **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, 2007, the AA Shares represented 41.9% of our outstanding capital stock and 95.0% 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, 2007, the AA Shares and A Shares together represented 44.1% 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;

## **Table of Contents**

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.

## **Table of Contents**

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 profits for the preceding year. They are required by law to allocate 5% of such net profits 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 profits 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.



## **Table of Contents**

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, 2007, Telmex had 12,840.2 million repurchased L Shares and 31.3 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.

## **Table of Contents**

### **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

## **Table of Contents**

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 April 27, 2007 approved up to an additional P.15 billion to 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 it 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.

## **Table of Contents**

### **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 entered into force on January 1, 1994 and has been amended by an additional protocol that entered into force 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.

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.

## **Table of Contents**

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*).

### ***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***

Under current Mexican law and regulations, there is no basis for the Mexican tax authorities to impose taxes on income realized by a nonresident holder from a disposition of shares or ADSs, provided that (i) 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, the Frankfurt Stock Exchange, NASDAQ and the *Mercado de Valores Latinoamericanos en Euros* (Latibex), and (ii) certain other requirements are met, including that the acquisition was made pursuant to a non-restricted open market offer.

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 a corporation 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.

## **Table of Contents**

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.

**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. 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.

## **Table of Contents**

### ***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, 2011 with respect to the ADSs, L Shares and A 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 and A 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 2006 or 2007 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 2008 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*).

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.

### ***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.

---

**Table of Contents**

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 has occurred 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



**Table of Contents**

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.

**CORPORATE GOVERNANCE PRACTICES**

The disclosure of the significant ways our corporate governance practices differ from those required for U.S. companies under the New York Stock Exchange and the NASDAQ listing standards is posted on our website and can be accessed at [www.telmex.com](http://www.telmex.com).

## **Table of Contents**

### **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](http://www.sec.gov) and at our website at [www.telmex.com](http://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, 2007, indebtedness denominated in foreign currencies was P.73,462 million, of which P.73,213 million was denominated in U.S. dollars and P.249 million was denominated in euros. Interest rate risk exists principally with respect to our indebtedness that bears interest at floating rates. We had P.49,481 million of indebtedness bearing interest at floating rates at December 31, 2007.

Market price risk exists principally with respect to our publicly traded marketable securities. As of December 31, 2007, we had P.718 million in marketable securities, which we hold for trading purposes. Our marketable securities are carried at market value, and gains and losses are recognized in our statement of income. We do not use any derivative instruments to hedge our marketable securities.

We use derivative 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 held at December 31, 2007 that would have resulted from a hypothetical, instantaneous and unfavorable 10% change in currency exchange rates, taking into account our hedging transactions, would have been approximately P.1,106 million. Such a change in currency exchange rates would also have resulted in additional interest expense of approximately P.506 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 held at December 31, 2007 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 hedging transactions, would have been approximately P.1,521 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

## **Table of Contents**

unfavorable change of 100 basis points in the interest rate applicable to floating-rate financial assets and liabilities held at December 31, 2007, taking into account our hedging transactions, would have resulted in additional interest expense of approximately P.52 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.

### **Market Prices**

The potential loss in fair value of marketable securities held at December 31, 2007 that would have resulted from a hypothetical, instantaneous and unfavorable 10% change in the market price of such securities would have been approximately P.72 million.

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

Not applicable.

## **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, 2007. 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

**Table of Contents**

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.

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, 2007. 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, 2007.

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 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

---

**Table of Contents**

**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.'s internal control over financial reporting as of December 31, 2007, 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.'s 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. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007 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. as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in stockholders' equity, and changes in financial position for each of the three years in the period ended December 31, 2007 of Teléfonos de México, S.A.B. de C.V. and our report dated June 23, 2008, expressed an unqualified opinion thereon.

Mancera, S.C.  
A member practice of

Ernst & Young Global

/s/ CPC Fernando Espinosa López  
C.P.C. Fernando Espinosa López

Mexico City, Mexico  
June 23, 2008



**Table of Contents****Item 16A. Audit Committee Financial Expert**

Our Board of Directors has determined that Mr. Rafael Moisés Kalach Mizrahi, the chairman of our audit committee and a member of our Board of Directors, qualifies as an audit committee financial expert. Mr. Mizrahi has a certified public accountant degree from the Universidad Nacional Autonoma of Mexico. He is a member of the Insitute of Certified Public Accountants and the Association of Certified Public Accountants of Mexico, and has been a member of audit, finance and planning, and evaluation and compensation committees of various Mexican companies. Mr. Mizrahi 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](http://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 Ernst & Young Global members during the years ended December 31, 2007 and 2006:

	Year ended December 31,			
	2007	2006		
	(in thousands of constant pesos as of December 31, 2007)			
Audit fees	P.	83,118	P.	84,174
Audit-related fees		1,593		8,393
Tax fees		7,396		2,850
All other fees		604		2,754
Total fees	P.	92,711	P.	98,171

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 and statutory and regulatory audits, and include audit fees billed for the same services provided to our subsidiaries that were transferred to Telmex Internacional in the *Escisión*.

**Table of Contents**

Audit-related fees in the above table are fees billed for services related to first-time compliance with SEC requirements pursuant to the Sarbanes-Oxley Act of 2002.

Tax fees in the above table are fees billed for tax compliance services. The increase in 2007 was mainly related to our request that our independent auditors commence a monthly review of monthly income tax prepayments beginning in 2007.

All other fees in the above table are fees billed primarily related to review of reports on our operations to industry regulatory agencies.

**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.



**Table of Contents****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 2007:

<b>Year ended December 31, 2007</b>	<b>Total Number of L Shares Purchased<sup>(1)</sup></b>	<b>Weighted Average Price Paid per L Share</b>	<b>Total Number of L Shares Purchased as Part of the Share Repurchase Program<sup>(2)</sup></b>	<b>Weighted Average Price Paid per L Share Purchased as Part of the Share Repurchase Program</b>	<b>Approximate Peso Value (in Thousands) of L Shares that May Yet Be Purchased Under the Share Repurchase Program<sup>(3)</sup></b>
January 1-31	128,600,000	P. 15.54	81,100,000	P. 15.30	P. 13,019,824
February 1-28	136,995,000	16.90	110,995,000	16.91	11,136,133
March 1-31	174,105,500	17.01	140,309,400	17.00	8,746,786
April 1-30	46,600,000	19.29	41,100,000	19.29	22,952,056
May 1-31	35,360,000	20.23	35,360,000	20.23	22,232,469
June 1-30	32,073,100	21.26	32,050,000	21.26	21,547,938
July 1-31	45,488,300	19.70	41,814,800	19.61	20,724,591
August 1-31	47,016,300	18.48	44,550,000	18.49	19,897,967
September 1-30	57,766,100	18.61	52,700,000	18.65	18,912,381
October 1-31	89,000,000	19.95	89,000,000	19.95	17,133,011
November 1-30	85,162,700	18.80	80,662,700	18.81	15,609,059
December 1-31	90,296,600	20.06	90,296,600	20.06	13,788,581
<b>Total/Average</b>	<b>968,463,600</b>	<b>18.17</b>	<b>839,938,500</b>	<b>18.36</b>	

- (1) We do not repurchase our L Shares other than through the share repurchase program. An aggregate of 129 million L Shares were purchased by our affiliated purchasers in 2007. 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 April 27, 2007, our shareholders authorized an additional P.15,000 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. These are nominal figures and have not been restated for inflation.

**Table of Contents**

The following table provides information on A Shares purchased by our company and affiliated purchasers in 2007:

Year ended December 31, 2007	Total Number of A Shares Purchased <sup>(1)</sup>	Weighted Average Price Paid per A Share	Total Number of A Shares Purchased as Part of the Share Repurchase Program <sup>(2)</sup>	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 <sup>(3)</sup>
January 1-31	220,900	P. 15.25	220,900	P. 15.25	P. 13,019,82
February 1-28	405,800	16.86	405,800	16.86	11,136,133
March 1-31	234,000	17.54	234,000	17.54	8,746,786
April 1-30	104,600	19.21	104,600	19.21	22,952,056
May 1-31	196,600	20.77	196,600	20.77	22,232,469
June 1-30	146,300	20.91	146,300	20.91	21,547,938
July 1-31	160,300	20.00	160,300	20.00	20,724,591
August 1-31	144,000	18.77	144,000	18.77	19,897,967
September 1-30	148,800	18.41	148,800	18.41	18,912,381
October 1-31	211,800	19.89	211,800	19.89	17,133,011
November 1-30	347,400	19.03	347,400	19.03	15,609,059
December 1-31	461,700	19.41	461,700	19.41	13,788,581
Total/Average	2,782,200	18.66	2,782,200	18.66	

- (1) No A Shares were purchased by us or our affiliated purchasers in 2007 other than under our share repurchase program.
- (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 April 27, 2007, our shareholders authorized an additional P.15,000 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. These are nominal figures and have not been restated for inflation.

**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.

**Table of Contents**

**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 21, 2007 (English translation).
- 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).
- 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 Management Services Agreement dated December 21, 2007 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 Seventh Amendment, dated as of December 12, 2007, to Management Services Agreement, dated January 2, 2001, between Teléfonos de México, S.A.B. de C.V. and AT&T Mexico, Inc.
- 7.1 Calculation of ratios of earnings to fixed charges.
- 8.1 List of 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.

**Table of Contents**

- 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.
- 15.1 Consent of Mancera, S.C., to the incorporation by reference into the effective registration statement on Form F-3 of Teléfonos de México, S.A.B. de C.V. (File No. 333-111040) of its report with respect to the consolidated financial statements of Teléfonos de México, S.A.B. de C.V., which appears in this Annual Report on Form 20-F.

**Table of Contents**

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.

**Table of Contents**

**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, 2007 and 2006, and the related consolidated statements of income, changes in stockholders' equity and changes in financial position for each of the three years in the period ended December 31, 2007. 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 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 financial statements referred to above present fairly, in all material aspects, the consolidated financial position of Teléfonos de México, S.A.B. de C.V. and subsidiaries at December 31, 2007 and 2006, and the consolidated results of their operations and changes in their financial position for each of the three years in the period ended December 31, 2007, 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.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated June 23, 2008, expressed an unqualified opinion thereon.

Mancera, S.C.  
A Member Practice of

Ernst & Young Global

/s/ C.P.C. Fernando Espinosa López  
C.P.C. Fernando Espinosa López

Mexico City, Mexico

June 23, 2008

**Table of Contents****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, with purchasing power at December 31, 2007)

	Year ended December 31			Millions of U.S. dollars, except for earnings per share 2007
	2007	2006	2005	
<b>Operating revenues:</b>				
Local service	P. 54,398,425	P. 58,250,991	P. 60,243,331	\$ 5,006
Long distance service:				
Domestic	17,348,649	18,324,142	18,907,216	1,596
International	9,678,537	10,531,469	10,592,995	891
Interconnection service	22,603,745	18,071,474	18,895,212	2,080
Corporate networks	11,339,790	10,877,371	11,182,832	1,044
Internet access services	10,940,226	10,157,799	8,799,632	1,007
Other	4,458,299	3,542,101	2,827,524	410
	130,767,671	129,755,347	131,448,742	12,034
<b>Operating costs and expenses:</b>				
Cost of sales and services	32,364,110	32,059,170	32,434,924	2,978
Commercial, administrative and general expenses	19,552,442	19,382,514	19,111,380	1,799
Transport and interconnection	16,541,561	13,337,914	13,350,346	1,522
Depreciation and amortization (Notes 5 and 6) (includes P. 17,434,266 in 2007, P. 17,621,037 in 2006 and P. 19,366,330 in 2005, respectively, not included in cost of sales and services)	18,425,285	18,711,403	20,314,295	1,696
	86,883,398	83,491,001	85,210,945	7,995
<b>Operating income</b>	<b>43,884,273</b>	<b>46,264,346</b>	<b>46,237,797</b>	<b>4,039</b>
Employee profit sharing	2,867,019	3,059,444	3,039,278	264
Other income, net	(2,822,658)	(445,949)	(987,330)	(260)
Comprehensive financing cost:				
Interest income	(1,396,088)	(1,495,017)	(2,036,087)	(128)
Interest expense	6,615,400	6,951,861	6,409,138	609
Exchange loss, net	643,137	1,159,178	3,554,181	59
Monetary gain, net	(2,513,085)	(2,846,024)	(2,228,689)	(232)
	3,349,364	3,769,998	5,698,543	308
Equity interest in net income (loss) of affiliates	17,245	8,723	(19,992)	1
Income before income tax	40,507,793	39,889,576	38,467,314	3,728
Income tax (Note 16)	11,618,710	12,189,035	11,204,758	1,069
Income from continuing operations	28,889,083	27,700,541	27,262,556	2,659
	7,166,312	2,615,031	4,926,583	659

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

Income from discontinued operations, net of income tax  
(Note 2)

<b>Net income</b>	<b>P. 36,055,395</b>	P. 30,315,572	P. 32,189,139	<b>\$ 3,318</b>
Distribution of net income:				
Majority interest	<b>P. 35,484,947</b>	P. 29,640,032	P. 30,957,197	<b>\$ 3,266</b>
Noncontrolling interest	<b>570,448</b>	675,540	1,231,942	<b>52</b>
	<b>P. 36,055,395</b>	P. 30,315,572	P. 32,189,139	<b>\$ 3,318</b>
Weighted average number of shares issued and outstanding (millions)				
	<b>19,766</b>	20,948	22,893	<b>19,766</b>
Majority net income per share from continuing operations	<b>P. 1.46</b>	P. 1.32	P. 1.19	<b>\$ 0.13</b>
Majority net income per share from discontinued operations	<b>P. 0.34</b>	P. 0.09	P. 0.16	<b>\$ 0.03</b>
<b>Majority net income per share</b>	<b>P. 1.80</b>	P. 1.41	P. 1.35	<b>\$ 0.16</b>

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



**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Consolidated Balance Sheets**

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

	December 31		Million of U.S. dollars 2007
	2007	2006	
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	P. 4,697,752	P. 10,765,752	\$ 432
Marketable securities (Note 3)	718,144	2,930,559	66
Accounts receivable, net (Note 4)	20,210,704	20,740,574	1,860
Inventories for sale, net	2,191,110	1,709,158	202
Prepaid expenses and others	2,838,094	2,607,923	261
Current assets from discontinued operations (Note 2)		27,038,249	
<b>Total current assets</b>	<b>30,655,804</b>	<b>65,792,215</b>	<b>2,821</b>
Plant, property and equipment, net (Note 5)	120,648,559	124,612,813	11,103
Inventories, primarily for operation of the telephone plant, net	1,747,582	2,145,189	161
Licenses, net (Note 6)	903,961	958,616	83
Equity investments (Note 7)	1,096,486	885,701	101
Net prepaid benefit obligation (Note 8)	15,621,167	19,892,861	1,437
Goodwill (Note 7)	431,652	448,168	40
Deferred charges, net	1,323,914	485,088	122
Non-current assets from discontinued operations (Note 2)		80,327,801	
<b>Total assets</b>	<b>P. 172,429,125</b>	<b>P. 295,548,452</b>	<b>\$ 15,868</b>
<b>Liabilities and stockholders equity</b>			
Current liabilities:			
Short-term debt and current portion of long-term debt (Note 9)	P. 12,282,260	P. 9,040,821	\$ 1,130
Accounts payable and accrued liabilities (Note 11)	16,952,481	18,717,642	1,559
Taxes payable	2,008,785	3,594,795	185
Deferred credits (Note 10)	1,321,489	1,288,483	122
Current liabilities from discontinued operations (Note 2)		28,139,915	
<b>Total current liabilities</b>	<b>32,565,015</b>	<b>60,781,656</b>	<b>2,996</b>
Long-term debt (Note 9)	79,179,854	81,376,228	7,287
Labor obligations (Note 8)	208,406	240,274	19
Deferred income tax (Note 16)	18,317,042	16,600,323	1,686
Long-term liabilities from discontinued operations (Note 2)		15,228,736	
<b>Total liabilities</b>	<b>130,270,317</b>	<b>174,227,217</b>	<b>11,988</b>
Stockholders equity (Note 15):			
Capital stock	9,402,561	28,011,334	865
Premium on sale of shares		20,919,197	
Retained earnings:			
Prior years	76,055,117	104,320,199	6,999
Current year	35,484,947	29,640,032	3,266

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

	<b>111,540,064</b>	133,960,231	<b>10,265</b>
Other accumulated comprehensive income	<b>(78,822,851)</b>	(64,725,867)	<b>(7,254)</b>
Majority stockholders' equity	<b>42,119,774</b>	118,164,895	<b>3,876</b>
Noncontrolling interest	<b>39,034</b>	3,156,340	<b>4</b>
Total stockholders' equity	<b>42,158,808</b>	121,321,235	<b>3,880</b>
Total liabilities and stockholders' equity	<b>P. 172,429,125</b>	P. 295,548,452	<b>\$ 15,868</b>

The accompanying notes are an integral part of these financial statements

F-3

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Consolidated Statements of Changes in Financial Position**

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

	Year ended December 31			Millions of U.S. dollars 2007
	2007	2006	2005	
<b>Operating activities</b>				
Net income	<b>P. 36,055,395</b>	P. 30,315,572	P. 32,189,139	<b>\$ 3,318</b>
Add (deduct) items not requiring the use of resources:				
Depreciation	<b>18,290,793</b>	18,603,118	20,208,466	<b>1,683</b>
Amortization	<b>134,492</b>	108,285	105,829	<b>12</b>
Deferred charges	<b>949,862</b>	230,960	331,654	<b>87</b>
Deferred income tax	<b>1,206,747</b>	(333,124)	(2,752,652)	<b>111</b>
Equity interest in net (income) loss of affiliates	<b>(17,245)</b>	(8,723)	19,992	<b>(2)</b>
Net period cost of labor obligations	<b>4,487,080</b>	4,760,925	4,760,134	<b>413</b>
Net income from discontinued operations	<b>(7,166,312)</b>	(2,615,031)	(4,926,583)	<b>(660)</b>
	<b>53,940,812</b>	51,061,982	49,935,979	<b>4,962</b>
Changes in operating assets and liabilities:				
(Increase) decrease in:				
Marketable securities	<b>2,212,415</b>	(2,920,436)	7,067	<b>204</b>
Accounts receivable	<b>1,223,280</b>	(221,579)	1,295,447	<b>113</b>
Inventories for sale	<b>(2,583,474)</b>	(988,367)	(503,154)	<b>(238)</b>
Prepaid expenses and others	<b>72,918</b>	(868,057)	(71,762)	<b>7</b>
(Decrease) increase in:				
Labor obligations:				
Contributions to trust fund	(64,935)	(100,722)	(63,800)	(6)
Payments to employees	(182,321)	(195,567)	(222,026)	(17)
Accounts payable and accrued liabilities	<b>(1,765,160)</b>	1,494,075	(371,568)	<b>(162)</b>
Taxes payable	<b>(1,647,953)</b>	435,327	(4,356,049)	<b>(152)</b>
Deferred credits	<b>33,007</b>	(31,076)	(111,970)	<b>3</b>
Resources provided by operating activities	<b>51,238,589</b>	47,665,580	45,538,164	<b>4,714</b>
<b>Financing activities</b>				
New loans	<b>14,930,842</b>	17,182,460	22,811,451	<b>1,374</b>
Payment of loans	<b>(10,750,844)</b>	(14,152,806)	(9,708,577)	<b>(989)</b>
Effect of exchange rate differences and variances in debt expressed in constant pesos	<b>(3,134,933)</b>	(2,811,511)	(7,570,258)	<b>(289)</b>
Decrease in capital stock and retained earnings due to purchase of Company's own shares	<b>(15,782,839)</b>	(24,683,786)	(18,926,971)	<b>(1,452)</b>
Payment of dividends	<b>(8,820,074)</b>	(8,846,171)	(9,237,377)	<b>(812)</b>
Resources used in financing activities	<b>(23,557,848)</b>	(33,311,814)	(22,631,732)	<b>(2,168)</b>
<b>Investing activities</b>				
Plant, property and equipment	<b>(13,846,483)</b>	(13,368,927)	(15,522,456)	<b>(1,274)</b>
Inventories for operation of the telephone plant	<b>406,826</b>	(367,982)	397,237	<b>37</b>
Available for sale securities			7,723,123	
Affiliated companies		(696,260)	151,011	
Other	<b>(239,005)</b>	(33,870)	(320,292)	<b>(22)</b>

