TELEFONOS DE MEXICO S A B DE C V
Form 20-F
July 16, 2007
Table of Contents

As filed with the Securities and Exchange Commission on July 13, 2007.

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, 2006

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)

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

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

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

American Depositary Shares, each representing 20

Series A Shares, without par value (A Share ADSs)

Series A Shares, without par value (A Shares)

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, 2006 was:

8,115 million	AA Shares
446 million	A Shares
11,642 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 x 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 x

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 x No ¨

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

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

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 ¨ Item 18 x

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 x

TABLE OF CONTENTS

		Page
Item 1.	Identity of Directors, Senior Management and Advisers	1
Item 2.	Offer Statistics and Expected Timetable	1
Item 3.	Key Information	1
	Selected Financial Data	1
	Exchange Rates	4
	Risk Factors	5
	Forward-Looking Statements	11
Item 4.	Information on the Company	12
	General	12
	Mexican Operations	15
	Non-Mexican Operations	29
	Capital Expenditures	39
	Other Matters	39
Item 4A.	Unresolved Staff Comments	40
Item 5.	Operating and Financial Review and Prospects	40
Item 6.	Directors and Officers of Registrant	60
Item 7.	Major Shareholders and Related Party Transactions	75
	Major Shareholders	75
	Related Party Transactions	77
Item 8.	Financial Information	80
	Consolidated Financial Statements	80
	Legal Proceedings	80
	Dividends	81
Item 9.	The Offer and Listing	82
	Trading Market	82
	Trading on the Mexican Stock Exchange	84
Item 10.	Additional Information	85
	Bylaws and Mexican Law	85
	Certain Contracts	92
	Exchange Controls	92
	Taxation	92
	Corporate Governance Practices	97
	Documents on Display	101
Item 11.	Quantitative and Qualitative Disclosures about Market Risk	101
	Exchange Rate and Interest Rate Risks	101
	Sensitivity Analysis Disclosures	101
Item 12.	Description of Securities Other Than Equity Securities	102
Item 13.	Defaults, Dividend Arrearages and Delinquencies	102
Item 14.	Material Modifications to the Rights of Securities Holders and Use of Proceeds	102
Item 15.	Controls and Procedures	102
Item 16A.	Audit Committee Financial Expert	104
Item 16B.	Code of Ethics	104
Item 16C.	Principal Accountant Fees and Services	104
Item 16D.	Exemptions from the Listing Standards for Audit Committees	105
Item 16E.	Purchases of Equity Securities by the Issuer and Affiliated Purchasers	105
Item 17.	Financial Statements	106
Item 18.	Financial Statements	106
Item 19.	Exhibits	107

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, 2006, which have been reported on by Mancera, S.C., a member 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 operating income, net income and total stockholders equity; and a condensed statement of cash flows under U.S. GAAP.

Pursuant to Mexican FRS, in the consolidated financial statements and the selected consolidated financial data set forth below:

- nonmonetary assets (excluding plant, property and equipment of non-Mexican origin) and stockholders equity are restated for inflation based on the Mexican National Consumer Price Index;

- plant, property and equipment of non-Mexican origin are restated based on the rate of inflation in the country of origin and converted into Mexican pesos using the prevailing exchange rate at the balance sheet date;

- gains and losses in purchasing power from holding monetary assets and liabilities are recognized in income; and

- all financial statements are restated in constant pesos as of December 31, 2006, based on weighted average factors that take into account the inflation rate and exchange rate fluctuations in each of the countries in which we operate. The weighting of the factors is determined according to the contribution to total revenues of our operations in each country.

We have not reversed the effect of inflation accounting under Mexican FRS in the reconciliation to U.S. GAAP of our net income and stockholders equity, except with respect to the methodologies for restatement of plant, property and equipment of non-Mexican origin and for restatement of financial statements of prior years. See Note 18 to our audited consolidated financial statements.

Table of Contents

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

	Year ended December 31,				
	2006	2005	2004	2003	2002
	(in millions of constant pesos as of December 31, 2006, except per share data)				
Income Statement Data:					
Mexican FRS:					
Operating revenues	P. 175,006	P. 173,505	P. 154,052	P. 137,311	P. 137,345
Operating costs and expenses	126,715	121,658	106,440	91,615	89,706
Operating income	48,291	51,847	47,612	45,696	47,639
Net income	29,062	30,904	30,626	25,982	23,549
Net income per share Basic[1]	1.36	1.31	1.27	1.04	0.91
Net income per share Diluted[1]	1.36	1.31	1.26	1.02	0.89
Dividends paid per share[1][2]	0.403	0.370	0.333	0.303	0.273
Weighted average number of shares outstanding (millions)					
Basic	20,948	22,893	23,906	24,908	25,972
Diluted	20,948	22,893	24,404	26,202	27,354
U.S. GAAP:					
Operating revenues	P. 175,006	P. 169,545	P. 150,537	P. 134,178	P. 134,211
Operating costs and expenses	132,396	124,600	109,807	94,382	94,021
Operating income	42,610	44,945	40,729	39,796	40,190
Net income	27,604	28,144	30,356	24,550	20,885
Net income per share Basic[1]	1.32	1.23	1.27	0.99	0.80
Net income per share Diluted[1]	1.32	1.23	1.27	0.96	0.79
Dividends paid per share[1][2]	0.403	0.370	0.333	0.303	0.273

(see footnotes on following page)

Table of Contents

	December 31, 2006	2005	2004	2003	2002
	(in millions of constant pesos as of December 31, 2006, except number of shares and ratios of earnings to fixed charges)				
Balance Sheet Data:					
Mexican FRS:					
Plant, property and equipment, net	P. 156,903	P. 160,334	P. 166,519	P. 140,113	P. 147,455
Total assets	264,030	266,203	278,363	214,994	203,129
Short-term debt and current portion of long-term debt	12,551	15,541	14,517	23,451	13,310
Long-term debt	88,192	81,312	84,552	56,035	66,277
Total stockholders equity	105,956	118,563	118,002	91,163	73,606
Capital stock	26,996	28,651	30,106	31,317	32,562
Number of outstanding shares (millions)					
Series AA	8,115	8,115	8,127	8,272	8,272
Series A	446	479	504	530	578
Series L	11,642	13,451	15,034	15,416	16,704
U.S. GAAP:					
Plant, property and equipment, net	P. 169,203	P. 164,788	P. 171,345	P. 143,351	P. 156,804
Total assets	261,334	266,587	281,192	218,670	212,802
Short-term debt and current portion of long-term debt	12,551	15,186	14,186	22,916	13,006
Long-term debt	88,409	79,456	82,622	54,756	64,765
Total stockholders equity	93,836	100,155	97,314	82,993	67,971
Capital stock	26,996	28,651	30,106	31,317	32,562
Other Data:					
Mexican FRS:					
Ratio of earnings to fixed charges(3)	6.5	6.7	8.2	7.4	6.5
U.S. GAAP:					
Ratio of earnings to fixed charges(4)	6.0	6.1	7.6	6.9	5.8

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

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

(3) Earnings for this purpose consist of earnings before provisions for income tax and employee profit sharing, 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.