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

Resources used in investment activities	<b>(13,678,662)</b>	(14,467,039)	(7,571,377)	<b>(1,259)</b>
Net changes in operating assets and liabilities from discontinued operations	<b>(20,070,079)</b>	(9,291,192)	(9,640,157)	<b>(1,847)</b>
Net decrease in cash and cash equivalents	<b>(6,068,000)</b>	(9,404,465)	5,694,898	<b>(560)</b>
Cash and cash equivalents at beginning of year	<b>10,765,752</b>	20,170,217	14,475,319	<b>991</b>
Cash and cash equivalents at end of year	<b>P. 4,697,752</b>	P. 10,765,752	P. 20,170,217	<b>\$ 431</b>

The accompanying notes are an integral part of these financial statements

F-4

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Consolidated Statements of Changes in Stockholders Equity for the years ended December 31, 2005, 2006 and 2007**

(In thousands of Mexican pesos, except for dividends per share, with purchasing power at December 31, 2007)

	Capital stock	Premium on sale of shares	Legal reserve	Retained earnings		Other accumulated comprehensive income	Majority stockholders equity	Noncontrolling interest	Comprehensive income	Total stockholders equity
				Unappropriated	Total					
Balances at January 1, 2005	P. 31,238,109	P. 20,919,197	P. 16,148,490	P. 109,621,694	P. 125,770,184	P. (61,521,121)	P. 116,406,369	P. 16,378,459		P. 132,784,828
Initial accumulated effect of swaps, net of deferred taxes						340,514	340,514			340,514
Appropriation of earnings approved at regular stockholders meeting held in April 2005:										
Cash dividends paid at P. 0.406 per share (P. 0.370 historical)				(9,237,377)	(9,237,377)		(9,237,377)			(9,237,377)
Repurchase of Company's own shares in cash	(1,509,671)			(17,417,300)	(17,417,300)		(18,926,971)			(18,926,971)
Excess of book value over sale price of shares sold to companies under common control				(105,052)	(105,052)		(105,052)			(105,052)
Gain on sale of entities to companies under common control				1,230,677	1,230,677	28,741	1,259,418	(1,259,418)		
Acquisition of noncontrolling interest and contribution from noncontrolling stockholders				3,889,439	3,889,439	268,108	4,157,547	(3,321,216)		836,331
Comprehensive income:										
Net income for the year				30,957,197	30,957,197		30,957,197	1,231,942	P. 32,189,139	32,189,139
Other comprehensive income:										
Effect of instruments available for										

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

sale:										
Gain for the year						1,815,271	1,815,271		1,815,271	1,815,271
Gain on sale recognized in income						(553,914)	(553,914)		(553,914)	(553,914)
Changes in fair value of swaps, net of deferred taxes						(182,617)	(182,617)		(182,617)	(182,617)
Effect of translation of foreign entities, net						2,368,145	2,368,145	999,277	3,367,422	3,367,422
Deficit from holding non-monetary assets, net of deferred taxes						(4,545,135)	(4,545,135)	(1,903,597)	(6,448,732)	(6,448,732)
Comprehensive income									P. 30,186,569	
Balance at December 31, 2005	29,728,438	20,919,197	16,148,490	118,939,278	135,087,768	(61,982,008)	123,753,395	12,125,447		P. 135,878,842
Appropriation of earnings approved at regular stockholders meeting held in April 2006:										
Cash dividends paid at P. 0.426 per share (P. 0.403 historical)				(8,846,171)	(8,846,171)		(8,846,171)			(8,846,171)
Cash dividends paid to noncontrolling stockholders in subsidiary				(200,830)	(200,830)		(200,830)	(245,503)		(446,333)
Repurchase of Company's own shares in cash	(1,717,104)			(22,966,682)	(22,966,682)		(24,683,786)			(24,683,786)
Acquisition of noncontrolling interest				387,835	387,835		387,835	(10,174,464)		(9,786,629)
Gain on dilution of investment in split-up affiliate				858,279	858,279		858,279	29,647		887,926
Comprehensive income:										
Net income for the year				29,640,032	29,640,032		29,640,032	675,540	P. 30,315,572	30,315,572
Other comprehensive income items:										
Changes in fair value of swaps, net of deferred taxes						(139,028)	(139,028)		(139,028)	(139,028)
Effect of translation of foreign entities, net						1,052,378	1,052,378	946,438	1,998,816	1,998,816

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

Deficit from holding non-monetary assets, net of deferred taxes						(3,657,209)	(3,657,209)	(200,765)	(3,857,974)	(3,857,974)
Comprehensive income									P. 28,317,386	
Balance at December 31, 2006	28,011,334	20,919,197	16,148,490	117,811,741	133,960,231	(64,725,867)	118,164,895	3,156,340		121,321,235
Appropriation of earnings approved at regular stockholders meeting held in April 2007:										
Cash dividends paid at P. 0.448 per share (P. 0.440 historical)				(8,820,074)	(8,820,074)		(8,820,074)			(8,820,074)
Repurchase of Company's own shares in cash	(780,210)			(15,002,629)	(15,002,629)		(15,782,839)			(15,782,839)
Acquisition of noncontrolling interest				(164,575)	(164,575)		(164,575)	(450,572)		(615,147)
Gain on dilution of investment in split-up affiliate				1,123,819	1,123,819		1,123,819			1,123,819
Comprehensive income:										
Net income for the year				35,484,947	35,484,947		35,484,947	570,448	P. 36,055,395	36,055,395
Other comprehensive income items:										

F-5

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2005, 2006 and 2007**

(In thousands of Mexican pesos, except for dividends per share, with purchasing power at December 31, 2007)

Changes in fair value of swaps, net of deferred taxes						499,089	499,089	499,089	499,089
Effect of translation of foreign entities, net						(2,739,571)	(2,739,571)	(369,053)	(3,108,624)
Deficit from holding non-monetary assets, net of deferred taxes						(927,126)	(927,126)	(184,575)	(1,111,701)
Comprehensive income									<b>P. 32,334,159</b>
Decrease due to the split-up of Telmex Internacional	(17,828,563)	(20,919,197)	(14,267,977)	(20,773,678)	(35,041,655)	(10,929,376)	(84,718,791)	(2,683,554)	(87,402,343)
Balance at December 31, 2007 (Note 15)	<b>P. 9,402,561</b>	<b>P. 1,880,513</b>	<b>P. 109,659,551</b>	<b>P. 111,540,064</b>	<b>P. (78,822,851)</b>	<b>P. 42,119,774</b>	<b>P. 39,034</b>		<b>P. 42,158,800</b>



**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**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 transmission to corporate networks and Internet services, and 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.

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. The concession defines, among other things, the quality standards for telephone service and establishes the basis for regulating rates.

Under this concession, the Company's basic telephone service rates are subject to a cap determined by the Federal Telecommunications Commission (COFETEL). During the last seven years, TELMEX management decided not to raise its rates for basic services.

TELMEX has concessions in México 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.

At an extraordinary meeting held on December 21, 2007, the stockholders of Teléfonos de México, S.A.B. de C.V. approved the split-up of the Company's Latin American entities, as well as of its yellow pages business. As a result of the split-up, Telmex Internacional, S.A.B. de C.V. (Telmex Internacional) was incorporated by the contribution of all the shares of Controladora de Servicios de Telecomunicaciones, S.A. de C.V. (Telmex's former subholding company). (See Note 2 for additional information). The split-up date for financial reporting and tax purposes is December 26, 2007, which was the date Telmex Internacional was legally incorporated and from which time the Company ceased to have control over the subsidiaries mentioned above.

On June 23, 2008, TELMEX's Chief Executive Officer, General Counsel and Chief Financial Officer authorized the issuance of the accompanying financial statements and these notes as of December 31, 2007 and 2006, and for each of the three years in the period ended December 31, 2007, which must also be approved by the Company's Board of Directors, Audit Committee and stockholders at their next meetings.

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

At December 31, 2007 and 2006, TELMEX's equity interest in its principal subsidiaries and affiliated companies was as follows:

Company	Country	% equity interest at December 31	
		2007	2006
<b>Subsidiaries:</b>			
Integración de Servicios TMX, S.A. de C.V.	Mexico	100.0%	
Alquiladora de Casas, S.A. de C.V.	Mexico	100.0	100.0%
Cía. de Teléfonos y Bienes Raíces, S.A. de C.V.	Mexico	100.0	100.0
Consortio Red Uno, S.A. de C.V.	Mexico	100.0	100.0
Teléfonos del Noroeste, S.A. de C.V.	Mexico	100.0	100.0
Uninet, S.A. de C.V.	Mexico	100.0	100.0
Telmex USA, L.L.C.	U.S.A.	100.0	100.0
<b>Affiliated companies:</b>			
Grupo Telvista, S.A. de C.V.	Mexico	45.0%	45.0%
2Wire, Inc.	U.S.A.	13.0	13.0

**II. Significant Accounting Policies**

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.

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.

The equity investment in subsidiaries is valued using the equity method, which basically consists of recognizing the Company's proportional share in the net income or loss and the stockholders' equity of the investees (see Note 7).

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

---

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**ii) Translation of financial statements of foreign subsidiaries**

The financial statements of the subsidiaries and affiliates located abroad were translated into Mexican pesos, as follows:

The financial statements as reported by the subsidiaries abroad were adjusted to conform to Mexican Financial Reporting Standards in force, in the local currency, and then re-expressed into constant local currency amounts based on the inflation rate of the country in which the subsidiary operates.

Once the financial information is re-expressed into constant currency of each country at December 31, all assets and liabilities are translated to Mexican pesos at the prevailing exchange rate at year-end closing. Stockholders' equity accounts are translated at the prevailing exchange rate at the time capital contributions were made and earnings were generated. Income statement amounts were translated to Mexican pesos with purchasing power at the prevailing exchange rate at the end of the reporting period.

Exchange differences and the monetary position effect derived from intercompany monetary items are included in the consolidated statements of income.

Translation differences are recorded in stockholders' equity in the caption "Effect of translation of foreign entities" under "Other comprehensive income items".

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

The Company recognizes the effects of inflation on its financial information. Consequently, the amounts shown in the accompanying financial statements and corresponding notes are expressed in thousands of Mexican pesos with purchasing power at December 31, 2007. In prior years' financial statements, the Company applied a weighted average factor determined based on revenues, as well as on the average weighted inflation rate and changes in the exchange rate for each of the countries in which the Company had operated. As a consequence of the split-up, the re-expression factors applied to the financial information of continuing operations for the years ended December 31, 2006 and 2005 were 1.0376 and 1.0796, which correspond to the rates of inflation for the periods from January 1, 2007 and 2006 through December 31, 2007, as determined based on the Mexican National Consumer Price Index (NCPI) published by Banco de México (Mexico's central bank). The re-expression of the financial information of discontinued operations was done using weighted re-expression factors (1.2596 for 2006 and 1.4277 for 2005), which were determined based on revenues, as well as on the average weighted inflation rate and changes in the exchange rate for each of the countries in which the Company operates.

Other non-monetary assets were re-expressed using the inflation adjustment factors for each country.

Capital stock, premium on sale of shares and retained earnings were re-expressed using adjustment factors obtained from the NCPI.

The deficit from re-expression of stockholders' equity consists 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 represents the difference between re-expression by the specific indexation method and re-expression based on the NCPI. This item is included in stockholders' equity under the "Other comprehensive income items" section.

The net monetary position gain represents the effect of inflation on monetary assets and liabilities. The related amounts were included in the statements of income as part of the caption "Comprehensive financing income".

## Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

The statement of changes in financial position is prepared based on the financial statements expressed in constant Mexican pesos. The source and application of resources represent the differences between beginning and ending financial statement balances in constant Mexican pesos. Monetary and foreign exchange gains and losses are not treated as non-cash items in the determination of resources provided by operations.

F-9

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**c) Recognition of revenues**

Revenues are recognized when services are rendered. Local service revenues are derived from 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 based on the number of minutes in the case of prepayment plans. 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.

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.

All these services are billed monthly, based on the rates authorized by the relevant regulatory bodies of each country. 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 agreements specify the rates to be paid by the carriers for the use of the interconnecting facilities.

**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.

**e) Cash equivalents, marketable securities and instruments available-for-sale**

Cash equivalents are represented primarily by time deposits in financial institutions with maturities of less than 90 days.

Marketable securities are represented by equity securities and corporate bonds held for trading and available-for-sale securities are represented by equity securities (see Note 3). All investments in trading and available-for-sale securities are presented at fair value. Changes in the fair value of instruments classified as trading securities are recognized in the statement of income. Changes in the fair value of instruments classified as available-for-sale securities are included in stockholders' equity until they are sold.

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

The Company is exposed to fluctuations in foreign currency exchange and interest rates. During recent years, the Company has contracted forwards to mitigate the short-term risk of exchange differences and when the market conditions are appropriate, cross-currency swaps have been used as longer-term hedges. To protect itself against fluctuations in interest rates, the Company makes significant use of interest-rate swaps, through which it pays or receives the net amount resulting from the payment or collection of a fixed rate on its outstanding long-term debt and from receiving or paying cash flows from a variable rate on notional amounts in Mexican pesos or U.S. dollars. These derivative financial instruments qualify and have been designated as cash flow hedges.

At the inception of the hedge and during the hedging period, each derivative is evaluated to determine whether it is highly effective because it offsets the changes in cash flows of the hedged position. Whenever it is determined that the hedge is not highly effective or that it is no longer highly effective, the hedging accounting treatment given to derivatives is prospectively suspended. Derivative instruments are recognized in the balance sheet at their fair value. The effective portion of the derivative's gain or loss is reported in Other accumulated comprehensive income in stockholders' equity while the ineffective portion of the gain or loss is reported in net income. The adoption of this policy in 2005 gave rise to a credit to income of P. 135,891, and a credit to stockholders' equity of P. 340,514, both net of deferred taxes.



**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**g) Allowance for doubtful accounts**

The allowance for doubtful accounts is determined based on the Company's experience, the age of balances and economic tendencies, as well as on the evaluation of accounts receivable in litigation. The allowance for doubtful accounts basically covers balances of accounts receivable more than 90 days old.

**h) Inventories**

Inventories for sale are valued at average cost and are re-expressed based on inflation. The stated value of inventories is not in excess of its net realizable value.

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

**i) Plant, property and equipment**

Plant, property and equipment and construction in progress are re-expressed as described below:

Through December 31, 1996, items comprising the telephone plant 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 registered with the National Banking and Securities Commission (NBSC).

Effective January 1, 1997, the use of appraisals was disallowed and therefore, as of such date, the Plant, property and equipment caption is re-expressed as follows:

The December 31, 1996 appraised value of the imported telephone plant, as well as the cost of subsequent additions to such plant, were re-expressed based on the rate of inflation in the respective country of origin and the prevailing exchange rate at the balance sheet date (specific indexation factors).

The appraised value of land, buildings and other fixed assets of domestic origin at December 31, 1996, and the cost of subsequent additions to such assets are re-expressed based on the NCPI.

At December 31, 2007, approximately 59% (58% in 2006) of the value of the plant, property and equipment has been re-expressed using specific indexation factors.

Telephone plant and equipment are depreciated using the straight-line method based on the estimated useful lives of the related assets (see Note 5b).

When there are indications of impairment in the value of long-lived assets, the related loss is determined based on the recovery values of the related assets, which is defined as the greater between the asset's net selling price and its value in use, which is computed based on discounted cash flows. When the net carrying amount of an asset exceeds its recovery value, the difference is recognized as an impairment loss. For the years ended December 31, 2007, 2006 and 2005, the Company detected no indications of impairment in the value of its long-lived assets.

**j) Leases**

When the risks and benefits inherent in the ownership of leased goods remain mostly with the lessor, they are classified as operating leases and accrued rent is charged to operations.

F-11



**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**k) Licenses**

TELMEX records licenses at acquisition cost and re-expresses them based on the inflation rate of each country. Licenses are amortized in conformity with the terms of each agreement, over periods of 5 to 20 years.

**l) Business acquisitions and goodwill**

Business and entity acquisitions are recorded using the acquisition method. The acquisition of noncontrolling interests 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 represents the difference between the acquisition cost and the fair value of the net assets acquired at the purchase date. Goodwill is no longer amortized but rather is subject to annual impairment valuations and adjustments at the end of each year, or during the year if there are indications of impairment, and is adjusted for the impairment that has been determined, if any.

Under Mexican FRS, an impairment loss on goodwill must be recognized if its book value exceeds its recoverable value. The company determines the recoverable value of goodwill through its perpetuity value, which is computed by dividing the average of the excess of the value in use of the cash generating unit, by the average of the appropriate discount rates in the determination of the present value of future cash flows of the cash generating unit.

**m) Liability provisions**

Liability provisions are recognized whenever (i) the Company has current obligations (legal or assumed) derived from past events, (ii) the liability will probably give rise to a future cash disbursement for its settlement and (iii) the liability can be reasonably estimated.

If the effect of the time value of money is material, provision amounts are determined as the present value of the expected 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. Where discounting is used, an increase in the provision is recognized as a financial expense.

The Company recognizes contingent liabilities 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**

Pension, seniority premium and dismissal costs 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 8).

**o) Exchange differences**

Transactions in foreign currency are recorded at the prevailing exchange rate on the day of the related transactions. Foreign-currency-denominated assets and liabilities are translated at the prevailing exchange rate at the balance sheet date. Exchange differences determined from such date to the time foreign-currency-denominated assets and liabilities are settled or translated at the balance sheet date are charged or credited to operations.