(4) Earnings for this purpose consist of earnings before provision for income tax but after provision for employee profit sharing, 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

Mexico has a free market for foreign exchange, and the Mexican government allows the peso to float freely against the U.S. dollar. There can be no assurance that the Mexican government will maintain its current policies with regard to the peso or that the peso will not depreciate or appreciate significantly in the future.

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 restated in constant currency units.

Period	High	Low	Average(1)	Period End
2002	P. 9.00	P. 10.43	P. 9.66	P. 10.43
2003	10.11	11.41	10.79	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:				
January	10.77	11.09	10.96	11.04
February	10.92	11.16	11.00	11.16
March	11.01	11.18	11.11	11.04
April	10.92	11.03	10.98	10.93
May	10.74	10.93	10.80	10.93
June	10.71	10.98	10.83	10.79

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

On July 13, 2007, the noon buying rate was P. 10.77 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 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 Mexico, Brazil and the other countries in which we operate could adversely affect our revenues and profitability

We face significant competition in Mexico, Brazil and the other countries in which we operate, which could result in decreases in current and potential customers, revenues and profitability. Governmental authorities in many of these countries 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 wireless providers and fixed-line operators and between cable television providers and telephony providers.

In Mexico, competition in local service, principally from wireless service providers, has been developing since 1999. In December 2006, there were approximately 57.0 million cellular lines in service, compared with approximately 19.9 million fixed lines in service (18.3 million of which are part of our network). As of year-end 2006, licenses have been granted to 27 local 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. Of these, 23 carriers (including Telmex and Telnor) are local fixed-line concessionaires and four carriers (including Telmex) are local wireless concessionaires in the 3.4 Ghz frequency band.

We have also begun to face new competition in Mexico from cable television providers, who 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, 2006, cable television providers have been granted 28 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.

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.

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

Table of Contents

World Trade Organization, or WTO, dispute settlement between the United States and Mexico has resulted in changes in regulation that will likely affect our business

In August 2000, the United States initiated a WTO dispute settlement against Mexico regarding alleged illegal barriers to competition in the Mexican telecommunications market. In June 2004, the United States and Mexico reached an agreement under which Mexico eliminated its uniform settlement rate system, its proportional return system and its requirement that the Mexican carrier with the greatest share of outgoing traffic to a particular country negotiate the settlement rate for that country on behalf of all Mexican carriers. Mexico also agreed to introduce new regulations authorizing the resale of outgoing international long distance service. In August 2005, Mexico adopted regulations authorizing resale of outgoing international and domestic long distance service, which will likely add to the downward pressure on the prices we charge our customers for our long distance services.

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.

We have invested in countries in which we have limited experience, and we may be unsuccessful in addressing the new challenges and risks they present

We have invested in a growing number of telecommunications businesses outside our historical core activity of providing fixed-line telecommunications services in Mexico, and we plan to continue to do so in the rest of Latin America. These investments have been made in some countries in which we have little experience and may involve economic, political and other risks to which we have not previously been exposed. Some of the investments are in countries that may present different or greater risks than Mexico, such as Brazil, Argentina, Chile, Colombia, Ecuador and Peru. We cannot assure you that these investments will be successful.

Risks Relating to Our Controlling Shareholder and Capital Structure

We are controlled by one shareholder

A majority of the voting shares of our company (71.2% as of April 30, 2007) 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, in practice it may be more difficult for minority shareholders of Telmex to enforce their rights against us or our directors or controlling shareholder than it would be for shareholders of a U.S. company.

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

We engage in transactions with certain subsidiaries of Grupo Carso, S.A.B. de C.V., or Grupo Carso, Grupo Financiero Inbursa, S.A.B. de C.V., or Grupo Financiero Inbursa, and América Móvil, S.A.B. de C.V., or América Móvil. Transactions with subsidiaries of Grupo Carso include the purchase of network construction services and materials, and transactions with Grupo Financiero Inbursa include banking services and insurance. We also have ongoing operational relationships with América Móvil, Carso Global Telecom, Grupo Carso and Grupo Financiero Inbursa, which are controlled, directly or indirectly, by Carlos Slim Helú and members of his immediate family, who, taken together, own a majority of the common stock of each company.

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.

You may not be entitled to preemptive rights

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

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

Our bylaws restrict transfers of shares in some circumstances

Our bylaws provide that any acquisition or transfer 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 or transfer 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, a substantial portion of our assets and their assets are located in Mexico and Brazil. 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.

Risks Relating to Developments in Mexico, Brazil and Other Countries

Economic and political developments may adversely affect our business

Our business operations and assets are principally 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, by inflation and high interest rates in Mexico and by political developments in Mexico. We also have substantial operations and assets in Brazil and our business may be affected by economic and political developments in Brazil.

Mexico has experienced adverse economic conditions

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

Changes in the value of the various currencies in which we conduct operations against the Mexican peso, and changes in the value of the Mexican peso or our various operating currencies against the U.S. dollar, affect our financial condition and results of operations in various ways. We report exchange gains or losses on our indebtedness and accounts payable, especially in U.S. dollars, and currency variations affect the results of our non-Mexican subsidiaries as reported in Mexican pesos. At December 31, 2006, our U.S. dollar-denominated indebtedness amounted to P.86,613 million. In 2006, the peso depreciated against the U.S. dollar by 1.5% and the Brazilian real appreciated against the U.S. dollar by 8.7%. As a result, we had a foreign exchange loss of P.1,639 million in 2006. In 2005, the peso appreciated against the U.S. dollar by 4.9% and the real appreciated against the U.S. dollar by 11.8% but our foreign exchange gain was more than offset by losses on hedges we had entered into to minimize our exposure to the U.S. dollar. As a result, we had a foreign exchange loss of P.3,762 million in 2005.

Major devaluation or depreciation of any such currencies may also result in disruption of the international foreign exchange markets and may limit our ability to transfer or to convert such currencies 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. The Brazilian government may impose temporary restrictions on the conversion of Brazilian reais into foreign currencies and on the remittance to foreign investors of proceeds from investments in Brazil. Brazilian law permits the government to impose these restrictions whenever there is a serious imbalance in Brazil s balance of payments or a reason to foresee a serious imbalance.

Table of Contents

High levels of inflation and high interest rates in Mexico, Brazil or other countries where we have operations could adversely affect our financial condition and results of operations

Both Mexico and Brazil have experienced, and Argentina is currently experiencing, 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.

Developments in other Latin American countries in which we operate may affect our business

We have expanded our operations through our investment in telecommunications companies and our acquisition of telecommunications assets in Brazil, Argentina, Chile, Colombia, Ecuador and Peru. These countries expose us to different or greater country risks than Mexico. Our future results may be significantly affected by the economic and financial condition of the countries in which we operate, the devaluation of the local currencies, inflation and high interest rates, political developments, changes in law or changes in labor conditions. Devaluation of a local currency against the U.S. dollar may increase our operating costs in that country, and depreciation of the local currency against the Mexican peso may negatively affect the results of our operations in that country.