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

See Note 12 for the Company's foreign currency position at the end of each year and the exchange rates used to translate foreign-currency-denominated balances.

F-12

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**p) Comprehensive income**

Comprehensive income consists of current year net income, the effect of translation of financial statements of foreign entities, changes in noncontrolling interest, the result from holding non-monetary assets and the effect of cash flow hedges applied directly to stockholders' equity.

**q) Income tax and employee profit sharing**

Deferred taxes are determined using the asset and liability method. Under this method, deferred tax assets and liabilities are determined on all temporary differences between the financial reporting and tax bases of assets and liabilities, applying the enacted income tax rate at the time the financial statements are issued, or the enacted income tax rate that will be in effect at the time the temporary differences giving rise to 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 are unlikely to be recovered.

Deferred employee profit sharing is recognized only on temporary items considered non-recurring with a known turnaround time.

**r) Income statement presentation**

Costs and expenses in the Company's income statement are presented by the combination of their function and nature, since such classification allows entities to evaluate both operating income and gross profit margin.

The caption "Operating income" is shown in the income statement, since this is an important indicator used for evaluating the Company's performance.

As a result of a ruling in favor of the Company related to the deductibility for income tax purposes of employee profit sharing paid in 2004 and 2005, the "Other income" caption for 2007 includes P. 1,653,123.

**s) Earnings per share**

The Company determined earnings per share by dividing majority net income from continuing operations and from discontinued operations and majority net income, by the average weighted number of shares issued and outstanding during the year, with the exception of shares acquired by the Company.

**t) Concentration of risk**

The Company invests a portion of its excess cash in time deposits in financial institutions with strong credit ratings. TELMEX does not believe it has significant concentrations of credit risks in its accounts receivable, as it has a broad customer base.

**u) Segments**

Segment information is prepared based on information used by the Company as if the Company had operated in the segments described in Note 17.



**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**v) Convenience translation**

United States dollar amounts as of December 31, 2007 shown in the financial statements have been included solely for the convenience of the reader and are translated from Mexican pesos with purchasing power as of December 31, 2007, as a matter of mathematical computation only, at an exchange rate of P.10.8662 per U.S.\$ 1.00, which is the December 31, 2007 exchange rate. Such translations should not be construed as a representation that the Mexican peso amounts have been or could be converted into U.S. dollars at this or any other rate.

**w) Reclassifications**

Certain captions shown in the 2006 and 2005 financial statements as originally issued have been reclassified for conformity of presentation with the 2007 financial statements. The effects of such reclassifications were applied retroactively in the accompanying income statements for the years ended December 31, 2006 and 2005, in accordance with Mexican FRS B-1, *Accounting Changes and Error Corrections*. An analysis is as follows:

	As originally reported 2006	As reclassified 2006	As originally reported 2005	As reclassified 2005
Employee profit sharing		P. 3,059,444		P. 3,039,278
Income before income tax	P. 42,949,020	39,889,576	P. 41,506,592	38,467,314
Net income	30,315,572	30,315,572	32,189,139	32,189,139

**x) New accounting pronouncements****i) The following are the new pronouncements that became effective on January 1, 2007:****Mexican FRS B-3, *Statement of Income***

Mexican FRS B-3 establishes the guidelines for classifying income, costs and expenses as either ordinary or non-ordinary, eliminates the operating income and initial accumulated effect of accounting changes captions, and allows entities to present costs and expenses in the statement of income, based on their function or nature or a combination of both.

When an entity does decide to include the operating income caption, Mexican FRS B-3 requires the disclosure of the items comprising such caption and a justification for its inclusion in the statement of income.

**Mexican FRS B-13, *Subsequent Events at the Date of the Financial Statements***

Mexican FRS B-13 modifies the former rules relative to subsequent events by establishing that certain events, such as the restructuring of assets and liabilities and the relinquishing by creditors of their collection rights in the case of debt default, shall be disclosed in the notes to the financial statements and recognized in the period in which they took place. Accordingly, the financial statements may no longer be adjusted to reflect such subsequent events, as was permitted under Mexican FRS.

The adoption of Mexican FRS B-13 had no effect on the Company's financial position.



---

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

***Mexican FRS C-13, Related Parties***

This Mexican FRS broadens the definition of related parties to include immediate family members of key management personnel or directors, as well as funds relating to labor obligation plans. Mexican FRS C-13 also requires the following disclosures: i) the relationship between the controlling company and its subsidiaries, irrespective of whether transactions were carried out between them in the period; ii) the name of the direct controlling company and, when different from such, the name of the principal controlling company of the economic entity to which the entity belongs; and iii) compensation granted to the entity's key management personnel or directors (in the case of a public company). This standard also allows entities to disclose that the terms of the transactions carried out with its related parties are equivalent to market terms, provided that such parity may be demonstrated.

The adoption of the requirements of Mexican FRS C-13 had no effect on the Company's financial position or on its results of operations.

***Mexican FRS D-6, Capitalization of the Comprehensive Result of Financing***

Mexican FRS D-6 establishes that entities must capitalize comprehensive result of financing (CRF), which had been optional under the previous Mexican accounting Bulletin C-6, Property, Plant and Equipment.

Capitalizable CRF is defined as the amount attributable to qualifying assets that could have been avoided if such acquisition had not taken place. Qualifying assets are defined as those assets acquired by an entity requiring a prolonged acquisition period in order to use, sell or lease them. Mexican FRS D-6 establishes the conditions necessary for the capitalization of CRF and the method under which the capitalizable amount must be determined and also provides guidelines for determining when such capitalization must be suspended.

The adoption of this Mexican FRS had no effect on the Company's financial position or results of operations, since the Company has no significant qualifying assets with prolonged acquisition periods.

***Mexican FRS interpretation 4, Presentation of Employee Profit Sharing in the Statement of Income***

The Mexican FRS interpretation 4 establishes that employee profit sharing must be presented in the statement of income as an ordinary expense.

***Mexican FRS interpretation 8, Effects of the Flat Rate Business Tax***

In December 2007, the Mexican Financial Information Standards Research and Development Board (Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera, A.C. or CINIF) issued Mexican FRS interpretation 8, which is effective for years beginning on or after October 1, 2007. Such Interpretation was created as a result of the need to clarify whether the new flat rate business tax (FRBT) should be treated as a tax on profits and to establish the guidelines for its accounting treatment.

Mexican FRS interpretation 8 establishes that the FRBT is a tax on profit and that for the year ended December 31, 2007, its effects should be recognized in conformity with the provisions of Mexican accounting Bulletin D-4, Accounting for Income Tax, Asset Tax and Employee Profit Sharing, and as of January 1, 2008, in conformity with Mexican FRS D-4, Taxes on Profits. Based on the conclusions of this Interpretation, an entity must first determine whether its tax base generates FRBT payable or income tax payable. To do so, taxpayers should prepare financial projections to determine if their tax on profits base will be for income tax or FRBT. Based on the results of these projections, taxpayers will be able to plan in advance for either FRBT or income tax as it arises each year.





---

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

Applying this interpretation had no effect on the Company's financial statements, since management estimates that it will have no FRBT payable in future years based on its current projections.

**ii) The following are the new pronouncements that became effective on January 1, 2008:**

***Mexican FRS B-2, Statement of Cash Flows***

Mexican FRS B-2 was issued by the CINIF to replace Mexican accounting Bulletin B-12, Statement of Changes in Financial Position. This standard establishes that the statement of changes in financial position will be replaced by a statement of cash flows as part of the basic financial statements. The main differences between both statements lie in the fact that the statement of cash flows will show the entity's cash receipts and disbursements for the period, while the statement of changes in financial position showed the changes in the entity's financial structure rather than its cash flows. In an inflationary environment, amounts in both financial statements are expressed in constant Mexican pesos.

However, in preparing the statement of cash flows, the entity must first eliminate the effects of inflation for the period and, accordingly, determine cash flows at constant Mexican pesos, while in the statement of changes in financial position, the effects of inflation for the period are not eliminated.

Under this new standard, the statement of cash flows may be prepared by applying the direct or indirect method. The transition provisions of Mexican FRS B-2 establish that the application of this standard is prospective. Therefore, the financial statements for years ended prior to 2008 presented for comparative purposes, should include a statement of changes in financial position, as established by Mexican accounting Bulletin B-12.

The Company is analyzing the method to be applied as of January 1, 2008. Mexican FRS B-2 establishes that in the statement of cash flows, the entity must first present cash flows derived from operating activities, then from investing activities, the sum of these activities and finally cash flows derived from financing activities.

***Mexican FRS B-10, Effects of Inflation***

Mexican FRS B-10, *Effects of Inflation*, replaces Mexican accounting Bulletin B-10, *Accounting Recognition of the Effects of Inflation on Financial Information*. Mexican FRS B-10 defines the rules of the recognition and presentation of the effects of inflation on financial information. The standard defines the two economic environments in Mexico that will determine whether or not entities must recognize the effects of inflation on financial information: i) inflationary, when inflation is equal to or higher than 26% accumulated in the preceding three fiscal years (an 8% annual average); and ii) non-inflationary.

Mexican FRS B-10 also establishes the accounting rules applicable whenever the economy changes from either type of environment to the other. When the economy changes from an inflationary environment to a non-inflationary one, the entity must maintain in its financial statements the effects of inflation recognized through the immediate prior year, since the amounts of prior periods are taken as the base amounts of the financial statements for the period of change and subsequent periods. Whenever the economy changes from a non-inflationary environment to an inflationary one, the effects of inflation on the financial information must be recognized retrospectively, meaning that all information for prior periods must be adjusted to recognize the accumulated effects of inflation for the periods in which the economic environment was considered non-inflationary.

---

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

This standard also abolishes the use of the specific-indexation method for the valuation of imported fixed assets and the replacement-cost method for the valuation of inventories, thus eliminating the result from holding non-monetary assets. Therefore, at the date this Mexican FRS comes into force, entities which have recognized any accumulated result from holding non-monetary assets in their stockholders' equity under retained earnings, must identify the realized and unrealized portions of such result.

The realized result from holding non-monetary assets must be reclassified to retained earnings, while the unrealized portion must be maintained as such within stockholders' equity and reclassified to results of operations when the asset giving rise to it is realized. Whenever it is deemed impractical to separate the realized from the unrealized result from holding non-monetary assets, the full amount of this item may be reclassified to the Retained earnings caption.

The effect of the adoption of this standard on the Company's 2008 financial statements is expected to result in the Company ceasing to recognize the effects of inflation on its financial information and reclassifying the total amount of the result from holding non-monetary assets, net of deferred taxes and the accumulated monetary position loss, to retained earnings.

**Mexican FRS D-3, *Employees Benefits***

As of January 1, 2008, Mexican FRS D-3 replaces Mexican accounting Bulletin D-3, *Labor Obligations*. The most significant changes contained in Mexican FRS D-3 are as follows: i) shorter periods for the amortization of unamortized items, with the option to credit or charge actuarial gains or losses directly to results of operations, as they accrue; ii) elimination of the recognition of an additional minimum pension liability and resulting recognition of an intangible asset and other comprehensive income item; iii) accounting treatment of current-year and deferred employee profit sharing, requiring that deferred employee profit sharing be recognized using the asset and liability method established under Mexican FRS D-4; and iv) current and deferred employee profit sharing expenses are to be presented as ordinary expenses in the income statement rather than as part of taxes on profits.

The adoption of this standard in 2008 will require that both the additional liability and the related intangible asset and comprehensive income item be eliminated and that the unamortized items be carried to results of operations in a period not exceeding five years. The initial effect of the recognition of deferred employee profit sharing, net of income tax, must be charged or credited to retained earnings with no effect on results of operations for the year ending December 31, 2008.

The cumulative effect for the adoption of this standard as of January 1, 2008, was a decrease in retained earnings of approximately P. 4,400,000.

**Mexican FRS D-4, *Income Taxes***

Mexican FRS D-4, *Income Taxes*, replaces Mexican accounting Bulletin D-4, *Accounting for Income Tax, Asset Tax and Employee Profit Sharing*. The most significant changes included in this standard with respect to Mexican accounting Bulletin D-4 are as follows: i) the concept of permanent differences is eliminated, since the asset and liability method requires the recognition of deferred taxes on all differences in balance sheet accounts for financial and tax reporting purposes, regardless of whether they are permanent or temporary; ii) since current and deferred employee profit sharing is considered as an ordinary expense, it is excluded from this standard and is now addressed under Mexican FRS D-3; iii) asset tax is required to be recognized as a tax credit and, consequently, as a deferred income tax asset only in those cases in which there is possibility as to its future realization; and iv) the cumulative effect of adopting Mexican accounting Bulletin D-4 is to be reclassified to retained earnings, unless it is identified with other comprehensive income items in stockholders' equity not yet taken to income.

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

The Company has presented the cumulative effect of the adoption of Bulletin D-4 in retained earnings since the time of its original adoption.

**Mexican FRS interpretation 5, *Accounting Recognition of the Additional Consideration Agreed at the Inception of a Derivative to Adjust the Instrument to its Fair Value***

This Interpretation clarifies that the additional consideration is part of the fair value of the derivative and, accordingly, it must be included in the value at which the derivative is initially recorded, which will be adjusted for changes in its fair value in subsequent periods. Therefore, the additional consideration should not be amortized.

**Mexican FRS interpretation 6, *Formally Designating a Hedge***

Mexican FRS interpretation 6 establishes that a derivative may be designated as a hedge at its inception date or contract date or at a subsequent date (with prospective hedge accounting treatment), provided that it meets the conditions established in Mexican accounting Bulletin C-10, *Accounting for Derivative Financial Instruments and Hedging Activities* for such designation.

**Mexican FRS interpretation 7, *Application of Comprehensive Income Item Generated by a Cash Flow Hedge on a Forecasted Purchase of a Non-financial Asset***

This interpretation clarifies that if a derivative is designated as a cash flow hedge on a forecasted transaction to set the price of the non-financial asset in its functional currency, the effect recognized in other comprehensive income is considered a complement to the cost of the hedged asset and therefore must be included in such cost.

Management anticipates that the application of interpretations 5, 6 and 7 are expected to have no effect on the Company's financial position or results of operations.

**2. Discontinued Operations**

On December 21, 2007, the stockholders of TELMEX approved the split-up of the Company's Latin American subsidiaries, as well as of its yellow pages business. As a result of the split-up, Telmex Internacional, S.A.B. de C.V. was incorporated on December 26, 2007 and the assets, liabilities and stockholders' equity of the majority of the foreign subsidiaries and of the yellow pages business were transferred to it. The split-up date for legal, book and tax purposes is December 26, 2007, on which date Telmex Internacional was legally incorporated as a separate Mexican company and from which time the Company ceased to have control over the subsidiaries mentioned above.

The terms of the split-up establish that neither TELMEX nor Telmex Internacional is to hold shares of the other. At the time of the split-up, each of the holders of TELMEX shares became the owner of an equal number of Telmex Internacional shares of the corresponding class and consequently, both companies are currently controlled by the same group of stockholders. The relationship between TELMEX and Telmex Internacional will be limited to: i) ordinary commercial relationships, such as those related to international traffic termination services and the preparation and distribution of telephone directories; ii) agreements relating to the implementation of the split-up; and iii) certain temporary agreements that will remain in force until Telmex Internacional has its own administrative capabilities.

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

In the accompanying balance sheets, all assets and liabilities of the split-up entity have been included in the current and non-current assets and liabilities of discontinued operations captions. All income and expenses of the new entity are presented in the statements of income under the caption Income from discontinued operations, net of income tax. The figures in the 2005, 2006 and 2007 financial statements corresponding to periods prior to the split-up and their corresponding notes were restructured to present only the assets and liabilities and revenues, costs and expenses of continuing operations, without including discontinued operations.

The assets and liabilities of the split-up operations were transferred to Telmex Internacional at book value. The amount of stockholders' equity transferred to Telmex Internacional in the split-up represents the difference between the assets and liabilities that were transferred. Such amount was recognized as a reduction to stockholders' equity at the time of the split-up.

A summary of the balance sheet at December 31, 2006 and the statements of income for the twelve-month periods ended December 31, 2007, 2006 and 2005 of the split-up operations are as follows:

**Balance Sheet at December 31, 2006**

<b>Assets</b>	
Current assets:	
Cash and cash equivalents	P. 6,905,498
Accounts receivable, net	19,129,133
Prepaid expenses	885,979
Other current assets	117,639
<b>Total current assets</b>	<b>27,038,249</b>
Other long-term accounts receivable	3,953,233
Plant, property and equipment, net	47,270,851
Inventories for operation of the telephone plant	939,545
Licenses and trademarks	5,748,356
Equity investments	2,799,888
Goodwill, net	11,083,769
Deferred taxes	8,532,159
<b>Total non-current assets</b>	<b>80,327,801</b>
<b>Total assets</b>	<b>P. 107,366,050</b>
<b>Liabilities and stockholders' equity</b>	
Current liabilities:	
Current portion of long-term debt	P. 4,931,916
Accounts payable and accrued liabilities	20,831,502
Taxes payable	1,247,322
Deferred credits	1,129,175

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

Total current liabilities	28,139,915
Long-term debt	12,558,450
Labor obligations	2,670,286
Total long-term liabilities	15,228,736
Total liabilities	43,368,651
Split-up stockholders' equity	63,997,399
Total liabilities and net investment in split-up assets	P. 107,366,050

F-19

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

	Statements of Income		
	Year ended December 31		
	2007	2006	2005
Operating revenues	P. 68,042,515	P. 65,799,021	P. 61,641,637
Operating costs and expenses	57,545,898	61,834,214	54,125,529
Operating income	10,496,617	3,964,807	7,516,108
Employee profit sharing	62,279	55,350	52,356
Other expenses (income), net	180,413	(1,583,765)	154,165
Comprehensive financing cost, net	297,876	2,008,699	1,021,949
Equity interest in net income of affiliated companies	689,075	577,567	122,714
Income before taxes on profits	10,645,124	4,062,090	6,410,352
Provision for:			
Income tax	3,478,812	1,447,059	1,483,769
Net income	P. 7,166,312	P. 2,615,031	P. 4,926,583
Distribution of net income:			
Majority interest	P. 6,595,675	P. 1,951,101	P. 3,721,211
Noncontrolling interest	570,637	663,930	1,205,372
	P. 7,166,312	P. 2,615,031	P. 4,926,583
Majority net income per share	P. 0.34	P. 0.09	P. 0.16

**3. Marketable Securities and Instruments Available for Sale**

An analysis of the Company's investments in financial instruments at December 31, 2007 and 2006 is as follows:

	December 31, 2007		December 31, 2006	
	Cost	Market value	Cost	Market value
<b>Trading securities:</b>				
Shares	P. 621,253	P. 709,346	P. 2,854,949	P. 2,920,986
Corporate bonds	11,050	8,798	11,050	9,573
<b>Total</b>	P. 632,303	P. 718,144	P. 2,865,999	P. 2,930,559

**Trading Securities**

At December 31, 2007, the net unrealized gain on trading securities was P. 85,841 (P. 64,560 in 2006).

## Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

The realized profit on the sale of shares in 2007 was P. 192,643 (loss of P. 444 in 2006 and gain of P. 275 in 2005), which corresponds to the difference between the original cost of the shares and their market value at the time of the sale.

In 2006, the Company acquired 20.7 million common shares in Portugal Telecom for P. 2,956,819 (US\$ 252.3 million). During 2007 and 2006, the Company sold 15.0 million shares for P. 2,236,333 (US\$ 204.8 million) and 0.7 million shares for P. 99,684 (US\$ 8.7 million), respectively. Portugal Telecom provides telecommunication services in Portugal and Brazil.

F-20

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**Subsequent event**

In January 2008, the Company sold the remaining 5.0 million shares it had in Portugal Telecom for P. 750,921 (US\$ 68.7 million), on which it realized a gain of P. 129,668.

**Instruments Available for Sale**

On April 9, 2005, TELMEX and other related parties entered into an agreement to sell their MCI shares to Verizon Communications Inc. (Verizon). On May 17, 2005, Verizon paid in cash USD 25.72 per MCI common stock, for a total of P. 8,018,490. TELMEX recognized a gain of P. 541,273 in 2005 as a result of the sale of these shares, which was recognized in *Other income, net*. In 2005, TELMEX received dividends from MCI of P. 128,193, which was recognized in *Other income, net*.

**4. Accounts Receivable**

An analysis of accounts receivable at December 31 is as follows:

	2007	2006
Customers	P. 17,851,875	P. 19,394,285
Net settlement receivables	406,297	485,597
Related parties	750,908	572,828
Other	2,927,593	2,096,637
	<b>21,936,673</b>	<b>22,549,347</b>
Less:		
Allowance for doubtful accounts	1,725,969	1,808,773
Total	<b>P. 20,210,704</b>	<b>P. 20,740,574</b>

An analysis of activity in the allowance for doubtful accounts for the years ended December 31, 2007, 2006 and 2005 is as follows:

	2007	2006	2005
Beginning balance at January 1	P. 1,808,773	P. 2,153,928	P. 2,744,162
Increase through charge to expenses	1,349,248	920,316	825,597
Charges to allowance	(1,373,875)	(1,184,603)	(1,334,907)
Monetary effect	(58,177)	(80,868)	(80,924)
Ending balance at December 31	<b>P. 1,725,969</b>	<b>P. 1,808,773</b>	<b>P. 2,153,928</b>

**5. Plant, Property and Equipment**



Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

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

	2007	2006
Telephone plant and equipment	<b>P. 310,040,259</b>	P. 301,991,906
Land and buildings	<b>36,845,783</b>	36,260,705
Computer equipment and other assets	<b>43,021,758</b>	41,297,476
	<b>389,907,800</b>	379,550,087
Less:		
Accumulated depreciation	<b>269,684,433</b>	255,503,787
Net	<b>120,223,367</b>	124,046,300
Construction in progress and advances to equipment suppliers	<b>425,192</b>	566,513
Total	<b>P. 120,648,559</b>	P. 124,612,813

F-21

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

b) Depreciation of the telephone plant has been calculated at annual rates ranging from 3.3% to 20.0%. The rest of the Company's assets are depreciated at rates ranging from 10% to 33.3%. Depreciation charged to operating costs and expenses was P. 18,290,793 in 2007, P. 18,603,118 in 2006 and P. 20,208,466 in 2005.

**6. Licenses**

An analysis of licenses cost and their amortization at December 31, 2007 and 2006 is as follows:

	2007	2006
Investment	P. 1,457,841	P. 1,431,535
Accumulated amortization	553,880	472,919
<b>Net</b>	<b>P. 903,961</b>	<b>P. 958,616</b>

An analysis of the changes in 2007, 2006 and 2005 is as follows:

	Balance at January 1, 2007	Investment and amortization for the year	Effect of translation	Balance at December 31, 2007
Investment	P. 1,431,535	P. 26,221	P. 85	P. 1,457,841
Accumulated amortization	472,919	80,847	114	553,880
<b>Net</b>	<b>P. 958,616</b>	<b>P. (54,626)</b>	<b>P. (29)</b>	<b>P. 903,961</b>

	Balance at January 1, 2006	Investment and amortization for the year	Effect of translation	Balance at December 31, 2006
Investment	P. 1,424,327	P. 6,796	P. 412	P. 1,431,535
Accumulated amortization	393,370	79,078	471	472,919
<b>Net</b>	<b>P. 1,030,957</b>	<b>P. (72,282)</b>	<b>P. (59)</b>	<b>P. 958,616</b>

	Balance at January 1, 2005	Investment and amortization of the year	Balance at December 31, 2005
Investment	P. 1,110,994	P. 313,333	P. 1,424,327

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

Accumulated amortization	326,289	67,081	393,370
<b>Net</b>	<b>P. 784,705</b>	<b>P. 246,252</b>	<b>P. 1,030,957</b>

Other deferred charges were amortized in the amount of P. 53,645, P. 29,207 and P. 38,748 in 2007, 2006 and 2005, respectively.

**7. Equity Investments**

**Investments in affiliates and others**

An analysis of the equity investments in affiliated companies at December 31, 2007 and 2006, and a brief description of each, is as follows:

	<b>2007</b>	<b>2006</b>
Equity investments in:		
Grupo Telvista, S.A. de C.V.	<b>P. 502,419</b>	P. 448,459
2Wire, Inc.	<b>110,916</b>	172,875
Other	<b>483,151</b>	264,367
	<b>P. 1,096,486</b>	P. 885,701

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**Grupo Telvista**

TELMEX holds 45% of the capital stock of Grupo Telvista, S.A. de C.V. which, through its subsidiaries, provides telemarketing services in Mexico and the U.S.A.

**2Wire**

In December 2005, through an agreement with Alcatel USA (Alcatel) and AT&T, the Company invested in 2Wire, Inc. (2Wire), a broadband platform service provider for homes and small offices, located in the U.S.A. On January 27, 2006, TELMEX acquired an 18.5% equity interest in 2Wire for which it paid P. 979,330 (US\$ 87.8 million), and AT&T paid TELMEX P. 290,564 (US\$ 26.05 million) to acquire, through the prepayment of an option and at the same price paid by TELMEX, an additional 5.5% equity interest in 2Wire. This transaction took place on December 1, 2006. Consequently, at December 31, 2007 and 2006, TELMEX holds a 13% equity interest in 2Wire. Goodwill generated was P. 448,168.

**Technology and Internet**

On June 21, 2005, the Company sold its 50% equity interest in Technology and Internet LLC to Grupo Condumex, S.A. de C.V., an entity under common control, for P. 46,904. As a result of this transaction, the Company recognized a charge of P. 105,052 in its stockholders' equity.

For the years ended December 31, 2007, 2006 and 2005, the equity interest in affiliated companies represented credits (charge) to results of operations of P. 17,245, P. 8,723 and P. (19,992), respectively, and credits (charge) to stockholders' equity of P. 1,703, P. (3,652) and P. 46,702, respectively.

An analysis of changes in goodwill during 2007 and 2006 is as follows:

	2007	2006
Initial balance	<b>P. 448,168</b>	
Goodwill generated		P. 448,168
Adjustments to the purchase balance of 2Wire	<b>(16,516)</b>	
Ending balance	<b>P. 431,652</b>	P. 448,168

**8. Labor Obligations****Pensions plans and seniority premiums**

Substantially all of the Company's employees are covered under defined benefit retirement and seniority premium plans. Pension benefits 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 its plans and has adopted the policy of making annual contributions to such fund, which are deductible for Mexican corporate income tax purposes. The unrecognized transition obligation, prior service cost and variances in actuarial assumptions are being amortized over a period of 12 years, which is the estimated average remaining service period for Company employees.

The most relevant information related to labor obligations is as follows:

F-23

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

*Net period cost*

	2007	2006	2005
Labor cost	<b>P. 3,672,437</b>	P. 3,327,889	P. 3,100,403
Financial cost on projected benefit obligation	<b>9,013,577</b>	8,019,378	7,048,461
Expected return on plan assets	<b>(9,585,397)</b>	(8,320,936)	(7,428,878)
Amortization of unrecognized net transition obligation and prior service cost	<b>1,339,448</b>	1,339,448	1,364,700
Amortization of unrecognized actuarial losses	<b>55,701</b>	284,042	508,421
Net periodic cost	<b>P. 4,495,766</b>	P. 4,649,821	P. 4,593,107

*Projected benefit obligation*

	2007	2006
Actuarial present value of labor obligation:		
Vested benefit obligation	<b>P. 75,647,910</b>	P. 66,818,703
Non-vested benefit obligation	<b>79,840,160</b>	64,462,873
Accumulated benefit obligation (ABO)	<b>155,488,070</b>	131,281,576
Effect of salary projection	<b>3,995,971</b>	4,093,089
Projected benefit obligation (PBO)	<b>P. 159,484,041</b>	P. 135,374,665

*Changes in the projected benefit obligation*

	2007	2006
Projected benefit obligation at beginning of year	<b>P. 135,374,665</b>	P. 114,428,410
Labor cost	<b>3,672,437</b>	3,327,889
Financial cost on projected benefit obligation	<b>9,013,577</b>	8,019,378
Actuarial loss	<b>18,706,480</b>	15,973,948
Benefits paid to employees	<b>(159,139)</b>	(174,111)
Payments from trust fund	<b>(7,123,979)</b>	(6,200,849)
Projected benefit obligation at end of year	<b>P. 159,484,041</b>	P. 135,374,665

*Changes in plan assets*

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

	2007	2006
Fair value of plan assets at beginning of year	<b>P. 143,585,989</b>	P. 123,519,970
Expected return on plan assets	<b>9,585,397</b>	8,320,936
Actuarial gain	<b>10,866,755</b>	17,845,210
Contributions to trust fund	<b>64,935</b>	100,722
Payments from trust fund	<b>(7,123,979)</b>	(6,200,849)
Fair value of plan assets at end of year	<b>P. 156,979,097</b>	P. 143,585,989

*Prepaid benefit obligation*

	2007	2006
Plan assets (short of) in excess of projected benefit obligation	<b>P. (2,504,944)</b>	<b>P. 8,211,324</b>
Unamortized actuarial loss	<b>16,459,211</b>	<b>8,675,189</b>
Unrecognized net transition obligation at the date of initial application	<b>1,466,562</b>	<b>2,771,232</b>
Unrecognized prior service cost and changes in the plan	<b>200,338</b>	<b>235,116</b>
Net prepaid benefit obligation	<b>P. 15,621,167</b>	<b>P. 19,892,861</b>

## Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

At December 31, 2007 and 2006, the market value of the trust fund for pension benefits and seniority premiums exceeded the accumulated benefit obligation by P. 1,491,027 and P. 12,304,413, respectively. The balance sheets show a net prepaid benefit obligation of P. 15,621,167 and P. 19,892,861 in 2007 and 2006, respectively.

F-24



**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

In 2007, the net actuarial loss of P. 7,839,725, was derived from the net effect of a favorable actuarial difference of P. 10,866,755, due to the behavior of the plan assets invested in shares of companies listed on the Mexican Stock Exchange, and an actuarial loss of P. 18,706,480, mostly attributable to changes made to the discount rates of the obligations that were determined by referencing long-term and low-risk financial instruments. The above-mentioned actuarial loss is also derived from changes in the experience with retired personnel and differences between the inflation rate and the estimated increase in salaries.

In 2006, the net actuarial gain of P. 1,871,262 was derived from the net effect of a favorable actuarial difference of P. 17,845,210, due to the behavior of the plan assets invested in shares of companies listed on the Mexican Stock Exchange and an increase in the rates of the Company's fixed-yield investments, and an actuarial loss of P. 15,973,948, mostly attributable to the revision made in July 2006 of the demographical actuarial hypotheses used in the computation of pension benefits. These latter changes were applied based on the Company's experience and general trends in Mexico during the last few years, as well as on future expectations. The above-mentioned actuarial loss is also due in part to the change in the estimated retirement age and the Company's experience with retired personnel.

The rates used in the actuarial studies at December 31, 2007, 2006 and 2005 are as follows:

	2007	2006	2005
	%	%	%
Discount of labor obligations:			
Long-term average	5.51	5.72	5.77
Increase in salaries:			
Long-term average	0.97	0.94	0.94
Annual return on fund	6.28	6.82	6.82

At December 31, 2007, 53.8% (43.7% in 2006) of plan assets were invested in fixed-income securities and the remaining 46.2% (56.3% in 2006) in variable-yield securities.

**Dismissals**

The most important information related to labor obligations for dismissals is as follows:

*Net period cost*

	2007	2006	2005
Labor cost	P. 13,371	P. 24,536	P. 8,304
Financial cost on projected benefit obligation	9,623	18,218	9,577
Amortization of unrecognized net transition obligation and prior service cost	(31,680)	68,350	149,146
Net periodic (benefit) cost	P. (8,686)	P. 111,104	P. 167,027

*Projected benefit obligation*

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

	2007	2006
Actuarial present value of labor obligation:		
Accumulated benefit obligation (ABO)	<b>P. 164,797</b>	P. 147,873
Effect of salary projection	<b>7,403</b>	6,902
Projected benefit obligation (PBO)	<b>P. 172,200</b>	P. 154,775

F-25

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

*Labor obligations for dismissals*

	2007	2006
Projected benefit obligation	<b>P. 172,200</b>	P. 154,775
Unamortized actuarial loss	<b>36,206</b>	85,499
<b>Net projected liability</b>	<b>P. 208,406</b>	P. 240,274

A reconciliation of the book reserve is as follows:

	2007	2006
Balance at beginning of year	<b>P. 240,274</b>	P. 150,626
Net periodic (benefit) cost	<b>(8,686)</b>	111,104
Payments to employees	<b>(23,182)</b>	(21,456)
<b>Balance at end of year</b>	<b>P. 208,406</b>	P. 240,274

**9. Long-term Debt**

Long-term debt consists of the following:

	Weighted- average interest rate at		Maturities from 2008 to	Balance at December 31	
	2007	2006		2007	2006
<i>Debt denominated in foreign currency:</i>					
Senior notes	<b>4.9%</b>	4.9%	2015	<b>P. 29,882,050</b>	P. 31,032,152
Banks	<b>5.0%</b>	5.7%	2016	<b>43,331,074</b>	45,744,867
Other	<b>2.0%</b>	2.0%	2022	<b>248,990</b>	254,990
<b>Total debt denominated in foreign currency:</b>				<b>73,462,114</b>	77,032,009
<i>Debt denominated in Mexican pesos:</i>					
Senior notes	<b>8.8%</b>	8.8%	2016	<b>4,500,000</b>	4,669,200
Domestic senior notes	<b>8.2%</b>	9.0%	2037	<b>10,700,000</b>	7,366,960
Banks	<b>7.6%</b>	7.5%	2010	<b>2,800,000</b>	1,348,880

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

Total debt denominated in Mexican pesos	<b>18,000,000</b>	13,385,040
<b>Total debt</b>	<b>91,462,114</b>	90,417,049
Less short-term debt and current portion of long-term debt	<b>12,282,260</b>	9,040,821
<b>Long-term debt</b>	<b>P. 79,179,854</b>	P. 81,376,228

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 taxes withheld. The Company's weighted average cost of borrowed funds at December 31, 2007 (including interest, interest-rate swaps, fees and Mexican taxes withheld) was approximately 6.9% (7.0% in 2006).

The Company's short-term debt at December 31, 2007 is P. 12,282,260 (P. 9,040,821 in 2006), which primarily includes

P. 1,392,557 in bank loans (P. 2,896,974 in 2006) and bonds of P. 10,866,200 (P. 6,121,840 in 2006).

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

***Senior notes:***

- a) On January 26, 2001, TELMEX issued a bond for P. 12,979,185 (US\$ 1,000 million), maturing in January 2006 and bearing 8.25% annual interest payable semiannually. Additionally, on May 8, 2001, TELMEX issued a supplemental bond for P. 6,120,527 (US\$ 500 million) with the same terms. In 2006, interest expense on the bonds was P. 72,855 (P. 1,460,395 in 2005). In 2005, TELMEX repurchased a total of P. 5,286,488 (US\$ 431.6 million) (nominal amount) of these bonds. The difference between the repurchase price and the nominal amount is P. 193,162 (US\$ 15.6 million), which was recognized in comprehensive financing cost. In January 2006, the Company repaid the outstanding balance on the bond of P. 12,048,731 (US\$ 1,068.4 million).
- b) On November 19, 2003, TELMEX issued a bond for P. 13,189,045 (US\$ 1,000 million) that matures in 2008 and bears 4.5% annual interest payable semiannually. In 2007, interest expense on the bond was P. 524,959 (P. 550,203 in 2006 and P. 570,124 in 2005).
- c) On January 27, 2005, TELMEX made a bond placement of P. 16,348,066 (US\$ 1,300 million) divided into two issuances of P. 8,174,033 (US\$ 650 million) each. The first placement matures in 2010 and bears a 4.75% annual interest and the second matures in 2015 and bears a 5.5% annual interest. Interest is payable semiannually. On February 22, 2005, such placements were reopened and the bonds issued were increased from P. 8,174,033 to P. 11,870,243 and P. 10,022,138, respectively (US\$ 950 million and US\$ 800 million, respectively). In 2007, interest expense on the bonds that mature in 2010 aggregates to P. 531,385 (P. 551,573 in 2006 and P. 514,307 in 2005) and P. 515,254 (P. 537,818 in 2006 and P. 506,982 in 2005) on the bond that matures in 2015.
- d) On January 26, 2006, TELMEX made a bond placement abroad of P. 4,500,000 (nominal amount), which matures in 2016 and bears annual interest at 8.75%. At December 31, 2007, accrued interest on the bond was P. 474,590 (P. 407,563 in 2006).

***Syndicated loan:***

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 (US\$ 3,000 million) structured into three tranches. The first tranche is for P. 14,963,659 (US\$ 1,300 million) and has a three-year maturity. The second tranche is for P. 11,510,507 (US\$ 1,000 million) and has a five-year maturity. The third tranche is for P. 8,057,355 (US\$ 700 million) with a seven-year maturity. The balance of these loans at December 31, 2007 is included under Banks (debt denominated in foreign currency).

On June 30, 2006, TELMEX entered into a syndicated loan agreement for P. 5,986,554 (US\$ 500 million) structured into two tranches. Each of the two tranches is for P. 2,993,277 (US\$ 250 million), and they have four-year and six-year maturities, respectively.

Substantially all of our bank loans bear interest at specified spreads over LIBOR.

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

At December 31, 2006, TELMEX had placed domestic senior notes ( certificados bursátiles ) for a total of P. 7,450,000 (nominal amount) under the program authorized by the NBSC in 2001; the balance at such date was P. 6,848,160 (P. 6,600,000 nominal amount). During 2007, P. 5,900,000 (nominal amount) of such placement was repaid and consequently, the balance at December 31, 2007 was P. 700,000. The term of

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

such program ended in April 2004 and TELMEX is now only repaying the outstanding balances of the previously placed instruments.

F-27

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

On September 30, 2005, TELMEX obtained authorization from the NBSC to place long-term domestic senior notes for P. 10,000,000 (nominal amount). At December 31, 2006, TELMEX had placed domestic senior notes for a total amount of P. 518,800 (P. 500,000 nominal amount) under this program and at December 31, 2007, domestic senior notes were issued for the total amount authorized under such program. Some of these domestic senior notes bear interest at fixed rates and some bear interest at specified spreads below the Mexican interbank equilibrium interest rate (*tasa de interés interbancaria de equilibrio* or TIEE).

**Lines of credit:**

At December 31, 2007, TELMEX had long-term lines of credit with certain foreign financial institutions. The unused portion of committed lines of credit totaled approximately P. 1,784,840 (US\$ 164.2 million), with a floating rate that approximates the London Interbank Offered Rate (LIBOR) plus 30 basis points.

**Prepaid debt:**

During 2007, TELMEX prepaid a portion of its debt with a number of financial institutions of approximately P. 2,596,637 (approximately US\$ 239.1 million) for which it paid P. 1,861 (US\$ 171) as a prepayment premium that is included under comprehensive cost of financing.

**Restrictions:**

The above-mentioned debt is subject to certain restrictive covenants with respect to maintaining certain financial ratios and the sale of a significant portion of assets, among others. At December 31, 2007, the Company was in compliance with such restrictive covenants.

A portion of the debt is also subject to early maturity or repurchase at the option of the holders in the event of change of control of the Company, as defined in the related instruments. The definition of change of control varies from instrument to instrument; however, no change in control shall be considered to have occurred as long as Carso Global Telecom, S.A.B. de C.V. (Carso Global Telecom) (TELMEX's controlling company) 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, 2007 is as follows:

	Foreign currency (in thousands)	Exchange rate at December 31, 2007 (in units)	Equivalent in Mexican pesos
U.S. dollar	6,737,694	P. 10.8662	P. 73,213,124
Euros	15,682	15.8766	248,990
<b>Total</b>			<b>P. 73,462,114</b>

Long-term debt maturities at December 31, 2007 are as follows:

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

<b>Years</b>	<b>Amount</b>
2009	P. 15,926,023
2010	16,302,306
2011	11,829,066
2012	10,459,446
2013 and thereafter	24,663,013
Total	P. 79,179,854

F-28



**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**Hedges:**

At December 31, 2007 and 2006, the financial instruments contracted by the Company are as follows:

Financial instrument	2007		2006	
	Notional amount (in millions)	Fair value	Notional amount (in millions)	Fair value
Interest-rate swaps in pesos	P. 23,752	P. (82)	P. 31,952	P. (1,510)
Interest-rate swaps in dollars	US\$ 1,150	123	US\$ 1,050	445
Interest-rate swaps in dollars	US\$ 1,050	(72)	US\$ 1,050	(291)
Cross currency swaps	US\$ 3,420	1,198	US\$ 2,250	794
Cross currency coupon swaps	US\$ 300	(260)		
Forwards dollar-peso	US\$ 3,160	(216)	US\$ 4,255	(790)
<b>Total</b>		<b>P. 691</b>		<b>P. (1,352)</b>

As part of its currency hedging strategy, during 2007 the Company entered into short-term exchange hedges which, at December 31, 2007, covered liabilities of P. 34,331,759 million (US\$ 3,160 million) (P. 48,015,203 or US\$ 4,255 million in 2006). In 2007, the Company recognized a charge of P. 578,926 (credit of P. 51,925 in 2006 and a charge of P. 7,701,067 in 2005) to results of operations for these hedges corresponding to changes in their fair value.

In 2007, the Company also entered into cross currency swaps that cover liabilities of P. 37,162,404 (US\$ 3,420 million) (P. 25,389,942 or US\$ 2,250 million in 2006). The Company recognized a credit of P. 93,087 (charge of P. 79,324 in 2006) to results of the operations for these swaps corresponding to changes in their fair value.

To offset its exposure to financial risks related to the variable-yield debt, the Company entered into interest-rate swaps. Under these contracts, the Company agreed to receive 28-day THIE and to pay a fixed rate. The difference between the market interest rate and the rates contracted under the swaps was recorded in results of operations.

At December 31, 2007, the Company had interest-rate swaps for a total base amount of P. 23,752,125 (nominal amount). The Company also had interest-rate swaps for a total base amount of P. 12,496,130 (US\$ 1,150 million), paying fixed rates and receiving a six-month LIBOR rate, and of P. 11,409,510 (US\$ 1,050 million) under which it pays a six-month LIBOR rate and receives a fixed rate.

At December 31, 2006, the Company had interest-rate swaps for a total base amount of P. 31,952,125 (nominal amount) and P. 11,848,640 (US\$ 1,050 million), paying fixed rates and receiving a six-month LIBOR rate, and of P. 11,848,640 (US\$ 1,050 million) under which it pays a six-month LIBOR rate and receives a fixed rate. During 2007, the Company also entered into cross currency coupon swaps that cover interest rate flows of P. 3,259,860 (US\$ 300 million). For the year ended December 31, 2007, the Company recognized a net expense for these swaps in comprehensive financing cost of P. 940,921 (P. 750,774 in 2006 and P. 200,225 in 2005). This amount includes a charge of P. 267,047 (P. 569,786 in 2006 and P. 315,043 in 2005), derived from the replacement of its Mexican peso-denominated interest rate swaps.

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**10. Deferred Credits**

Deferred credits consist of the following at December 31, 2007 and 2006:

	2007	2006
Advance billings	P. 1,288,148	P. 1,258,275
Advances from subscribers and others	33,341	30,208
<b>Total</b>	<b>P. 1,321,489</b>	<b>P. 1,288,483</b>

**11. Accounts Payable and Accrued Liabilities**

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

	December 31	
	2007	2006
Suppliers	P. 6,662,440	P. 5,572,279
Sundry creditors	3,151,513	3,457,427
Net settlement payables	12,436	14,589
Related parties	2,373,795	2,553,453
Interest payable	1,142,003	1,869,339
Accrual for other contractual employee benefits	1,151,700	1,131,334
Accrual for vacations	1,256,783	1,234,716
Other	1,201,811	2,884,505
	<b>P. 16,952,481</b>	<b>P. 18,717,642</b>

The activity in the main accruals for the years ended December 31, 2007, 2006 and 2005 is as follows:

**Accrual for other contractual employee benefits:**

	2007	2006	2005
Beginning balance at January 1	P. 1,131,334	P. 1,226,045	P. 1,106,526
Increase through charge to expenses	3,434,180	3,690,215	3,722,096
Payments	(3,371,492)	(3,738,313)	(3,563,953)
Monetary effect	(42,322)	(46,613)	(38,624)
<b>Ending balance at December 31</b>	<b>P. 1,151,700</b>	<b>P. 1,131,334</b>	<b>P. 1,226,045</b>

**Accrual for vacations:**

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Beginning balance at January 1	<b>P. 1,234,716</b>	P. 1,233,780	P. 1,255,125
Increase through charge to expenses	<b>2,690,063</b>	2,600,485	2,725,456
Payments	<b>(2,621,810)</b>	(2,550,372)	(2,705,986)
Monetary effect	<b>(46,186)</b>	(49,177)	(40,815)
Ending balance at December 31	<b>P. 1,256,783</b>	P. 1,234,716	P. 1,233,780

F-30

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**12. Foreign Currency Position and Transactions**

a) At December 31, 2007 and 2006, the Company had the following foreign-currency-denominated assets and liabilities:

		Foreign currency in millions			
		Exchange rate at		Exchange rate at	
	2007	December 31, 2007	2006	December 31, 2006	
<b>Assets:</b>					
U.S. dollars	<b>202</b>	<b>P. 10.87</b>	436	P. 10.88	
<b>Liabilities:</b>					
U.S. dollars	<b>7,028</b>	<b>10.87</b>	7,005	10.88	
Euro	<b>16</b>	<b>15.88</b>	17	14.32	

At June 23, 2008, exchange rates were as follows:

Currency	Exchange rate
U.S. dollars	<b>P. 10.3156</b>
Euro	15.9957

b) In the years ended December 31, 2007, 2006 and 2005, the Company had the following transactions denominated in foreign currencies. Currencies other than the U.S. dollar were translated to U.S. dollars using the average exchange rate for the year.

	(millions of dollars)		
	2007	2006	2005
Revenues	<b>US\$ 492</b>	US\$ 432	US\$ 312
Operating costs and expenses	<b>335</b>	262	131
Interest income	<b>4</b>	12	32
Interest expense	<b>393</b>	357	391

**13. Commitments and Contingencies****Commitments**

At December 31, 2007, TELMEX had non-cancelable commitments of P. 7,539,472 (P. 8,530,674 in 2006) for the purchase of equipment, including P. 1,837,743 (P. 2,581,909 in 2006) of non-cancelable commitments with related parties. Payments made under the related purchase agreements aggregated P. 5,482,022 in 2007, P. 4,533,443 in 2006 and P. 7,994,046 in 2005.

**Contingencies**

## Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

a) On December 4, 1997, the Federal Commission of Economic Competition (COFECO) issued a preliminary ruling declaring that Teléfonos de México, S.A.B. de C.V. exercises substantial power over what it referred to as five telecommunications markets. Teléfonos de México, S.A.B. de C.V. filed an appeal against such ruling and refuted the final ruling issued by COFECO on February 19, 1998. After several judicial instances and rulings, the plenary meeting of COFECO issued a ruling dated February 23, 2007, in which it revoked and ordered that the file be closed.

F-31

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

b) In December 1995, a competitor that provides cellular telephone services reported Teléfonos de México, S.A.B. de C.V. to COFECO for alleged monopolistic practices and undue concentration.

In July 2001, COFECO ruled that Teléfonos de México, S.A.B. de C.V. was responsible for monopolistic practices and undue concentration. Teléfonos de México, S.A.B. de C.V. filed an appeal for reconsideration against the ruling, but the appeal was declared unfounded and the ruling confirmed.

The respective defense against the confirmation of the ruling has been filed with the Federal Court of Justice for Tax and Administrative Matters.

c) On November 22, 2005, COFETEL issued a resolution in which it determined the guidelines that must be followed by Teléfonos de México, S.A.B. de C.V. in making changes to local service areas. Teléfonos de México, S.A.B. de C.V. filed a motion for review first with COFETEL and then with the Federal Court of Justice for Tax and Administrative Matters, which granted the Company a temporary reprieve against the ruling in dispute. This case is still open and the Company will continue to defend itself in the matter, since management's opinion is that the guidelines issued by the authority violate the law.

Also, since the Company was granted the temporary reprieve, all acts or processes arising from the resolution regarding the guidelines have been suspended (including the three resolutions through which COFETEL ordered the consolidation of local service areas) until the court issues a final ruling.

d) Between November 2007 and February 2008, COFECO initiated inquests of the Company's possible substantial power in the following five areas: (i) calling party pays and domestic calling party pays programs; (ii) termination of public switched traffic; (iii) sourcing of public switched traffic; (iv) local transit services; and (v) leasing of lines or circuits. There are also two ongoing investigations for alleged monopolistic practices regarding the broadband Internet access service market for domestic residential customers and in the fixed network interconnection services markets.

As a result of COFECO's ongoing investigations, Teléfonos de México, S.A.B. de C.V. could be deemed by the agency to exercise substantial power over these relevant markets and COFECO then might issue a statement of dominance. Consequently, through proceedings conducted with COFETEL, Teléfonos de México, S.A.B. de C.V. would receive specific instructions from COFECO regarding rates and the quality of services and information and, if applicable, the Company could be fined.

Notwithstanding the fact that the arguments of Teléfonos de México, S.A.B. de C.V. are considered to be well founded, the Company's in-house and external lawyers handling the above-mentioned cases consider that given the litigious nature of these matters, there is no certainty that the Company will receive favorable rulings.

e) 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, it was 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 restatements at July 2, 2003. Teléfonos de México, S.A.B. de C.V. filed an appeal with the Federal Court of Justice for Tax and Administrative Matters, and in accordance with Mexican law, by means of a bank trust the Company guaranteed payment of such tax liability through July 19, 2008. The Company's external lawyers who are handling this matter are of the opinion that although the Company's appeal is well founded, there is no guarantee that it will prevail.

f) In accordance with Mexican law, after the split-up, 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. for a three-year period beginning December 21, 2007, which is the date on which the stockholders approved the split-up. This responsibility, however, does not cover obligations with those creditors who have granted their express

authorization, relieving Teléfonos de México, S.A.B. de C.V. from these obligations and consenting to the split-up.

F-32

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**14. Related Parties**

a) In the years ended December 31, 2007, 2006 and 2005, the Company had the following transactions with related parties:

	2007	2006	2005
<b>Investment and expenses:</b>			
Purchase of materials, inventories and fixed assets (1)	<b>P. 3,928,422</b>	P. 5,609,050	P. 6,336,524
Payment of insurance premiums and fees for administrative and operating services, security trading and others (2)	<b>5,106,398</b>	5,212,642	5,453,912
Interconnection payments under the Calling Party Pays program and other telecommunication services (3)	<b>12,976,239</b>	9,344,380	10,106,924
Cost of termination of international calls (6)	<b>612,594</b>	313,015	30,437
<b>Revenues:</b>			
Sale of materials and other services (4)	<b>1,540,633</b>	1,490,002	1,769,688
Sale of long distance and other telecommunications services (5)	<b>5,844,988</b>	5,605,463	4,313,699
Revenue from termination of international calls (6)	<b>1,920,392</b>	1,244,983	34,977
Sale of 50% of Technology and Internet LLC			46,904

- (1) Includes P. 2,824,739 in 2007 (P. 4,451,279 in 2006 and P. 6,286,991 in 2005) for purchase of network construction services and 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, the company that controls Teléfonos de México, S.A.B. de C.V. Also includes P. 1,047,685 in 2007 (P. 825,353 in 2006 and P. 0 in 2005) for purchase of equipment for broadband platform services from 2Wire.
- (2) Includes P. 1,216,067 in 2007 (P. 1,346,539 in 2006 and P. 1,652,442 in 2005) for network maintenance services from subsidiaries of Carso Group P. 847,605 in 2007 (P. 786,060 in 2006 and P. 803,734 in 2005) for services received from subsidiaries of Impulsora del Desarrollo y el Empleo en América Latina, S.A.B. de C.V. (IDEAL); P. 1,450,330 in 2007 (P. 1,528,820 in 2006 and P. 1,382,200 in 2005) for the preparation and distribution of telephone directories of white pages and advertising in yellow pages paid to the subsidiaries of Telmex Internacional; P. 431,074 in 2007 (P. 458,097 in 2006 and P. 383,646 in 2005) for insurance premiums paid to Seguros Inbursa, S.A. (Seguros), which, in turn, places most of this amount in reinsurance with third parties; P. 93,162 in 2007 (P. 66,305 in 2006 and P. 135,855 in 2005) for security trading fees paid to Inversora Bursátil, S.A. (Inversora) and P. 571,544 in 2007 (P. 441,265 in 2006 and P. 499,707 in 2005) for fees paid for administrative and operating services to technology partners (AT&T and Carso Global Telecom). Carso Group, IDEAL, Telmex Internacional, Seguros and Inversora are entities under common control with Carso Global Telecom.
- (3) Includes P. 12,810,940 (P. 9,255,932 in 2006 and P. 9,990,486 in 2005) for interconnection expenses under the Calling Party Pays program derived from outgoing calls from a fixed lined telephone to a cellular telephone paid to subsidiaries of América Móvil, S.A.B. de C.V. (América Móvil). América Móvil is an entity under common control with Carso Global Telecom.
- (4) Includes P. 253,095 in 2007 (P. 358,402 in 2006 and P. 456,426 in 2005) for the sale of materials and other services rendered to subsidiaries of Carso Group; P. 335,480 in 2007 (P. 289,847 in 2006 and P. 239,196 in 2005) for billing and collection services rendered to



## Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

a subsidiary of Grupo Financiero Inbursa; P. 363,529 in 2007 (P. 357,028 in 2006 and P. 348,783 in 2005) for billing and collection services rendered to subsidiaries of Telmex Internacional and P. 439,660 (P. 345,756 in 2006 and P. 412,438 in 2005) for property leases and other services rendered to subsidiaries of América Móvil.

- (5) Includes P. 4,662,247 in 2007 (P. 4,396,648 in 2006 and P. 4,245,589 in 2005) for revenues invoiced to a subsidiary of América Móvil for the rental of circuits and long distance services.
- (6) Includes costs and revenues with the companies of AT&T, as well as with the subsidiaries of América Móvil and Telmex Internacional.

F-33

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

b) At December 31, 2007, TELMEX had net amounts payable to a subsidiary of the Carso Group and a subsidiary of América Móvil of P. 257,610 and P. 1,247,415, respectively, (P. 434,915 and P. 1,147,363, respectively, in 2006). At December 31, 2007, the Company also had net amounts receivable from certain AT&T companies of P. 235,284 (P. 329,246 in 2006) and a subsidiary of América Móvil of P. 212,647.

c) The companies mentioned in this note are considered to be related parties, since the Company's main stockholders are also, directly or indirectly, stockholders in such companies. Carso Global Telecom holds the majority of the Company's voting shares. AT&T is a noncontrolling stockholder of the Company.

d) An analysis of employee benefits granted to the Company's key managers or relevant directors is as follows:

	2007	2006	2005
Short- and long-term direct benefits	P. 57,421	P. 56,504	P. 55,853
Post-retirement benefits	2,536	2,403	2,166
<b>Total</b>	<b>P. 59,957</b>	<b>P. 58,907</b>	<b>P. 58,019</b>

**15. Stockholders' Equity**

a) At an extraordinary meeting held on December 5, 2006, based on the requirements of the Securities Market Law in force, the stockholders approved amendments to the Company's bylaws, primarily to modify the integration, organization and functioning of its corporate bodies. In this regard, several resolutions derived from the approved changes were adopted and are related to: i) the exchange of certain series of shares that in due time must be carried out; ii) changes to the corporate powers previously conferred on the stockholders; iii) the functioning of the Board of Directors, the Corporate Practices Committee and the Audit Committee under their current structures; iv) the appointment and ratification of the President of the Corporate Practices Committee and of the President of the Audit Committee; and v) the revocation of the appointments of the Statutory Auditor and the Alternate Statutory Auditor. Also, in accordance with the provisions of the Securities Market Law, the stockholders resolved to modify the relevant clause in the Company's bylaws to change its business name to Teléfonos de México, Sociedad Anónima Bursátil de Capital Variable (or its abbreviation, S.A.B. de C.V.).