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 U.S. Securities and Exchange Commission, or 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 outside of Mexico;
- 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, Brazil 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 and government policies in Mexico or elsewhere, 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 the largest fixed-line telecommunications system in Mexico, where we are the only nationwide provider of fixed-line telephony services and the leading provider of fixed local and long distance telephone services. We also provide other telecommunications and telecommunications-related services such as corporate networks, Internet access services, directory services, information network management, telephone equipment sales, satellite services, paging services and interconnection services to other carriers. Since February 2004, we have offered voice, data and Internet access services in Brazil, Argentina, Chile, Colombia and Peru. In addition, we began providing cable television services in Brazil in 2005 (through an affiliate) and in Colombia in 2006 and telecommunications services in Ecuador in 2007.

In Mexico, 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 76.4% in 2006 to approximately 1.8 million. At the same time, we are extending our voice and Internet access services to remote areas. Through e-Mexico II, 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*), through which we will provide voice and Internet access services to over 7,000 communities.

In 2006, 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.

Outside Mexico, we have already begun combining voice, data and video services in Brazil and Colombia, and we plan to further expand our multiple-service products through the acquisition of other cable service providers in Latin America. In addition, we have taken steps to offer better and more integrated telecommunications services to our customers throughout Latin America and to improve operating efficiencies in our international operations. At the same time, we have focused on consolidating and enhancing our international operations. In 2006, we conducted a tender offer for the remaining outstanding shares of Embratel Participações S.A., or Embratel, simultaneously in Brazil and the United States. As a result, we owned approximately 98.0% of Embratel s capital stock as of June 30, 2007. In coming years we will continue to increase our presence outside Mexico in order to strengthen our competitive position globally.

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.

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

Table of Contents

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 spun off our Mexican wireless business and other operations to América Móvil, S.A.B. de C.V., or América Móvil. Beginning in 2004, we expanded our operations outside Mexico through a series of acquisitions. As a result, we provide voice, data and Internet access services in Brazil, Argentina, Chile, Colombia and Peru. In addition, we entered the cable television business in Brazil in 2005 (through an affiliate) and in Colombia in 2006; we acquired a publisher of Spanish-language telephone directories in the United States in 2006; and we entered the telecommunications business in Ecuador in 2007.

Significant Subsidiaries and Investees

The following table sets forth our significant subsidiaries and investees accounted for using the equity method at December 31, 2006:

Name of Company	Jurisdiction of establishment	Percentage of ownership and voting interest	Description
Subsidiaries			
Controladora de Servicios de Telecomunicaciones, 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
Anuncios en Directorios, S.A. de C.V.	Mexico	100.0%	Producer of yellow pages directories
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
Embratel Participações S.A.	Brazil	97.0%[(1)]	Intermediate holding company of subsidiary that provides domestic and international long distance, local and data services in Brazil
Empresa Brasileira de Telecomunicações S.A. EMBRATEL	Brazil	96.0%	Provider of domestic and international long distance, local and data services in Brazil
Star One S.A.	Brazil	76.8%	Provider of satellite services in Brazil
PrimeSys Soluções Empresariais S.A.	Brazil	96.0%	Provider of high level value-added services, such as net integration and outsourcing
Telmex do Brasil, Ltda.	Brazil	97.0%	Provider of telecommunications services to corporate customers in Brazil
Telmex Chile Holding, S.A.	Chile	100.0%	Holding company for assets acquired from AT&T Latin America Corp. in Chile
Telmex Corp. S.A. (formerly Chilesat Corp S.A.)	Chile	99.7%	

			Intermediate holding company whose subsidiaries provide long distance, Internet access and data network services in Chile
Techtel-LMDS Comunicaciones Interactivas, S.A.	Argentina	100.0%	Provider of wireless voice, data and video transfer services and local and long distance fixed-line voice services in Argentina

Table of Contents

Name of Company	Jurisdiction of establishment	Percentage of ownership and voting interest	Description
Telmex Argentina S.A.	Argentina	100.0%	Provider of telecommunications services to corporate customers in Argentina
Metrored Telecomunicaciones S.R.L.	Argentina	100.0%	Provider of data services in Argentina
Telmex Colombia S.A.	Colombia	100.0%	Provider of telecommunications services to corporate customers in Colombia
Superview Telecomunicaciones, S.A.	Colombia	99.2%	Cable television provider in Colombia
Telmex Perú S.A.	Peru	100.0%	Provider of telecommunications services to corporate customers in Peru
Sección Amarilla USA L.L.C.	Delaware	80.0%	Publisher of Spanish-language telephone directories with presence in 19 states in the United States
Telmex USA, L.L.C.	Delaware	100.0%	Authorized long distance service re-seller, telephone card sales, receipt of payments for lines in Mexico (installation expenses and monthly rental) and authorized by the FCC to provide facility-based long distance services in the United States
Affiliated companies			
Net Serviços de Comunicação S.A.	Brazil	38.6%[2]	Provider of cable television and local telephone services and bidirectional broadband Internet access services in Brazil
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

(1) At December 31, 2006, Telmex held 98.0% of the voting shares of Embratel Participações S.A., or Embratel.

(2) Corresponds to Telmex s indirect interest in Net Serviços de Comunicação S.A., or Net, held through Embratel. The direct and indirect interest of Embratel in Net at December 31, 2006 was 39.9%.

Table of Contents

MEXICAN OPERATIONS

At March 31, 2007, we had 18.3 million local fixed lines in service in Mexico, down 2.0% from March 31, 2006. In long distance services, we estimate that during December 2006, our share of traffic in cities open to competition was 79.1% for domestic long distance and 78.3% for international long distance calls originating in Mexico.

Of our revenues from our Mexican operations in 2006, 43.8% was attributable to local service, 21.5% to long distance service, 13.6% to interconnection, 8.4% to corporate networks and 7.5% to Internet access services. Other services, including yellow pages and equipment sales, accounted for 5.2% of revenues.

Overview

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

	December 31,				
	2006	2005	2004	2003	2002
Lines in service (thousands)	18,251	18,375	17,172	15,683	14,446
Internet access accounts (thousands)	2,660	2,116	1,741	1,452	1,165
Billed line equivalents for data transmission (thousands)	2,330	2,011	1,517	1,139	1,229
Lines in service per employee	402.0	399.6	371.2	331.4	301.2
Domestic long distance call minutes for the year (millions)	17,971	17,853	16,700	15,376	14,347
International long distance call minutes for the year (millions)[(1)]	8,913	7,131	6,297	4,513	4,922
Total local calls (millions)	26,575	26,680	26,782	26,625	25,679
Prepaid telephone service cards sold (millions)	230	258	273	279	274

(1) Includes incoming and outgoing traffic.

Local Service

We are a leading provider of local telephone service in Mexico. We provide local telephone service to approximately 23 thousand communities throughout Mexico. Of all lines in service, 38.5% are in the Mexico City, Monterrey and Guadalajara areas, and 28.1% 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 2006 decreased by 0.4% compared to 2005, for a total of 26,575 million calls. The decrease in billed traffic in 2006 was attributable primarily to the competition of fixed-line local service provided by other carriers and cellular service as well as the migration of switched traffic to corporate networks, virtual private networks, VoIP and other alternative service offerings. We expect that the increase in penetration of alternative service offerings and increasing competition will continue to curb measured service growth.