As mentioned in Note 2, at an extraordinary meeting held on December 21, 2007, the stockholders of TELMEX approved the split-up of the Latin American subsidiary entities, as well as the Company's yellow pages business. After the split-up took effect and TELMEX made the contribution to Telmex Internacional, the capital stock of TELMEX was represented by the same number of shares in the three series, with no change in the number of shares that represent capital.

At an extraordinary stockholders' meeting held on April 28, 2005, the stockholders approved the restructuring of the number of outstanding Series AA, A and L shares, through a two-for-one stock split (two new shares for each prior outstanding share) as of May 25, 2005.

All figures related to the number of shares included in the accompanying financial statements and in these notes consider the aforementioned stock split, regardless of whether such figures refer to dates prior to the date of the split.

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

b) At December 31, 2007, capital stock was represented by 19,360 million outstanding shares with no par value, representing the Company's fixed capital (20,203 million in 2006). An analysis is as follows:

	2007	2006
8,115 million Series AA shares	<b>P. 5,569,721</b>	P. 16,125,189
430 million Series A shares (446 in 2006)	<b>345,936</b>	1,038,553
10,815 million Series L shares with limited voting rights (11,642 in 2006)	<b>3,486,904</b>	10,847,592
<b>Total</b>	<b>P. 9,402,561</b>	P. 28,011,334

The Company's historical capital stock at December 31, 2007 and 2006 was P. 83,590 and P. 252,539, respectively.

An analysis of changes in 2007, 2006 and 2005 is as follows:

	Series AA		Capital stock (1) Series A		Series L	
	Number	Amount	Number	Amount	Number	Amount
Balances at January 1, 2005	8,127	P. 16,149,509	504	P. 1,174,698	15,034	P. 13,913,902
Repurchase of Company's own shares in cash			(6)	(14,439)	(1,614)	(1,495,232)
Conversion of AA shares to L shares	(12)	(24,320)			12	24,320
Conversion of A shares to L shares			(19)	(43,823)	19	43,823
<b>Balances At December 31, 2005</b>	<b>8,115</b>	<b>16,125,189</b>	<b>479</b>	<b>1,116,436</b>	<b>13,451</b>	<b>12,486,813</b>
Repurchase of company's own shares in cash			(4)	(9,158)	(1,838)	(1,707,946)
Conversion of A shares to L shares			(29)	(68,725)	29	68,725
<b>Balance At December 31, 2006</b>	<b>8,115</b>	<b>16,125,189</b>	<b>446</b>	<b>1,038,553</b>	<b>11,642</b>	<b>10,847,592</b>
<b>Repurchase of Company's own shares in cash</b>			<b>(3)</b>	<b>(6,423)</b>	<b>(840)</b>	<b>(773,787)</b>
<b>Conversion of A shares to L shares</b>			<b>(13)</b>	<b>(30,395)</b>	<b>13</b>	<b>30,395</b>
<b>Reduction due to the split-up Telmex Internacional</b>		<b>(10,555,468)</b>		<b>(655,799)</b>		<b>(6,617,296)</b>
<b>Balance at December 31, 2007</b>	<b>8,115</b>	<b>P. 5,569,721</b>	<b>430</b>	<b>P. 345,936</b>	<b>10,815</b>	<b>P. 3,486,904</b>

(1) Number of shares in millions.

Series AA shares, which may be subscribed only by Mexican individuals and corporate entities, must represent at all times no less than 20% of capital stock and no less than 51% of the combined number of Series AA shares and A shares. Series A shares, which may be freely subscribed, must account for no more than 19.6% of capital stock and no more than 49% of the combined number of Series AA shares and A shares. Series AA and A shares combined may not represent more than 51% of capital stock. The combined number of Series L shares, which have limited voting rights and may be freely subscribed, and Series A shares may not exceed 80% of capital stock.

**Voting rights**

Each Series AA and A share entitles the holder to one vote at general stockholders meetings. Each series L share entitles the holder to one vote at any stockholders meeting in which Series L holders are authorized to vote. According to clause 8 of the bylaws, Series L shares will only have the right to vote to designate two directors to the board of directors and their corresponding alternate directors, and on the following matters:

The transformation of the corporation from one type of company to another;

F-35

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

Any merger in which the corporation is not the surviving entity or any merger with an entity whose principal corporate purposes are different from those of the corporation (when the corporation is the surviving entity); and

Cancellation of the registration of the shares issued by the Company on the Mexican National Registry of Securities and on any foreign stock exchange on which they are registered.

Resolutions adopted in extraordinary stockholders meetings related to any of the matters on which the Series L shares are entitled to vote will also be required to receive a majority vote of Series AA and Series A shareholders in order to be valid.

Under Mexican law, holders of any Series of shares are also entitled to vote as one class on any proposal that could adversely affect the rights of the holders of that particular series and 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. Determining whether a proposal requires the vote 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 proposal. 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.

c) In 1994, the Company initiated a program to purchase its own shares. A charge is made to retained earnings for the excess cost of the shares purchased over the percentage of capital stock represented by the shares acquired.

At a regular meeting held on April 27, 2007, the stockholders approved an increase of P. 15,000,000 (historical), in the total authorized historical amount to be used by the Company to acquire its own shares, bringing the total maximum amount to be used for this purpose to P. 23,046,597 (historical).

In 2007, the Company acquired 839.9 million Series L shares for P. 15,729,975 (historical cost of P. 15,423,889) and 2.8 million Series A shares for P. 52,864 (historical cost of P. 51,902).

In 2006, the Company acquired 1,838.0 million Series L shares for P. 24,629,704 (historical cost of P. 23,092,355) and 3.9 million Series A shares for P. 54,082 (historical cost of P. 50,682).

In 2005, the Company acquired 1,614.0 million Series L shares for P. 18,854,604 (historical cost of P. 17,172,604) and 6.2 million Series A shares for P. 72,367 (historical cost of P. 65,761).

At December 31, 2007, 2006 and 2005, the Company had 12,872 (12,840 Series L and 32 Series A shares), 12,029 (12,000 Series L and 29 Series A shares) and 10,187 (10,162 Series L and 25 Series A shares) million treasury shares, respectively.

d) In conformity with the Mexican Corporations Act, at least 5% of net income for 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.

e) At December 31, 2007, the caption Other accumulated comprehensive income includes the deficit from the re-expression of stockholders equity, the effect of fair value of swaps, net of deferred taxes, and the effect of translation of foreign entities of P. (78,719,991), P. 535,119 and P. (637,979), respectively (P. (83,869,501), P. 36,030 and P. 19,107,604, respectively in 2006).



**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**16. Income Tax, Asset Tax, Flat Rate Business Tax and Employee Profit Sharing**

a) The Ministry of Finance and Public Credit authorized Teléfonos de México, S.A.B. de C.V. to consolidate the group tax returns effective January 1, 1995. Instituto Tecnológico de Teléfonos de México, S.C., the Mexican subsidiaries acquired during the year and the foreign subsidiaries are excluded from this tax consolidation.

On November 1, 2004, the Ministry of Finance and Public Credit authorized the transfer of the tax consolidation of Teléfonos de México, S.A.B. de C.V. to that of Carso Global Telecom (controlling company of TELMEX), starting in 2005 and in conformity with the Mexican Income Tax Law. However, such transfer does not result in the tax deconsolidation of Teléfonos de México, S.A.B. de C.V. or its subsidiaries, or in their ceasing to consolidate for tax purposes.

b) As of January 1, 2007, asset tax rate is payable at 1.25% of the average value of most assets. Through December 31, 2006, asset tax was payable at the 1.8% rate on the average value of most assets net of certain liabilities. Asset tax for the years ended December 31, 2007, 2006 and 2005 was P. 1,838,181, P. 725,658 and P. 584,799, respectively. Such amounts were remitted through the crediting of income tax paid in both years.

c) The Flat Rate Business Tax Law (FRBT) was published on October 1, 2007. This Law came into force as of January 1, 2008 and abolished the Asset Tax Law.

Current-year FRBT is computed by applying the 17.5% (16.5% in 2008 and 17% in 2009) rate to income determined on the basis of cash flows, net of authorized credits.

When a negative FRBT base is determined because deductions exceed taxable income, there will be no FRBT payable. The amount of the negative base multiplied by the FRBT rate results in an FRBT credit, which may be applied against income tax for the same year or, if applicable, against FRBT of the subsequent ten periods.

FRBT credits result mainly from the unamortized negative FRBT base, salary credits and social security contributions, as well as credits resulting from the deduction of certain investments, such as inventories and fixed assets, during the transition period starting on the date on which the FRBT became effective.

FRBT shall be payable only to the extent it exceeds income tax for the same period. In other words, to determine FRBT payable, income tax paid in a given period shall first be subtracted from the FRBT of the same period and the difference shall be the FRBT payable.

Based on tax result projections, the Company considers that it will not be subject to the payment of FRBT in the following years.

d) An analysis of income tax provisions is as follows:

	2007	2006	2005
Current year income tax	P. 10,411,963	P. 12,522,159	P. 13,957,410
Deferred tax, net of related monetary position gain of P. 744,406 (P. 766,101 in 2006 and P. 629,287 in 2005)	1,206,747	(333,124)	(2,752,652)

Total	<b>P. 11,618,710</b>	P. 12,189,035	P. 11,204,758
-------	----------------------	---------------	---------------

F-37



**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

On December 1, 2004, an annual gradual decrease in the 33% corporate income tax rate was approved to 30% in 2005, 29% in 2006 and 28% in 2007 and succeeding years. A reconciliation of the statutory corporate income tax rate to the effective rate recognized for financial reporting purposes is as follows:

	2007 %	2006 %	2005 %
Statutory income tax rate	28.0	29.0	30.0
Depreciation		(2.2)	(0.6)
Financial cost	0.3	0.1	(0.2)
Employee profit sharing	0.1	0.1	0.2
Social security benefits	1.1	1.1	1.1
Other	(0.8)	2.4	(1.4)
<b>Effective income tax rate</b>	<b>28.7</b>	<b>30.5</b>	<b>29.1</b>

At December 31, 2007 and 2006, the Company recognized temporary items that gave rise to deferred taxes as follows:

	2007	2006
<b>Deferred tax assets:</b>		
Allowance for bad debts and slow-moving inventories	P. 495,246	P. 518,935
Tax loss carry forwards	6,851	81,460
Advance billings	416,980	355,169
Accrued liabilities	963,942	852,986
Employee profit sharing	786,677	835,204
Financial instruments		63,156
	<b>2,669,696</b>	<b>2,706,910</b>
<b>Deferred tax liabilities:</b>		
Fixed assets	(15,777,011)	(13,052,049)
Inventories	(97,529)	(193,903)
Licenses	(113,219)	(124,416)
Pensions	(4,325,241)	(5,546,093)
Prepaid expenses	(302,572)	(390,772)
Financial instruments	(371,166)	
	<b>(20,986,738)</b>	<b>(19,307,233)</b>
<b>Net deferred tax liability</b>	<b>P. (18,317,042)</b>	<b>P. (16,600,323)</b>

## Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

e) The Company is subject to payment of employee profit sharing (in Mexico) in addition to its contractual compensation and benefits. In 2007, 2006 and 2005, employee profit sharing was computed applying a 10% rate to taxable income, excluding the inflationary component and the restatement of depreciation expense.

The Company recognizes deferred employee profit sharing for the year, since as of 2006, companies are permitted to deduct employee profit sharing from the income tax base at the time employees are paid.

f) At December 31, 2007, the balance of the restated contributed capital account (CUCA) and the net tax profit account (CUFIN) was P. 10,526,355 and P. 19,303,767, respectively. These amounts correspond to Teléfonos de México, S.A.B. de C.V. on an individual basis.

F-38

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**17. Segments**

Subsequent to the split-up mentioned in Note 2, TELMEX primarily operates in two segments: local and long distance telephone service. Local telephone service corresponds to fixed-line local service. Long distance service corresponds to domestic and international service. Other segments include long distance calls made from public and rural telephones, corporate networks, Internet 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 as if the Company had operated in these segments:

(In millions of Mexican pesos with purchasing power at December 31, 2007)

	Local service	Long distance	Other segments	Adjustments	Consolidated total
<b>December 31, 2007</b>					
<b>Revenues:</b>					
External revenues	P. 76,151	P. 31,032	P. 23,585		P. 130,768
Intersegment revenues	10,438		1,096	P. (11,534)	
Depreciation and amortization	11,901	2,331	4,193		18,425
Operating income	23,233	8,695	11,956		43,884
Segment assets	283,463	53,766	54,852		392,081
<b>December 31, 2006</b>					
<b>Revenues:</b>					
External revenues	P. 78,824	P. 27,522	P. 23,409		P. 129,755
Intersegment revenues	10,551		1,210	P. (11,761)	
Depreciation and amortization	12,424	2,471	3,816		18,711
Operating income	25,078	8,875	12,311		46,264
Segment assets	276,796	54,108	51,358		382,262
<b>December 31, 2005</b>					
<b>Revenues:</b>					
External revenues	P. 82,259	P. 27,224	P. 21,966		P. 131,449
Intersegment revenues	10,577		1,246	P. (11,823)	
Depreciation and amortization	13,594	2,788	3,932		20,314
Operating income	26,343	8,980	10,915		46,238
Segment assets	268,840	54,009	48,677		371,526

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

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**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 ).

The Mexican FRS consolidated financial statements include the effect of inflation as provided for under Bulletin B-10. The discontinued operations include the effect of inflation as provided for under Bulletin B-15. The reconciliation to U.S. GAAP includes a reconciling item for the reversal of the effect of applying Bulletin B-15 for the re-expression into constant pesos as of December 31, 2007 for the years ended December 31, 2006 and 2005, because the application of such provisions is equivalent to not presenting our comparative financial statements in the same currency for all periods presented, as required by Securities and Exchange Commission (SEC) rules.

The Mexican and U.S. GAAP 2006 and 2005 amounts, included throughout Note 18, are presented in constant Mexican pesos by using the 1.0376 and 1.0796 Mexican inflation factors, respectively.

The reconciliation to U.S. GAAP does not include the reversal of the adjustments to the financial statements for the effects of inflation required under Mexican FRS (Bulletin B-10), because the application of Bulletin B-10 represents a comprehensive measure of the effects of price level changes in the Mexican economy as permitted by the SEC.

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:***

Under Mexican FRS, the Company presents consolidated statements of changes in financial position, as described in Note 1. The changes in the consolidated financial statement balances included in this statement constitute resources provided by and used in operating, financing and investing activities stated in constant pesos (including monetary and foreign exchange gains and losses).

Statement of Financial Accounting Standards No. 95 ( SFAS 95 ), *Statement of Cash Flows*, does not provide guidance with respect to inflation adjusted financial statements. In accordance with Mexican FRS, the changes in current and long-term debt due to re-expression into constant pesos, including the effect of exchange differences, is presented in the statement of changes in financial position in the financing activities section. Also, under U.S. GAAP non-cash investing activities are not reported in the statement of cash flows; whereas under Mexican FRS non-cash transactions that affect the financial structure of an entity must be presented separately in the statement of changes in financial position. In addition, cash flows related to discontinued operation are presented in various categories whereas under Mexican FRS they are presented as a net item.

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

If the monetary gain and the exchange gain or loss related to the debt, were treated as components of operating activities, summarized consolidated statements of cash flows derived from information prepared in accordance with U.S. GAAP would be as follows:

	Year ended December 31,		
	2007	2006	2005
<b>Cash flows from operating activities:</b>			
Net income under U.S.GAAP	<b>P. 35,375,221</b>	P. 28,638,041	P. 29,221,391
Income from discontinued operations under U.S. GAAP	<b>6,390,179</b>	1,556,165	3,026,366
Income from continuing operations under U.S. GAAP	<b>28,985,042</b>	27,081,876	26,195,025
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
Depreciation	<b>19,759,421</b>	20,712,706	22,899,092
Amortization	<b>134,492</b>	108,285	105,829
Amortization of deferred charges	<b>949,862</b>	230,960	331,654
Effect of exchange rate differences on debt	<b>234,465</b>	786,986	(4,685,420)
Monetary gain, net	<b>(3,056,539)</b>	(3,437,039)	(2,699,192)
Deferred taxes	<b>956,606</b>	(605,533)	(3,119,977)
Equity interest in net (income) loss of affiliates	<b>(17,245)</b>	(8,723)	19,992
Noncontrolling interest	<b>(189)</b>	5,284	26,570
Net periodic cost of labor obligations	<b>3,716,277</b>	4,128,142	3,799,480
Marketable securities	<b>2,151,503</b>	(2,989,468)	(83,186)
Change in operating assets and liabilities	<b>(4,920,703)</b>	(448,675)	(4,195,088)
<b>Total adjustments</b>	<b>19,907,950</b>	18,482,925	12,399,754
<b>Net cash provided by operating activities of continuing operations</b>	<b>48,892,992</b>	45,564,801	38,594,779
<b>Cash flows from investing activities:</b>			
Investment in plant, property and equipment and inventories	<b>(13,439,657)</b>	(13,736,911)	(15,136,587)
Instruments available for sale			8,018,490
Net cash contributed to split-up subsidiary	<b>(14,077,287)</b>	(10,337,966)	(5,845,282)
Investment in affiliated companies		(696,260)	104,107
Sale of affiliated company			46,904
Other investments	<b>(239,005)</b>	(33,870)	(320,292)
<b>Net cash used in investing activities of continuing operations</b>	<b>(27,755,949)</b>	(24,805,007)	(13,132,660)
<b>Cash flows from financing activities:</b>			
New loans	<b>14,930,842</b>	17,182,460	22,811,451
Repayment of loans	<b>(10,750,844)</b>	(14,152,806)	(9,708,577)
Repurchase of Company's own shares and cash dividends paid	<b>(24,602,913)</b>	(33,529,957)	(28,164,348)
<b>Net cash used in financing activities of continuing operations</b>	<b>(20,422,915)</b>	(30,500,303)	(15,061,474)

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

Effect of inflation accounting on cash and cash equivalents	(789,336)	(710,730)	(910,872)
Net changes in cash and cash equivalents of discontinued operations	(5,992,792)	1,046,774	(3,794,875)
Net (decrease) increase in cash and cash equivalents	(6,068,000)	(9,404,465)	5,694,898
Cash and cash equivalents at beginning of year	10,765,752	20,170,217	14,475,319
Cash and cash equivalents at end of year	P. 4,697,752	P. 10,765,752	P. 20,170,217

Supplemental disclosure of cash flow information:

Interest paid	P. 6,438,212	P. 4,737,728	P. 5,148,692
Income tax paid	10,501,615	11,052,117	14,205,942
Employee profit sharing paid	2,954,488	2,946,413	3,011,485

Cash flows from purchases of trading securities during 2006 were P.2,956,819 and cash flows from sales of trading securities during 2007 were P.2,232,020 (P. 101,428 and P. 5,861 in 2006 and 2005, respectively).

F-41

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

***Capitalized interest:***

Under U.S. GAAP, interest on borrowings in foreign currencies or comprehensive cost of financing 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 comprehensive cost of financing for U.S. GAAP purposes was determined by applying the weighted average rate of interest of financing.

Under Mexican FRS in force through December 31, 2006, the Company did not capitalize the comprehensive cost of financing in its Mexican FRS financial statements. Starting January 1, 2007, although the Company adopted the policy of capitalizing the comprehensive result of financing on assets under construction, as a result of Mexican FRS D-6, the Company did not capitalize any comprehensive result of financing as described in Note 1.

The reconciling items for 2007, 2006 and 2005 show the capitalization of interest as required under U.S. GAAP.

***Valuation of inventories and plant, property and equipment:***

As previously discussed in Note 1.II.i, the re-expression of plant property and equipment is 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 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, plant, property and equipment and stockholders' equity increased by P. 2,806,415 (P. 3,890,586 in 2006), and the depreciation expense for 2007 increased by P. 1,127,069 (P. 1,632,733 and P. 2,078,805 in 2006 and 2005, respectively).

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

As mentioned in Note 1.II.q, under Mexican FRS, deferred income tax is determined on all temporary 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 Statement of Financial Accounting Standards No. 109 ( SFAS 109 ), *Accounting for income taxes*.

The Company is required to pay employee profit sharing in accordance with Mexican labor law. Deferred employee profit sharing under U.S. GAAP has been determined following the guidelines of SFAS 109, while under Mexican FRS, the deferred consequences of employee profit sharing are determined on temporary differences considered non-recurring with a known turnaround time.

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.

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

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

2005	P. 367,325
2006	272,409
<b>2007</b>	<b>250,141</b>

The effect of deferred income tax and deferred employee profit sharing on the difference between the indexed cost and the specific indexation factor valuation of fixed assets and inventories, primarily for operation of the telephone plant is applied as an adjustment to stockholders' equity. The related accumulated amounts at December 31, 2007 and 2006 that decreased equity were P. (907,244) and P. (1,048,651), respectively.

The yearly changes in the accumulated amount for deferred taxes applied to equity as a result of this effect from 2005 through 2007 are the following:

2005	P. (708,403)
2006	373,264
<b>2007</b>	<b>141,407</b>

In 2007, 2006 and 2005, monetary gains of P. 15,064, P. 16,955 and P. 19,074, respectively, on the deferred taxes balance related to the difference between the indexed cost and specific indexation cost valuation of fixed assets and inventories, primarily for operation of the telephone plant, were taken to equity, as part of the change of the year.



**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

Significant components of deferred taxes under U.S. GAAP at December 31, 2007 and 2006 are as follows:

	2007			2006		
	Income tax	Employee profit sharing	Deferred taxes	Income tax	Employee profit sharing	Deferred Taxes
Deferred tax assets:						
Allowances for bad debts and slow-moving inventories	P. 495,246	P. 160,139	P. 655,385	P. 518,935	P. 165,985	P. 684,920
Tax loss carry forwards	6,851		6,851	81,460		81,460
Advance billings	416,980	127,396	544,376	348,823	122,410	471,233
Accrued liabilities	963,942	330,739	1,294,681	859,329	306,131	1,165,460
Employee profit sharing	2,535,721		2,535,721	2,501,532		2,501,532
Pensions	254,798	268,240	523,038			
Derivatives				33,072	1,911	34,983
<b>Total deferred tax assets</b>	<b>4,673,538</b>	<b>886,514</b>	<b>5,560,052</b>	<b>4,343,151</b>	<b>596,437</b>	<b>4,939,588</b>
Deferred tax liabilities:						
Fixed assets	(16,443,517)	(4,755,824)	(21,199,341)	(14,045,733)	(5,091,733)	(19,137,466)
Inventories	(113,587)	(66,965)	(180,552)	(209,840)	(105,950)	(315,790)
Capitalized interest or net financing cost	(386,577)	(138,063)	(524,640)	(482,193)	(172,213)	(654,406)
Licenses	(113,219)	(43,712)	(156,931)	(124,416)	(69,379)	(193,795)
Pensions				(2,231,894)	(797,105)	(3,028,999)
Prepaid expenses	(302,572)	(101,698)	(404,270)	(390,772)	(130,103)	(520,875)
Financial instruments	(370,973)	(123,862)	(494,835)			
Exchange gain on debt		(129,773)	(129,773)		(181,124)	(181,124)
<b>Total deferred tax liabilities</b>	<b>(17,730,445)</b>	<b>(5,359,897)</b>	<b>(23,090,342)</b>	<b>(17,484,848)</b>	<b>(6,547,607)</b>	<b>(24,032,455)</b>
<b>Net deferred tax liabilities</b>	<b>P. (13,056,907)</b>	<b>P. (4,473,383)</b>	<b>P. (17,530,290)</b>	<b>P. (13,141,697)</b>	<b>P. (5,951,170)</b>	<b>P. (19,092,867)</b>

For Mexican FRS purposes, as earlier discussed in Note 16, the deferred income tax liabilities recognized for the Mexican operations amounted to P.18,317,042 and P.16,600,323 at December 31, 2007 and 2006, respectively.

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, are 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.

## Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

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.

### *Income taxes on unremitted foreign earnings*

TELMEX does not provide taxes on unremitted foreign earnings because it considers them to be permanently invested. In the event that that 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.

F-44

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**Employee benefit obligation:**

In 2007, 2006 and 2005, pension and seniority premium plans expense under U.S. GAAP totaled P. 3,724,963, P. 4,128,142 and P. 3,799,480, respectively. The components of these employee benefit obligations calculated in accordance with the provisions of Statement of Financial Accounting Standards No. 87 ( SFAS No. 87 ), *Employers Accounting for Pensions*, consist of the following:

	2007	December 31, 2006	2005
Labor cost	P. 3,672,437	P. 3,327,889	P. 3,100,403
Financial cost on projected benefit obligation	9,013,577	8,019,378	7,048,461
Expected return on plan assets	(9,585,397)	(8,320,936)	(7,428,878)
Amortization of unrecognized net transition obligation and prior service cost	624,346	624,349	624,326
Amortization of unrecognized losses		477,462	455,168
Net periodic cost under U.S. GAAP	3,724,963	4,128,142	3,799,480
Net periodic cost under Mexican FRS	4,495,766	4,760,925	4,760,134
Cost reduction under U.S. GAAP	P. (770,803)	P. (632,783)	P. (960,654)

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 US 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 12 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 8.

**Plan assets:**

The weighted-average asset actual allocation of plan assets by asset category is as follows:

	Percentage of plan assets at December 31,	
	2007	2006
Debt securities:		
Mexican Government	43.9%	36.6%
Mexican private companies	9.9%	7.0%
Equity securities:		
Mexican companies	43.5%	51.5%

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

U.S. companies	2.7%	4.9%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>

F-45

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

The asset allocation of plan assets at December 31, 2007 and 2006 and the target allocation for 2008 by asset category are as follows:

	Target allocation		
	2008	2007	2006
Fixed-income securities	50-60%	53.8%	43.6%
Variable-income securities	40-50%	46.2%	56.4%

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, 2007, securities held by the plan included 330.0 million shares of TELMEX (402.7 million shares in 2006) and 1,622.2 million shares of related parties (1,139.1 million shares in 2006), with a fair value of P. 6,658,724 (P. 6,401,580 in 2006) and P. 62,338,004 (P. 48,634,548 in 2006), respectively. In 2007, the plan purchased 955.4 million shares of related parties (21.9 million shares in 2006) and sold 472.3 million shares of related parties (434.7 million shares in 2006). In 2007, the plan purchased 1.1 million shares of TELMEX and sold 73.8 million shares of TELMEX. (9.7 million shares in 2006). Dividends received by the plan in 2007 were P. 1,187,117 (P. 528,979 in 2006).

As of December 31, 2007, securities held by the plan also included P. 399,105 (notional amount) of TELMEX debt securities (P. 514,597 in 2006) and P. 12,018,279 (notional amount) of related parties' debt securities (P. 15,919,070 in 2006), with a fair value of P. 400,416 and P. 12,057,512, respectively (P. 517,964 and P. 15,990,898, respectively in 2006). In 2007, the plan purchased P. 256,453,937 (P. 128,090,532 in 2006) and sold P. 260,563,449 (P. 113,614,931 in 2006) of related parties' debt securities, and purchased P. 54,550,809 (P. 470,728 in 2006) and sold P. 54,670,290 in 2007 of TELMEX debt securities; interest income recognized by the plan in 2007 was P. 17,322 (P. 21,432 in 2006) on TELMEX securities and P. 83,836 (P. 106,883 in 2006) on related parties securities.

Expected cash flows for pension benefits plan and seniority premiums are as follows:

Expected contributions to trust fund:	
2007	P. 4,862,247
Expected benefit payments:	
2007	P. 6,450,521
2008	6,754,890
2009	7,094,754
2010	7,597,706
2011	8,182,248
2012-2016	50,086,060
Total	P. 86,166,179



---

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

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).

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 real short-term interest rates for the last 20 years in Mexico. Before 1984, debt securities yielded negative interest rates in real terms and for that reason the Company decided not to go beyond twenty years of historical interest rates, with the purpose to adopt the current Mexican monetary policy. As part of the policy's criteria, interest rates used in the projection are those available at the end of the last year.

The unrecognized net transition obligation under SFAS No. 87 of P. 7,074 924 at January 1, 1997, is being amortized over the average future working lifetime of the employee group, which has been determined to be 12 years, being 2008 the last year of the amortizing period. The portion of the unrecognized net (loss) gain that exceeds 10% of the greater of projected benefit obligation or plan assets will also be recognized over 12 years.

In 1995, consistent with the deferral of the unrecognized net (loss) gain, TELMEX included in income of such year an amount of P. 828,628 as monetary gain on the unfunded liability and deferred P. 4,362,666, which represented the difference between the amount credited to income and the full monetary gain on the unfunded liability. For 1996, the Company did not defer the monetary gain for such year, as the rates used in the actuarial study were similar to actual inflation for 1996, and amortized P. 228,411 of the monetary gain deferred in 1995. The monetary gain deferred in 1995 was being amortized in 12 years. In 2007, 2006 and 2005, the Company amortized P. 375,845 each year, on the monetary gain deferred in 1995. At December 31, 2007, the balance pending of amortization was P. 0 (P. 375,839 in 2006).

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**SFAS 158 Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R):**

SFAS 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements no. 87, 88, 106 and 132(R)* 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 other comprehensive income in the year the changes occur.

The requirement to recognize the funded status of a defined benefit plan and the disclosure requirements were effective for fiscal years ending after December 15, 2006.

The impact of adoption of SFAS 158 resulted in the following:

	Prior to adopting SFAS 158	Effect of adopting SFAS 158	As reported at December 31, 2006
Net prepaid benefit obligation	P. 18,727,983	P. (10,516,659)	P. 8,211,324
Deferred income tax liability	(4,719,452)	2,650,198	(2,069,254)
Deferred employee profit sharing liability	(1,872,798)	1,051,666	(821,132)
Other	(12,135,733)		(12,135,733)
Decrease in stockholders' equity, net of deferred taxes		6,814,795	6,814,795

Additionally, the statement of changes in stockholders' equity includes an increase of P. 587,353, net of deferred taxes, from discontinued operations.

The components of the plan funded status that are reflected in the consolidated statement of financial position as of December 31, 2007 and 2006 are as follows:

	2007	2006
Fair value of plan assets	P. 156,979,097	P. 143,585,989
Projected benefit obligation	159,484,041	135,374,665
(Under) over funded status	P. (2,504,944)	P. 8,211,324

Amounts recognized in other accumulated comprehensive income consist of the following:

	2007	2006
Unrecognized actuarial loss	P. 16,942,095	P. 9,102,373



Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

Unrecognized net transition obligation at the date of initial application	<b>589,587</b>	1,179,164
Unrecognized prior service cost and changes in the plan	<b>200,354</b>	235,123
Total	<b>P. 17,732,036</b>	P. 10,516,660

Under Mexican FRS labor obligations are accounted for under rules similar to SFAS 87, 88 and 112, (other than assumption use during its first application) prior to its amendment by SFAS 158, thereby constituting a difference with U.S. GAAP.

F-48

---

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

***Effects of inflation accounting on U.S. GAAP adjustments:***

To determine the net effect on the consolidated financial statements of recognizing the U.S. GAAP adjustments described throughout this Note, it is also necessary to recognize the effects of inflation on such adjustments as described in Note 1. These effects are taken into consideration in the preparation of U.S. GAAP reconciliations of net income and stockholders' equity.

However, we have reversed the re-expression of the financial information for prior periods, as related to discontinued operations, into constant pesos at December 31, 2007, using the weighted average inflation factors of 1.02596 for 2006 and 1.4277 for 2005 (Note 1 II b), and re-expressed such prior periods into constant pesos at December 31, 2007 using the Mexican-only inflation factors of 1.0376 for 2006 and 1.0796 for 2005, in order to present our financial statements in the same reporting currency for all periods included in this Note.

***Disclosure about fair value of financial instruments:***

In accordance with Statement of Financial Accounting Standards No. 107 ( SFAS 107 ), *Disclosures about fair value of financial instruments*, 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 short-term investments, accounts receivable and accounts payable and accrued liabilities approximate fair values due to the short maturity of these instruments.

The fair value of total debt, excluding capital leases, 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, 2007 and 2006. As of December 31, 2007, the carrying value of total debt is P. 91,462,114 (P. 90,417,049 at December 31, 2006) and the fair value is P. 91,391,969 (P. 89,950,034 at December 31, 2006).

***Reporting comprehensive income:***

Cumulative effects of the deficit from re-expression of stockholders' equity, deferred taxes on the difference between indexed cost and specific indexation factor valuation, effect of SFAS 158, net of deferred taxes, effect of translation of foreign entities and effect of market value of swaps, net of deferred taxes, as adjusted for U.S. GAAP purposes, included in *Other accumulated comprehensive income* at December 31, 2007, (decreased) increased stockholders' equity by P. (41,474,609), P. (5,433,921), P. (9,999,319), P. 17,475,251 and P. 199,487, respectively.

Cumulative effects of the deficit from re-expression of stockholders' equity, deferred taxes on the difference between indexed cost and specific indexation factor valuation, effect of adoption of SFAS 158, net of deferred taxes, the effect of translation of foreign entities and the effect of fair value of swaps accounted for as cash flow hedges, net of deferred taxes, as adjusted for U.S. GAAP purposes, included in *Accumulated other comprehensive income* at December 31, 2006, (decreased) increased stockholders' equity by P. (41,259,303), P. (4,923,199), P. (6,227,442), P. 5,203,787 and P. (299,602), respectively.

***Penalties and interest:***

Under MFRS penalties and interest on tax settlements are presented as other income (expense), net; whereas under US GAAP, such gains are presented in interest income (expense). The Company does not have penalties or interest on tax settlements.

---

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

***Noncontrolling interest:***

In conformity with Mexican FRS, noncontrolling interest is not added back in the company's income statement, also it is included as a component of stockholders' equity and is presented immediately after the caption total majority stockholders' equity and noncontrolling interest in net income is not eliminated from net income. For U.S. GAAP purposes, noncontrolling interest is excluded from the Company's net income and from stockholders' equity and included as a separate caption in the balance sheet.

***Accounting for derivative instruments and hedging activities:***

On January 1, 2005, for Mexican FRS purposes, the Company adopted the provisions of Bulletin C-10 *Accounting for derivative instruments and hedging activities*, which requires that all derivatives be recorded in the balance sheet as either an asset or liability measured at fair value. Bulletin C-10 also requires that changes in the derivative's fair value be recognized in current earnings or stockholders' equity depending on the intended use of the derivative and the resulting designation. Based on the adoption of Bulletin C-10, there are no differences in accounting for derivative instruments between U.S. GAAP and Mexican FRS as they relate to the Company; therefore, no U.S. GAAP adjustment was recorded related to the accounting for derivatives as of December 31, 2007 and 2006. The adjustment recognized in 2005 was made to reverse the cumulative effects recognized under Mexican FRS.

***Accounting for uncertainty in income taxes:***

The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48) as of January 1, 2007.

We establish reserves to remove some or all of the tax benefit of any of our tax positions at the time we determine 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) we presume 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.

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.

---

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

The adoption of FIN 48 did not have a material impact on the Company's financial statements and did not result in a cumulative adjustment to retained earnings at adoption.

***EITF 06-3***

In June 2006, the Emerging Issues Task Force ratified the consensus on EITF Issue No. 06-3 (EITF 06-03), *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement* (That is, Gross versus Net Presentation). EITF 06-03 concluded that the presentation of taxes assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer, such as sales, use, value-added and certain excise taxes is an accounting policy decision that should be disclosed in a company's financial statements.

In addition, companies that record such taxes on a gross basis should disclose the amounts of those taxes in interim and annual financial statements for each period for which an income statement is presented if those amounts are significant. EITF 06-03 is effective for interim and annual reporting periods beginning after December 15, 2006. The Company continued with its accounting policy of net presentation; therefore, the adoption of EITF 06-03 did not have any impact on our financial condition or results of operations.

**A summary of the most important new pronouncements in U.S. GAAP that will come into force in 2008 or after and may apply to the Company is as follows:**

***Fair value measurements (FASB Statement No. 157):***

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for the measurement of fair value, and enhances disclosures about fair value measurements. The statement does not require any new fair value measures. The statement is effective for fair value measures already required or permitted by other standards for fiscal years beginning after November 15, 2007. The Company is required to adopt SFAS No. 157 beginning on January 1, 2008. SFAS No. 157 is required to be applied prospectively, except for certain financial instruments. Any transition adjustment will be recognized as an adjustment to opening retained earnings in the year of adoption. In February 2008, the FASB approved FASB Staff Position FAS 157-2 ( FSP 157-2 ) that permits companies to partially defer the effective date of SFAS No. 157 for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. FSP 157-2 did not permit companies to defer recognition and disclosure requirements for financial assets and financial liabilities or for nonfinancial assets and nonfinancial liabilities that are remeasured at least annually. The Company is currently evaluating the impact of adopting this standard on its consolidated results of operations and financial position.

***The fair value option for financial assets and financial liabilities, including an amendment of FASB Statement No. 115 (FASB Statement No.159):***

In February 2007 the FASB published SFAS No. 159, *The Fair Value Option for Financial Assets and Financial liabilities*. This statement permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities.



**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

This statement does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. This Statement does not establish requirements for recognizing and measuring dividend income, interest income, or interest expense. This statement does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS No. 157, Fair Value Measurements, and SFAS No. 107, Disclosures about Fair Value of Financial Instruments. SFAS No. 159 will be effective for all fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact this statement will have on its financial position, results of operations and disclosures, should the Company elect to measure certain financial instruments at fair value.