Our charges for fixed-line local telephone service include (a) installation charges, (b) monthly line rental charges, (c) monthly measured service charges, (d) digital services and (e) charges for other services, such as the transfer of a line to another address and reconnection. Residential customers pay a fixed charge per local call in excess of a monthly allowance of 100 local calls, and commercial customers pay for every local call at the same fixed rate per call. We estimate that in any given month in 2006, approximately 58.0% of residential customers made fewer than 100 local calls on average. 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, Telmex SRI Digital Trunk Options (*Opciones Telmex SRI para troncales digitales*), which includes up to 24,000 local calls and, since February 2006, Home Line (*Línea Hogar*), which includes up to 400 local calls.

In 2006, we did not increase rates for local telephone service, resulting in lower rates in real terms for every year since March 2001.

Domestic Long Distance Service

We are the leading provider of domestic long distance telecommunications services in Mexico. Our domestic long distance transmission network consists of close to 30 thousand kilometers of optical fiber connecting Mexico s major cities, and includes secondary branches and additional transmission rings around Mexico City designed to avoid network congestion.

Domestic long distance traffic increased by 0.7% during 2006 for a total of 17,971 million minutes at the end of 2006. The slower growth in domestic long distance traffic in 2006 compared to the 6.9% growth recorded in 2005 was primarily due to a decrease in traffic delivered by other long distance carriers to Telmex for completion and the introduction in November 2006 of the calling party pays system for domestic and international long distance service. 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 plan offers a monthly package of 200 domestic long distance minutes for P.100. In December 2006, we had 1,466 thousand Lada 100 subscribers, an increase of 28.3% over 2005.

In 2005, we introduced the Lada America plan, which allows residential and commercial customers to make domestic long distance calls for P.1.00 per minute and international long distance calls to the rest of North America and all of Central and South America for P.2.00 per minute for a monthly fee of P.189. In December 2006, we had 35,840 Lada America subscribers, an increase of 128.8% over 2005.

In 2006, we did not increase rates for domestic long distance service, resulting in lower rates in real terms for every year since March 1999.

International Long Distance Service

We are the leading 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.

Table of Contents

In 2006, incoming international long distance traffic increased by 31.8%, or by 1,696 million minutes, while outgoing international long distance traffic increased by 4.8%, or by 86 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 between 12:00 a.m. and 4:59 p.m. on Sunday. Our Favorite Lada Destinations plan offers discounts on calls to certain cities in the United States 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.200. In December 2006, we had 711.4 thousand Favorite Lada Destinations subscribers and 70.1 thousand Lada 100 International subscribers, an increase of 7.8% and 29.3%, respectively, over 2005.

In 2006, we did not increase rates for international long distance service, resulting in 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 80% 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, 2007. In 2006, we paid U.S.$0.033 per minute for northbound (Mexico to the United States) calls (compared to U.S.$ 0.0301 per minute in 2005) and received an average rate of U.S.$0.0478 per minute for completing international calls originated in the United States (compared to U.S.$0.0486 per minute in 2005).

Our international long distance revenues are affected by the use 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,

Table of Contents

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. Though we have agreed with most local and long distance carriers to request regulatory intervention to eliminate local bypass, we believe our interconnection revenues will continue to be adversely affected by this practice.

Corporate Networks

Corporate networks consist of the transmission of voice, video and data between two or more end points using private or virtual circuits. During 2006, the number of 64 Kbps line equivalents provided by means of corporate networks increased by 15.9%, to 2,330 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, along with Next Generation VoIP services. 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. Ladalinks and Frame Relay 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 2006, the number of our Internet customers increased to approximately 2.7 million at year-end, an increase of 25.7% compared with 2005. We estimate that we are the leading Internet access provider in Mexico in terms of number of subscribers with a market share of 58.2% of dial-up connections and 69.0% of broadband connections at December 31, 2006, 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, e-mail and protocol conversion. Infinitum operates over Asymmetric Digital Subscriber Line, or ADSL, technology. In 2006, 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, we increased our ADSL customer base by 790 thousand accounts. At year-end 2006, we had approximately 1.8 million ADSL customers, an increase of 76.4% over 2005. 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 20 to 100 meters. At December 31, 2006, we maintained over 700 public hot spots in over 50 cities in Mexico, providing wireless Internet access to our customers.

In 2006, we separated connectivity from computer equipment sales in order to allow customers greater flexibility to upgrade their equipment.

Consistent with our strategy of retaining our current customers and maximizing the value of residential and business Internet accounts, in 2006 we launched 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 for a discounted price.

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, (c) Prodigy Roaming, a service that provides traveling customers with a connection from anywhere in Mexico at the rate for local calls and (d) Prodigy Patrol, a service that allows customers to limit access to certain websites. Customers who purchase both Internet access service and computer equipment from us are eligible for a 10% discount in their monthly equipment payments.

Other Services

We provide various other telecommunications and telecommunications-related products and services, including printed and online yellow pages directories, public phones, prepaid cards, Internet portals, billing and collection services to third parties and sales of telecommunications and computer equipment and accessories. We use our network of over 380 Telmex stores (*Tiendas Telmex*) to offer our products and services throughout Mexico.

Yellow Pages Directories

We offer both a printed and an Internet-based yellow pages directories. Our yellow pages website (www.seccionamarilla.com.mx) had 19 thousand registered users during 2006, an increase of 32.0% compared with 2005. During 2006, our yellow pages website was visited 16 million times and had 271 million page views.

Billing and Customer Service

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

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

In 2006, we developed our website (www.telmex.com) to serve as a customer service platform, where users can easily find information about the company, 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. In addition, as a result of the integration and redesign of our website, which is based on a user center design philosophy, we can now inform our customers of ongoing offers and joint promotions across all of our service offerings through a more user-friendly and intuitive navigation experience.

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 767 thousand fixed-line public telephones in operation at December 31, 2006. In the increasingly competitive market to provide telecommunications services, independent operators have installed public telephones for which we provide access. There were more than 66 thousand independently operated public telephones at December 31, 2006, an increase of 38.1% compared with 2005.

Table of Contents

In 2006, we sold over 187.2 million prepaid cards under the brand name Ladatel for use in public phones, a decrease of 15.3% from 2005, and 42.4 million prepaid cards under the brand name Multifon for use in public and residential telephones, a decrease of 11.0% from 2005. This represents an average of almost 2.2 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, 2006, Multifon lines totaled 1.2 million, a decrease of 35.1% compared to December 31, 2005 due to the cancellation of 864 thousand lines that had payment problems or were not in use. Revenues from sales of prepaid cards (based on an estimate of usage) accounted for 3.5% of our consolidated revenues in 2006. In 2006, our revenues from public telephony decreased by 15.5% as a result of intense competition from wireless carriers.

Network

Our local and long distance fiber optic network, the largest in Mexico, consists of close to 94 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 18.3 million local fixed lines in service at December 31, 2006, a decrease of 0.7% compared to December 31, 2005, reflecting 1.6 million new lines and 1.7 million disconnections in 2006.

As a result of our substantial investment, our network has been 100% digital since 2000, providing a wide variety of telephony, data and video services. During 2006, 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 2006 was 8.1 million (44.2% of the total number of lines in service), representing an increase of 6.1% from 2005. This increase was due largely to an increase in the number of new lines.

Our network includes network access cables and domestic and long distance transmission equipment. In addition, we use advanced routing technology to connect end-users with our network. We use fiber optic cable to transmit both voice and high bandwidth applications such as video and data.

Our external copper network is capable of supporting not only conventional telephone services, but also modern broadband applications 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 of up to 4 Mbps.

Our network is fully redundant and is supported by optic rings, which allow the network to be restored within 50 milliseconds in the event of a system failure. In addition, 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 a fiber optic infrastructure is not available. We also have satellite systems that support domestic and international network traffic.

Core Network

Our core transmission network uses Synchronous Digital Hierarchy, or SDH, and Next Generation SDH technologies, which route transmissions through a series of optic rings, giving us the unique ability to protect information carried on the network from origin to destination. This level of protection is achieved through the rings self-repairing mechanism, which minimizes the risk of interruption of the signal in the event of network failure. The 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.

Additionally, 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.

Telephone communication 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 100 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, seven days a week. 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.

Next Generation Network

As part of our transition to a Next Generation Network, we are developing a new network platform based on Internet Protocol, or IP, which permits us to create an entirely convergent multi-service network environment. We are also deploying a local broadband access network with complete connectivity within the Next Generation Network, supplemented by a high-capacity optical transmission network, which facilitate the transmission of information. The DSL equipment currently being installed on the access network has the capacity to manage IP packet-based technologies and can support multimedia services. Next Generation SDH equipment with the capacity to manage various IP packet-based services and applications is being deployed in the transmission network, and Softswitch-based equipment is being installed in the processing network, in which traffic control and applications are centralized and operate using a VoIP-based technology. The processing network is expected to evolve towards an IP Multimedia Subsystem model with centralized and standardized service control that will facilitate the addition of new multimedia services in a broadband environment.

As of December 31, 2006, our cumulative investment in the Next Generation Network totaled P.13,803 million (U.S.$1,269 million). In 2007, we have budgeted approximately U.S.$367 million for investment in our Next Generation Network infrastructure.

Competition

The Mexican market for fixed-line domestic and international long distance services was opened to competition beginning in 1996. Thirty-three carriers have been granted licenses to provide long distance service in Mexico, and 14 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. Most competing carriers have been principally focused on the long distance market, although some carriers also provide business customers with direct access to their long distance networks using lines leased from us.

At the end of 2006, several of our competitors merged, when Maxcom Telecommunicaciones, S.A. de C.V., or Maxcom, acquired Grupo Telereunión and Axtel acquired Avantel.

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 six 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 addition to pre-subscription, customers eventually may be able to select a long distance carrier on a call-by-call basis by dialing a three-digit prefix. 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. As of December 31, 2006, 27 carriers have licenses to provide local fixed-line and 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 2006, there were 10 fixed-line and wireless local operators (in addition to Telmex and Telnor), primarily carriers competing in regional markets, mainly in Mexico City, Guadalajara, Monterrey and other large cities. Axtel and Maxcom are our principal fixed-line local competitors. To date, our competitors in local service have focused on servicing first-time customers and providing second lines in new housing, as well as inducing our customers to switch carriers.

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.

At December 31, 2006, we estimate that our market share in Mexico was 79.1% in domestic long distance service and 78.3% 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 open to competition. At December 31, 2006, our market share in Internet access services was 58.2% of dial-up connections and 69.0% of broadband connections, measured on the basis of the total number of Internet access accounts in Mexico. Compared to the approximately 18.3 million fixed lines in service in our network, at December 31, 2006 our local fixed-line competitors had approximately 1.6 million lines in service, which represented an increase in the number of our competitors lines of service of 41.6% in 2006 and 26.2% in 2005. In local service and public telephony, we also face competition from cellular carriers, which we estimate had a combined total of 57.0 million cellular lines in service at year-end 2006. 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.

Table of Contents

Regulation

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

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

General

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

Recent Developments

There have been recent changes to Mexican law that may affect our business. 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 two laws, 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 April 2006, the Communications Ministry proposed 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. In October 2006, the Communications Ministry adopted the regulations. 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 and telephone number portability as well as the adoption of an interconnection framework. To date, the regulatory process has not been completed. 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.

The changes described above are recent and we cannot predict their outcome. We are also unable to predict the actions of broadcasting companies or paid audio and television concessionaires, but they could result in the entry of new competitors to our business.

In April 2006, the Mexican Congress approved an amendment to the Antitrust Law (*Ley Federal de Competencia Económica*), which was published in the Official Gazette in June 2006. 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 monopolistic practices, provides a more rigorous approval process for business combinations and establishes more stringent penalties, including substantially higher fines and the divestiture of assets. As a result of this amendment, it is likely that the Competition Commission will more actively enforce the Antitrust Law, which could restrict our operations and increase competition.

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.

The Federal Telecommunications Law provided for the establishment of an administrative agency, Cofetel, to regulate the telecommunications industry. Cofetel commenced operations in August 1996. It 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.

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.

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

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

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

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

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

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

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

Table of Contents

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 addressed the defect of the February 1998 resolution and 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. There can be no assurance, however, that the Competition Commission or Cofetel will not issue new resolutions or regulations that are substantially similar to those that we successfully challenged, or that our judicial challenges will be successful in the future.

Rates

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

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

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

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 14 competing long distance carriers operating in Mexico (including Telmex and Telnor) and concessions have been granted to a total of 33 long distance companies, all of which also have concessions for international long distance services. As of February 2007, there were 27 local fixed-line and wireless licensees (including Telmex and Telnor), primarily in Mexico City, Guadalajara, Monterrey, Puebla and other large and medium-sized cities. See *Mexican 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. See *Regulation Recent Developments.*

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.

In August 2000, the United States initiated a WTO dispute settlement against Mexico regarding alleged illegal barriers to competition in the Mexican telecommunications market. In June 2004, the United States and Mexico reached an agreement under which Mexico eliminated its uniform settlement rate system, its proportional return system and its requirement that the Mexican carrier with the greatest share of outgoing traffic to a particular country negotiate the settlement rate for that country on behalf of all Mexican carriers. Mexico also agreed to introduce new regulations authorizing the resale of outgoing international long distance service. In August 2005, Mexico adopted regulations authorizing resale of outgoing international and domestic long distance service, which will likely add to the downward pressure on the prices we charge our customers for our long distance services.

Interconnection

We are required under the Federal Telecommunications Law to permit any other long distance concessionaire to connect to our network in a manner that enables customers to choose the network by which their long distance calls are carried. Cofetel rules governing the interconnection rights and obligations of local service concessionaires require local service concessionaires to provide interconnection on a nondiscriminatory basis to any other concessionaire.

The Concession provides that other terms of interconnection, including fees, are to be negotiated between us and each other long distance carrier, and that, in the event the parties are unable to agree, the Communications Ministry imposes the terms. We were unable to agree with our competitors on interconnection rates for 1997 through 2000, and accordingly Cofetel imposed rates which were subsequently the subject of numerous legal challenges. Since 2002, however, 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 76% 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.