***Business Combinations (FASB Statement No. 141(R)):***

In December 2007, the FASB issued Statement of Financial Accounting Standards ( FAS ) No. 141 (revised 2007), *Business Combinations ( FAS 141(R) )* which replaces FAS No.141, Business Combination. FAS 141(R) retains the underlying concepts of FAS 141 in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting but FAS 141(R) changed the method of applying the acquisition method in a number of significant aspects. FAS 141(R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 15, 2008, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies. FAS 141(R) amends FAS 109 such that adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the effective date of FAS 141(R) would also apply the provisions of FAS 141(R). Early adoption is not allowed. The adoption of FAS 141(R) is expected to have effects in future acquisitions.

***Non-controlling Interests in Consolidated Financial Statements (FASB Statement No. 160):***

In December 2007, the FASB issued Statement of Financial Accounting Standards ( FAS ) No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB 51 ( FAS 160) )*. FAS 160 amends ARB 51 to establish new standards that will govern the accounting for and reporting of (1) noncontrolling interest in partially owned consolidated subsidiaries and (2) the loss of control of subsidiaries. FAS 160 is effective on a prospective basis for all fiscal years, and interim periods within those fiscal years beginning, on or after December 15, 2008, except for the presentation and disclosure requirements, which will be applied retrospectively. Early adoption is not allowed. The Company is currently evaluating the impact of adopting this standard on its consolidated results of operations and financial position.

***Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (FASB Statement No. 161):***

On March 19, 2008, the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (FAS 161)*. This new standard requires enhanced disclosures for derivative instruments, including those used in hedging activities. It is effective for fiscal years and interim periods beginning after November 15, 2008, with early adoption encouraged. The Company is currently evaluating the impact of adopting this standard on its consolidated results of operations and financial position.

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

***The Hierarchy of Generally Accepted Accounting Principles (FASB Statement No. 162):***

In May 2008, the FASB issued Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles (FAS 162)*, which identifies the sources of accounting principles and the framework for selecting principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States. This statement is not expected to result in a change in current practice.

***Amendment of FASB Interpretation No. 39 (FSP FIN 39-1):***

In April 2007, the FASB issued FASB Staff Position ( FSP ) FIN 39-1, which amends certain aspects of FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts - an interpretation of APB Opinion No. 10 and FASB Statement No. 105* ( FSP FIN 39-1 ). FSP FIN 39-1 amends paragraph 10 of FIN 39 to permit a reporting entity to offset fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) against fair value amounts, including amounts that approximate fair value, recognized for derivative instruments executed with the same counterparty under the same master netting arrangement. Derivative instruments permitted to be netted for the purposes of the FSP include those instruments that meet the definition of a derivative in FASB Statement No. 133, *Accounting for Derivative Financial Instruments and Hedging Activities*, including those that are not included in the scope of Statement 133 (for example, a financial guarantee, weather derivatives, etc.). The decision to apply the guidance of the FSP FIN 39-1 is an accounting policy decision and should be consistently applied.

The FSP is effective for fiscal years beginning after November 15, 2007, with early application permitted. A reporting entity should recognize the effects of applying this FSP as a change in accounting principle through retrospective application for all financial statement presented. If it is impracticable to apply the guidance in this FSP retrospectively for all financial statements presented, the reporting entity should disclose why it is impracticable and apply the guidance in this FSP retrospectively for as many consecutive prior financial statements as practicable. Upon adoption of this FSP, a reporting entity is permitted to change its accounting policy to offset or not offset fair value amounts recognized for derivative instruments under master netting arrangements. The Company is currently evaluating the impact of adopting this standard on its consolidated results of operations and financial position.

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**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,		
	2007	2006	2005
Income from continuing operations as reported under Mexican FRS	<b>P. 28,889,083</b>	P. 27,700,541	P. 27,262,556
U.S. GAAP adjustments:			
Capitalized interest of net financing cost			11,368
Depreciation of capitalized interest	<b>(341,559)</b>	(476,855)	(611,821)
Deferred income tax under U.S. GAAP included in this reconciliation	<b>(215,262)</b>	(79,097)	174,196
Deferred employee profit sharing under U.S. GAAP included in this reconciliation	<b>(42,648)</b>	(29,236)	(20,532)
Deferred employee profit sharing	<b>508,051</b>	380,742	213,661
Pension and seniority premium plan cost	<b>770,803</b>	632,783	960,654
Difference between the re-expression of depreciation expense based on specific indexation factors and on the basis of the NCPI	<b>(1,127,069)</b>	(1,632,733)	(2,078,805)
Effect of derivative instruments			(165,697)
Stock option plan			5,512
Noncontrolling interest	<b>189</b>	(5,284)	(26,570)
Effects of inflation accounting on U.S. GAAP adjustments	<b>543,454</b>	591,015	470,503
Total U.S. GAAP adjustments in income from continuing operations	<b>95,959</b>	(618,665)	(1,067,531)
Income from continuing operations under U.S. GAAP, net of noncontrolling interest	<b>28,985,042</b>	27,081,876	26,195,025
Income from discontinued operations as reported under Mexican FRS	<b>7,166,312</b>	2,615,031	4,926,583
Inflation adjustment (*)		(164,665)	(835,724)
Income from discontinued operations as reported under Mexican FRS after inflation adjustment	<b>7,166,312</b>	2,450,366	4,090,859
Total U.S. GAAP adjustments in income from discontinued operations	<b>(776,133)</b>	(894,201)	(1,064,493)
Income from discontinued operations under U.S. GAAP, net of noncontrolling interest	<b>6,390,179</b>	1,556,165	3,026,366
Net income under U.S. GAAP	<b>P. 35,375,221</b>	P. 28,638,041	P. 29,221,391
Weighted average number of shares issued and outstanding (in millions):	<b>19,766</b>	20,948	22,893
Net income per share under U.S. GAAP (in pesos)	<b>P. 1.79</b>	P. 1.37	P. 1.28



**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

	December 31	
	2007	2006
Total stockholders' equity under Mexican FRS	<b>P. 42,158,808</b>	P. 121,321,235
Inflation adjustment (*)		(11,410,568)
Total stockholders' equity under Mexican FRS after inflation adjustment	<b>42,158,808</b>	109,910,667
U.S. GAAP adjustments, net of effects of inflation on monetary items:		
Capitalized interest of net financing cost	<b>12,783,898</b>	12,783,898
Accumulated depreciation of capitalized interest or net financing cost	<b>(11,413,906)</b>	(11,072,347)
Deferred income tax on U.S. GAAP adjustments included in this reconciliation	<b>6,122,406</b>	4,426,803
Deferred employee profit sharing on US GAAP adjustments included in this reconciliation	<b>1,657,552</b>	975,380
Deferred employee profit sharing	<b>(6,085,961)</b>	(6,846,076)
Deferred taxes on the difference between the indexed cost and specific indexation factor valuation of fixed assets and inventories	<b>(907,244)</b>	(1,048,651)
Pension and seniority premium plan cost	<b>(394,073)</b>	(1,262,279)
Difference between the re-expression of fixed assets and inventories based on specific indexation factors and on the basis of the NCPI	<b>2,806,415</b>	3,890,586
Labor obligations (SFAS 158)	<b>(17,732,036)</b>	(10,516,660)
Noncontrolling interest	<b>(39,034)</b>	(41,230)
Total U.S. GAAP adjustments from continuing operations, net	<b>(13,201,983)</b>	(8,710,576)
Total U.S. GAAP adjustments from discontinued operations, net		(3,864,946)
Total stockholders' equity under U.S. GAAP	<b>P. 28,956,825</b>	P. 97,335,145

(\*) Adjustment that reverses the re-expression of the financial information of the discontinued operations for prior periods into constant pesos as of December 31, 2007, using the weighted average inflation factors of 1.2596 for 2006 and 1.4277 for 2005 (see Note 1 II b), and remeasured into constant pesos as of December 31, 2007, using the Mexican only inflation factors of 1.0376 for 2006 and 1.0796 for 2005, in order to present our financial statements in the same reporting currency for all periods included in this Note.

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**Condensed financial information under U.S. GAAP**

The following table presents consolidated condensed income statements for the years ended December 31, 2007, 2006 and 2005, 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:

	2007	2006	2005
Operating revenues	<b>P. 130,767,671</b>	P. 129,755,347	P. 131,448,742
Operating costs and expenses	<b>89,982,839</b>	87,675,744	89,781,554
Operating income	<b>40,784,832</b>	42,079,603	41,667,188
Other income, net	<b>1,169,535</b>	445,949	987,330
Comprehensive financing cost	<b>(2,805,910)</b>	(3,178,983)	(5,382,369)
Equity interest in net income (loss) of affiliates	<b>17,245</b>	8,723	(19,992)
Income before income tax	<b>39,165,702</b>	39,355,292	37,252,157
Income tax	<b>10,180,849</b>	12,268,132	11,030,562
Income from continuing operations	<b>28,984,853</b>	27,087,160	26,221,595
Income from discontinued operations, net of income tax	<b>6,848,291</b>	1,080,760	3,099,805
Income before noncontrolling interest	<b>35,833,144</b>	28,167,920	29,321,400
Noncontrolling interest	<b>(457,923)</b>	470,121	(100,009)
Net income	<b>P. 35,375,221</b>	P. 28,638,041	P. 29,221,391

F-56

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

The following table presents consolidated condensed balance sheets at December 31, 2007 and 2006, 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:

	2007	2006
<b>Assets</b>		
Current assets	<b>P. 32,537,405</b>	P. 40,427,852
Current assets from discontinued operations		28,107,461
Total current assets	<b>32,537,405</b>	68,535,313
Plant, property and equipment, net	<b>124,824,966</b>	130,214,952
Net prepaid benefit obligation		8,249,487
Equity investments	<b>1,528,138</b>	1,333,869
Other non-current assets	<b>3,975,457</b>	3,588,893
Non-current assets from discontinued operations		59,699,428
Total assets	<b>P. 162,865,966</b>	P. 271,621,942
<b>Liabilities and stockholders equity</b>		
Short-term debt and current portion of long-term debt	<b>P. 12,282,260</b>	P. 9,040,822
Other current liabilities	<b>20,282,755</b>	23,976,759
Current liabilities from discontinued operations		21,282,188
Total current liabilities	<b>32,565,015</b>	54,299,769
Long-term debt	<b>79,179,854</b>	81,376,228
Labor obligations	<b>2,713,348</b>	
Deferred taxes	<b>19,411,890</b>	20,766,756
Long-term liabilities from discontinued operations		17,802,814
Total liabilities	<b>133,870,107</b>	174,245,567
Noncontrolling interest	<b>39,034</b>	41,230
Stockholders equity:	<b>28,956,825</b>	97,335,145
Total liabilities and stockholders equity	<b>P. 162,865,966</b>	P. 271,621,942

*Reclassifications under U.S. GAAP*

In the consolidated condensed income statements, the Company reclassified a) P. 1,653,123 related to a ruling in favor of the deductibility for income tax purposes of employee profit sharing paid in 2004 and 2005, from the Other income, net caption in 2007 to the Income Tax caption, b) the employee profit sharing from 2007, 2006 and 2005 for P.2,401,616, P.2,707,938 and P. 2,846,149, respectively, from the Other income,

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

net caption to the Operating cost and expenses caption.

In the consolidated condensed balance sheets, the Company reclassified from 2007 and 2006, P. 1,881,601 and P. 1,673,886, respectively, from the long-term Deferred tax liability caption to the Other current assets caption.

F-57

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

**Condensed combined financial information under U.S. GAAP**

As stated in Note 2, the shares of Telmex Internacional were authorized and issued pursuant to the TELMEX's shareholders' 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 shareholders' 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 MFRS 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 shareholders as of December 31, 2007, the split-up entities cannot be considered distributed to its shareholders for U.S. GAAP purposes as of December 31, 2007. Therefore, under U.S. GAAP the split-up entities cannot be treated as distributed or discontinued operations until the shares are actually delivered to Telmex Internacional's shareholders, and thus the consolidated financial statements of the Company would have to include the assets, liabilities and results of operations of the subsidiaries that have been contributed to Telmex Internacional.

The financial statements of Telmex Internacional as of December 31, 2007 and 2006 and for the three years ended December 31, 2007, are included in Telmex Internacional's registration statement on Form 20-F filed with the SEC on May 30, 2008, which is incorporated by reference herein.

In order to comply with U.S. GAAP, condensed combined financial information under U.S. GAAP as of December 31, 2007 and 2006 and for the three years then ended is as follows:

	Year Ended December 31,		
	2007	2006	2005
Operating revenues	P. 196,495,603	P. 181,586,353	P. 175,920,029
Operating costs and expenses	144,943,835	137,374,093	129,285,064
Operating income	51,551,768	44,212,260	46,634,965
Other income, net	946,417	1,709,196	839,104
Comprehensive financing cost	(2,857,729)	(4,248,113)	(6,158,931)
Equity interest in net income of affiliates	734,974	513,926	340,389
Income before income tax	50,375,430	42,187,269	41,655,527
Income tax	14,542,286	14,019,348	12,334,127
Income before noncontrolling interest	35,833,144	28,167,921	29,321,400
Noncontrolling interest	(457,923)	470,120	(100,009)
Net income	P. 35,375,221	P. 28,638,041	P. 29,221,391
Net income per share (in pesos)	P. 1.79	P. 1.37	P. 1.28



**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

	December 31,		
	2007	2006	
<b>Assets</b>			
Current assets	<b>P. 67,812,233</b>	P. 68,164,798	
Plant, property and equipment, net	<b>183,492,722</b>	175,564,668	
Net prepaid benefit obligation		8,152,786	
Equity investments and goodwill	<b>23,822,554</b>	14,672,821	
Other non-current assets	<b>19,374,024</b>	4,605,120	
<b>Total assets</b>	<b>P. 294,501,533</b>	P. 271,160,193	
<b>Liabilities and stockholders' equity</b>			
Short-term debt and current portion of long-term debt	<b>P. 16,987,068</b>	P. 13,023,200	
Other current liabilities	<b>41,873,152</b>	40,923,592	
<b>Total current liabilities</b>	<b>58,860,220</b>	53,946,792	
Long-term debt	<b>90,035,154</b>	91,733,582	
Labor obligations	<b>3,833,082</b>	1,564,619	
Deferred taxes	<b>19,358,488</b>	20,720,589	
<b>Total liabilities</b>	<b>172,086,944</b>	167,965,582	
Noncontrolling interest	<b>4,910,669</b>	5,859,466	
<b>Stockholders' equity</b>	<b>117,503,920</b>	97,335,145	
<b>Total liabilities and stockholders' equity</b>	<b>P. 294,501,533</b>	P. 271,160,193	
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Net cash provided by operating activities	<b>P. 61,415,314</b>	P. 54,319,241	P. 48,130,182
Net cash used in investing activities	<b>(40,262,466)</b>	(36,691,433)	(23,849,058)
Net cash used in financing activities	<b>(18,254,871)</b>	(25,131,015)	(21,206,095)

**Table of Contents****TELÉFONOS DE MÉXICO, S.A.B. DE C.V. AND SUBSIDIARIES****Notes to Consolidated Financial Statements**

Years Ended December 31, 2007 and 2006

(In thousands of Mexican pesos with purchasing power at December 31, 2007)

	Capital stock	Premium on sale of shares	Other capital contributions	Retained earnings		Other accumulated comprehensive income	Comprehensive income	Total
				Legal reserve	Unappropriated			
Balances at January 1, 2005	P. 31,238,109	P. 23,258,918		P. 16,148,490	P. 77,527,583	P. 93,676,073	P. (47,204,085)	P. 100,969,015
Appropriation of earnings approved at regular stockholders meeting held in April, 2005:								
Cash dividends paid at P.0.406 per share (P.0.370 historical)					(9,237,377)	(9,237,377)		(9,237,377)
Repurchase of Company's own shares in cash	(1,509,671)				(17,417,300)	(17,417,300)		(18,926,971)
Other Comprehensive income:					(105,052)	(105,052)		(105,052)
Net income for the year					29,221,391	29,221,391	P. 29,221,391	29,221,391
Other comprehensive income:								
Deferred taxes allocated to equity, net of effect of inflation							541,724	541,724
Effect of instruments available for sale:								
Gain for the year							1,773,844	1,773,844
Gain on sale recognized in income							(541,273)	(541,273)
Changes in fair value of swaps, net of deferred taxes							(178,449)	(178,449)
Effect of translation of foreign entities, net							404,506	404,506



Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

Comprehensive income							P. 31,221,743	
Balances at December 31, 2005	29,728,438	23,258,918		16,148,490	79,989,245	96,137,735	(45,203,733)	103,921,358
Appropriation of earnings approved at regular stockholders meeting held in April, 2006:								
Cash dividends paid at P. 0.426 per share (P. 0.403 historical)					(8,846,171)	(8,846,171)		(8,846,171)
Cash dividend paid to noncontrolling stockholders in subsidiary					(200,830)	(200,830)		(200,830)
Repurchase of Company's own shares in cash	(1,717,104)				(22,966,682)	(22,966,682)		(24,683,786)
Gain on dilution of investment in split-up affiliate		P. 808,559						808,559
Comprehensive income:								
Net income for the year					28,638,041	28,638,041	P. 28,638,041	28,638,041
Other comprehensive income:								
Deferred taxes allocated to equity, net of effect of inflation							105,523	105,523
Changes in fair value of swaps, net of deferred taxes							(121,153)	(121,153)
Effect of translation of foreign entities, net							3,941,046	3,941,046
Comprehensive income							P. 32,563,457	
Effect of adoption of SFAS 158, net of deferred taxes							(6,227,442)	(6,227,442)
Balances at December 31, 2006	28,011,334	23,258,918	808,559	16,148,490	76,613,603	92,762,093	(47,505,759)	97,335,145
Appropriation of earnings approved at regular stockholders								

Edgar Filing: TELEFONOS DE MEXICO S A B DE C V - Form 20-F

meeting held in April, 2007:				
Cash dividends paid at P.0.448 per share (P.0.440 historical)		(8,820,074)	(8,820,074)	(8,820,074)
Repurchase of Company's own shares in cash	(780,210)	(15,002,629)	(15,002,629)	(15,782,839)
Gain on dilution of investment in split-up affiliate	1,123,819			1,123,819
Comprehensive income:				
Net income for the year		35,375,221	35,375,221	P. 35,375,221 35,375,221
Other comprehensive income:				
Deferred taxes allocated to equity, net of effect of inflation			(726,028)	(726,028) (726,028)
Changes in fair value of swaps, net of deferred taxes			499,089	499,089 499,089
Effect of translation of foreign entities, net			12,271,464	12,271,464 12,271,464
Effect of SFAS 158, net of deferred taxes			(3,771,877)	(3,771,877) (3,771,877)
Comprehensive income				P. (43,647,869)
Balances at December 31, 2007	P. 27,231,124	P. 23,258,918	P. 1,932,378	P. 16,148,490 P. 88,166,121 P. 104,314,611 P. (39,233,111) P. 117,503,920

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

**Table of Contents**

**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.

Date: June 27, 2008

TELÉFONOS DE MÉXICO, S.A.B. DE C.V.

By: /s/ Adolfo Cerezo Pérez

Name: Adolfo Cerezo Pérez

Title: Chief Financial Officer