NON-MEXICAN OPERATIONS

Through our subsidiaries, we provide voice, data and Internet access services in Brazil, Argentina, Chile, Colombia and Peru. The revenues of our non-Mexican operations represented 26.7% of our consolidated revenues for 2006. We commenced operations outside Mexico through our acquisition of AT&T Latin America Corp., or AT&T Latin America, in February 2004 (with operations in all five countries), Techtel-LMDS Comunicaciones Interactivas, S.A., or Techtel, in April 2004, Chilesat Corp. S.A., or Chilesat, and Metrored Telecomunicaciones S.R.L., or Metrored, in June 2004 and Embratel Participações S.A., or Embratel, in a series of transactions beginning in July 2004. In 2005, we acquired a non-controlling interest in the Brazilian cable television provider Net Serviços de Comunicação S.A., or Net, which we transferred to Embratel later in 2005. In 2006, we acquired Superview Telecomunicaciones S.A., or Superview, a cable television provider in Colombia and a controlling interest in Cobalt Publishing LLC, a publisher of Spanish-language directories in the United States. In 2007, we acquired a telecommunications provider in Ecuador and entered into agreements to acquire cable television providers in Colombia and Peru.

The following table sets forth selected financial information for the year ended December 31, 2006, expressed in constant pesos as of December 31, 2006 and as a percentage of our total consolidated group.

Table of Contents

	Year Ended December 31, 2006							
	(in millions of constant Mexican pesos as of December 31, 2006, except percentages)							
	Mexico		Brazil		Other Countries (1)		Consolidated (2)	
Revenues	P. 128,267	73.3%	P. 42,676	24.4%	P. 4,926	2.8%	P. 175,006	100.0%
Operating income	47,756	98.9	307	0.6	219	0.5	48,291	100.0
Assets(3)	P. 368,230	76.1%	P. 106,320	22.0%	P. 9,069	1.9%	P. 483,619	100.0%

(1) Includes all other revenues, which consist of intersegment revenues that have to be eliminated upon consolidation.
(2) Includes elimination of intersegment revenues.
(3) Assets include plant, property and equipment (without deducting accumulated depreciation), construction in progress, advances to suppliers and inventories for operation of the telephone plant. See Note 16 to our audited consolidated financial statements.

Brazil

Embratel

We operate in Brazil through Embratel Participações S.A. and its subsidiaries. Throughout this Annual Report, we refer to Embratel Participações S.A. and, where the context requires, its consolidated subsidiaries, as Embratel. Of our revenues from our Brazilian operations in 2006, 68.6% was attributable to voice services (including local services), approximately 27.5% was attributable to data services and the remainder was attributable to other services. Voice services include domestic and international long distance and local service. Data services include data and Internet access services. Other services include the transmission of television and radio, telex and mobile satellite communications services.

Embratel holds concessions and authorizations to provide voice services. The domestic and international long distance concessions were renewed in December 2005 and will expire in December 2025. The initial grant of the concessions did not require payment of a fee, but beginning in 2006, Embratel is required to pay a fee every two years equal to 2.0% of the annual net revenues from the provision of long distance services in the prior year (excluding taxes and social contributions).

As of December 31, 2006, we owned 98.0% of the outstanding voting stock and 95.9% of the outstanding non-voting stock of Embratel (97.0% of the total outstanding capital stock) as a result of a series of transactions from 2004 through 2006. In July 2004, we purchased 51.8% of the outstanding voting stock of Embratel from MCI for a cash purchase price of P.4,958 million (U.S.$400 million). We purchased additional voting stock through a tender offer in December 2004; both voting and non-voting stock in 2005 in Embratel s approximately U.S.$700 million capital increase; and new voting stock in October 2005, valued at approximately P.4,785 million (U.S.$432.4 million) (based on the Bank of Brazil s commercial selling rate of 2.2623 for real/U.S. dollar exchanges on the date of transfer) in exchange for the capital stock of Telmex do Brasil and our 37.1% interest in Net.

In May 2006, we announced a cash tender offer for any and all publicly held shares of Embratel s voting and non-voting stock at a price of 6.95 Brazilian reais per 1,000 shares, plus an adjustment at a monthly index published by the Bank of Brazil. The tender offer was registered in September 2006 by the Brazilian Securities and Exchange Commission (*Commissão de Valores Mobiliários*, or CVM) and launched simultaneously in Brazil and the United States in October 2006. In accordance with the terms of the tender offer, in November 2006 we acquired through an auction held on the São Paulo Stock Exchange *(Bolsa de Valores de São Paulo*, or Bovespa) all tendered shares of Embratel s voting and non-voting stock, including non-voting shares represented by ADSs, increasing our interest in Embratel to 98.0% of the outstanding voting stock and 94.7% of the outstanding non-voting stock. As required under Brazilian law, we continued to purchase shares at the tender offer price following the expiration of the tender offer. As of June 30, 2007, we owned approximately 98.0% of Embratel s total outstanding capital stock. In March 2007, we caused Embratel to terminate the deposit agreement governing its ADSs, followed by the delisting of its ADSs and non-voting stock from the New York Stock Exchange in April 2007. In June 2007, Embratel filed a Form 15F with the SEC to terminate its reporting obligations under the U.S. securities laws.

Table of Contents

Through Embratel and its subsidiaries, we are one of the leading providers of communications services in Brazil. Of Embratel s total revenues in 2006, approximately 61% were derived from corporate customers and the remainder from residential customers. Our principal service offerings in Brazil include domestic and international long distance, local, data and other communications services. Through Embratel s high-speed data network, we offer a broad array of products and services to a substantial number of Brazil s 500 largest corporations. Telmex do Brasil provides telecommunications services to corporate customers in Brazil s largest cities, including Rio de Janeiro and São Paulo, complementing Embratel s business in those cities.

The Brazilian domestic and international long distance markets are increasingly open to full competition. Competitors have gained market share at our expense and are placing pressure on our prices and competing with us for desirable customers in the long distance and data businesses. In response to these competitive pressures, we are pursuing a marketing strategy to increase and retain our customer base in Brazil and further develop our service offerings with a focus on price clarity and attractive pricing.

Embratel was founded in 1965 and later became the long distance subsidiary of Telecomunicações Brasileiras S.A. Telebrás, or Telebrás, the Brazilian government-owned telephone company. In 1998, Telebrás was broken up into 12 new holding companies, which were then privatized, including one holding company, Embratel, for the domestic and international long distance operator. After the opening up of the Brazilian local service market, Embratel began providing local telephone services in 2002. In 2003, Embratel acquired Vésper S.A. and Vésper São Paulo S.A. and their subsidiaries, wireless local loop, local service and broadband data operators with operations in São Paulo and 16 other Brazilian states. In November 2005, Embratel bolstered its offerings of value-added services such as net integration and outsourcing through the acquisition by its principal operating subsidiary of 100% of the capital stock of PrimeSys Soluções Empresariais S.A., or PrimeSys.

Through Embratel s subsidiary Star One S.A., or Star One, we are also Brazil s leading provider of satellite services, with applications including broadcasting, broadband data and telephony. Star One currently has four satellites in orbit, which cover the entire territory of Brazil as well as Argentina, Uruguay and Paraguay. Star One also owns 11 transponders on board of AMC-12 operated by SES Americom. We expect to replace one of the satellites by the third quarter of 2007 with a new satellite that will provide coverage over South America and part of Florida. We also expect to replace another satellite by the fourth quarter of 2007 with a new satellite that will provide coverage over South America, Mexico, the west coast of the United States and part of Florida.

Embratel owns the largest long distance telecommunications network in Latin America and the largest network of broadband fiber optic transmission systems in Brazil. The network, which connects all of the regional fixed-line and cellular operators throughout Brazil, uses a 100% digital switching system for voice and data services, and packet-switched data communications in asynchronous transfer mode, or ATM, and frame relay networks for data and Internet access services. The domestic long distance and international transmission facilities extend to all 26 states and the Federal District of Brazil and include fiber optic, digital microwave, satellite and copper wireline networks.

The network of Telmex do Brasil, a subsidiary of Embratel, extends to seven major cities in Brazil and has points of presence, or POPs, for data and voice services in two other cities. POPs are nodes that are extensions of a network that permit access to customers in cities where a provider does not have metropolitan networks. The network is based on fiber optic cable and, like Embratel s, uses primarily ATM transport technology.

Since March 2006, Embratel and Net have jointly offered a package consisting of paid television, broadband Internet and voice services to residential customers along Net s network.

Investment in Net

Embratel owns a non-controlling interest in Net, the largest cable television operator in Brazil. As of December 31, 2006, Net had approximately 1.8 million connected cable television subscribers and 727 thousand subscribers to its high-speed cable modem Internet access service. As part of the package provided jointly with Embratel, Net also offers the Net Fone via Embratel voice service, which had approximately 182 thousand subscribers as of December 31, 2006. Net had total revenues under U.S. GAAP of U.S.$1,144.7 million (P.12,448 million) and net income of U.S.$204.7 million (P.2,226 million) during 2006.

In 2005, pursuant to agreements with Globo Comunicações e Participações S.A., Distel Holding S.A. and Roma Participações Ltda. (together, Globo), we acquired (a) 49% of the voting interests and all of the non-voting interests in GB Empreendimentos e Participações S.A., or GB, a special-purpose company that owns 51% of the voting shares of Net and (b) 37.4% of the voting and 7.7% of the non-voting shares of Net. Globo owns the remaining 51% of the voting interests in GB. The total cost of these transactions was U.S.$313 million (P.3,569 million), and our resulting total direct and indirect equity interest in Net was 37.1% (calculated by multiplying the shares of Net held by GB by our percentage equity interest in GB, and adding the shares we owned directly in Net).

In October 2005, we transferred our interest in Net to Embratel for new voting stock of Embratel valued at approximately P.3,865 million (U.S.$349.3 million) (based on the Bank of Brazil s commercial selling rate of 2.2623 for real/U.S. dollar exchanges on the date of transfer). In May 2006, Embratel acquired, in exchange for R$240.9 million, an additional 5.1% interest in Net from Globo Comunicações e Participações S.A. and one of its subsidiaries. In addition, in May 2006, in exchange for R$65.1 million, Embratel acquired the rights of Globo Comunicações e Participações S.A. to acquire additional shares of Net in a capital increase. Embratel exercised these rights in June 2006, thereby increasing its total direct and indirect equity interest in Net to 43.1%. As a result of Net s acquisition of a 36.7% interest in Vivax S.A., or Vivax, the second largest cable television provider in Brazil, in exchange for newly issued shares of Net valued at R$537 million, Embratel s total direct and indirect equity interest in Net decreased to 39.9% in December 2006. Net also entered into an agreement to acquire the remaining interest in Vivax through the issuance of additional new shares of Net. The transaction has received the necessary regulatory and shareholder approvals. Following its completion, Vivax will become a wholly owned subsidiary of Net and Embratel s interest in Net will likely be diluted further.

Under current Brazilian law governing cable operators, because Embratel is not controlled by Brazilian persons, it is not permitted to control Net. Globo owns a majority of the voting interests in GB, which owns a majority of the voting shares of Net. If Brazilian law changes to allow Embratel to own a controlling interest in Net, Embratel has the right to purchase an additional interest in GB to give it control of 51% of the voting shares of Net, and Globo has the right to cause Embratel to purchase such interest.

Table of Contents

Regulation

The Brazilian Telecommunications Law (*Lei Geral das Telecomunicações Brasileiras*) provides a framework for telecommunications regulation. Pursuant to Article 8 of the Telecommunications Law and Decree No. 2,338 of October 7, 1997, the primary regulator of Embratel is the Brazilian Federal Telecommunications Agency (*Agência Nacional de Telcomunicações*, or Anatel).

Companies wishing to offer telecommunications services to consumers are required to apply to Anatel for a concession or an authorization. Concessions are granted for services in the public regime and authorizations are granted for services in the private regime.

Embratel s concession for the provision of long distance service was renewed in December 2005 and will expire on December 31, 2025. The initial grant of the concession to Embratel did not require payment of a fee. Beginning January 1, 2006, Embratel is required to pay a fee every two years equal to 2% of the annual net revenues from the provision of long distance services in the prior year (excluding taxes and social contributions). This requirement will last throughout the rest of the 20-year renewal period.

Since the privatization of the Brazilian telecommunications system, concessionaires have been required to meet certain universal service and quality targets. Failure to meet these targets carries the possibility of fines and penalties from Anatel.

After the privatization of the Brazilian telecommunications system, authorizations were granted to new competitors wishing to offer switched fixed telephone services in the private regime, including local, intra-regional long distance, inter-regional long distance and international long distance services. Providers granted authorizations are not subject to the same obligations concerning network expansion (universal service obligations) and continuity of service as those applicable to concessionaires providing switched fixed telephone services in the public regime, although individual authorizations may contain certain related obligations. There are no limitations on the number of authorizations that may be granted. In July 2002, Telmex do Brasil obtained authorizations to provide local switched fixed telephone services and domestic and international multimedia communications services, which allow it to provide facilities-based voice services. The local switched fixed telephone authorization includes the seven largest business centers in Brazil.

In May 2005, Anatel consolidated the authorizations to provide local switched fixed telephone services held by Embratel and Telmex do Brasil. In August 2005, pursuant to requirements of Anatel, Embratel eliminated all overlapping service areas with its affiliates, including Telmex do Brasil.

Embratel s concession establishes a mechanism of annual rate adjustment, based on rate baskets and an adjustment for inflation. Anatel defines rate baskets for local, intra-regional long distance, inter-regional long distance and international long distance services. While the weighted percentage increase for the entire basket is capped by Anatel, tariffs for individual services within the basket may be increased at Embratel s discretion. Because Telmex do Brasil operates under an authorization granted by Anatel and not a concession, the rates it charges its customers are not regulated by Anatel.

Competition

The strongest operators in Brazil s telecommunications market are the companies that were split off from Telebrás, the former government-owned telephone company, upon its privatization, Telefónica S.A., or Telefónica, Brasil Telecom S.A., or Brasil Telecom, and Telemar Participações S.A., or Telemar. Following the breakup and privatization of Telebrás, three mirror companies were created by the auction of mirror licenses to provide local services over public switched networks in the same geographic areas served by the incumbent carriers. In 2003, Embratel acquired Vésper S.A. and Vésper São Paulo S.A., two of the three mirror companies. Global Village Telecom holds the third mirror license for local service. Intelig holds a mirror license for the provision of domestic and international long distance service, in competition with Embratel.

Since 2002, the Brazilian federal government has been authorized to grant an unlimited number of authorizations for the provision of any type of telecommunications service. Embratel was granted a nationwide license in August 2002 to provide local telephone service after it met certain universal service requirements.

Our principal competitors in Brazil vary by region and type of service. In northern and eastern Brazil, we compete with Telemar and CTBC Telecom for local services and Telemar and Intelig for long distance services. In São Paulo, we compete with Telefónica for local services and Telefónica and Intelig for long distance services. In southern and western Brazil, we compete with Brasil Telecom and Global Village Telecom for local services and Brasil Telecom and Intelig for long distance services.

Argentina

Techtel LMDS Comunicaciones Interactivas S.A., or Techtel, Telmex Argentina S.A. and Metrored Telecomunicaciones S.R.L., or Metrored, are our three Argentine subsidiaries. They provide data, Internet access and local and long distance voice services to corporate and residential customers in Argentina; operate fiber optic rings in metropolitan areas that provide last-mile access to reach our customers; and offer data administration and hosting through two data centers. In 2006, we extended our yellow page directory operations to Argentina.

The main telecommunications regulatory authorities in Argentina are the Secretary of Communications (*Secretaría de Comunicaciones*) and the Communications Commission (*Comisión de Comunicaciones*), both under the authority of the Ministry of Federal Planning, Public Investment and Services. Telefónica de Argentina S.A. and Telecom Argentina S.A. are our main competitors. Several new entrants in the Argentine telecommunications market, such as Impsat S.A., Comsat S.A. and NSS S.A., also compete with us in fixed-line telephony, public telephony, data and Internet access services.

With the purpose of expanding our access infrastructure and service offerings, in November 2006, we agreed to purchase 100% of Ertach, S.A., from Sociedad Comercial del Plata, S.A., a holding company which is currently subject to insolvency proceedings in Argentina, for U.S.$22.5 million, subject to adjustments. This acquisition is expected to close in the third quarter of 2007, subject to approval by the Argentine Secretary of Communications and by the judge presiding over the insolvency proceedings, in addition to certain other closing conditions. Ertach provides Internet access, data and voice services through a wireless network integrating Wireless Local Loop (WLL) and WiMax technologies over the 3.5 Ghz frequency band and covering more than 160 cities in Argentina.

In April 2004, we acquired an 80% indirect interest in Techtel in two separate purchases. We acquired a 20% interest from an affiliate of Techint Compañía Técnica Internacional S.A.C.I., or Techint, one of Argentina s largest industrial groups, for P.310 million (U.S.$25 million). We subsequently acquired a 60% interest from América Móvil, on the same pricing terms, for P.930 million (U.S.$75 million). In June 2004, we acquired all of the assets of Metrored for P.167 million (U.S.$13.5 million).

In June 2004, we capitalized Techtel with P.271 million (U.S.$21.8 million) in cash to repay debt of Techtel and we indirectly capitalized Techtel s Uruguayan subsidiary Telstar, S.A. in the amount of P.55 million (U.S.$4.4 million) to acquire telephone equipment, increasing our ownership of Techtel by 3.4%. After the capitalization, the Techint affiliate continued to hold the remaining 16.6% indirect interest in

Table of Contents

Techtel. Pursuant to an agreement with the Techint affiliate, in June 2005, we exercised our right to acquire an additional interest in Techtel of approximately 10% for which we paid P.177 million (U.S.$15 million), increasing our ownership to 93.4%. In December 2005, pursuant to a further agreement with the Techint affiliate, we exercised our right to acquire the Techint affiliate s remaining 6.6% indirect interest in Techtel for P.115 million (U.S.$10 million), thereby increasing our ownership in Techtel to 100%.

Techtel began providing long distance fixed line voice services and call center support in December 2000 and launched local fixed line voice services in August 2001. Currently, Techtel operates a local point-multipoint distribution service, or LMDS, and fiber optic network in Argentina, and provides voice, data, video and other telecommunications services. LMDS is a wireless service using radio signals to transmit voice, video and data.

In June 2004, we acquired a controlling interest in Metrored, which has one of the largest fiber optic networks in Buenos Aires. In 2005, Metrored established an international information center that monitors the services provided by us to our international customers located throughout Latin America which was further consolidated during 2006. Metrored is currently in the process of developing a new wireless network using pre-WiMax technology in the 3.3 Ghz frequency band to provide wireless telecommunications services to small and medium companies.

We have a fiber optic network of over 7,600 km that covers major cities in Argentina and reaches approximately 53% of its population. Our voice network covers approximately 80 interconnected cities. During 2006, we implemented a number of enhancements throughout our network in Argentina, including the national IP/MPLS platform, Softswitch technology, new nodes in the main Argentine cities and Metro Ethernet interface over the IP backbone, with the goals of simplifying network administration as well as providing complex services and higher capacities to our customers.

In 2006, over 51% of our revenues from operations in Argentina were attributable to voice services, approximately 36% to data and Internet access services, and the remainder to other services.

Chile

We started operations in Chile in February 2004, with the acquisition of all of the assets of AT&T Latin America, including AT&T Chile Holding S.A., renamed Telmex Chile Holding S.A., or Telmex Chile, which was organized as Telmex s holding corporation in Chile. In April 2004, through Telmex Chile, we acquired approximately 40% of Chilesat Corp. S.A., or Chilesat, for P.652 million (U.S.$47 million) from Redes Ópticas, S.A. and RedesÓpticas, (Cayman) Corp., entities owned by Southern Cross Latin American Private Equity Fund L.P. and GE Capital Equity Investments, Ltd. In June 2004, through a cash bid required by Chilean law, we acquired an additional interest of 59.3% in Chilesat, increasing our ownership to 99.3%. Thereafter, we changed the name of Chilesat to Telmex Corp. S.A., or Telmex Corp. In June 2004, we successfully integrated the operations of Telmex Corp. and Telmex Chile and in April 2005, Telmex Chile caused the delisting of Telmex Corp. from the New York Stock Exchange, or NYSE.

At present, Telmex Chile is a provider of advanced telecommunications services. To business customers in Chile, we provide data transmission, long distance and local telephony, private telephony, virtual private and long distance networks, dedicated Internet access and high capacity media services. The range of Telmex Chile products also includes other advanced services, such as videoconference, virtual PABX, Internet hosting as well as datacenter and contact center services. In the residential market, we have focused our efforts on long distance and value-added services.

Our fiber optic network covers more than 4,600 kilometers of the continental territory of Chile from Arica to Santiago, Santiago to Valparaiso and Santiago to Valdivia. In the southern regions of Chile and Isla de Pascua, we use a satellite platform. We also own and operate metropolitan fiber networks covering Santiago and Chile s other major cities.

Our fiber optic network in Santiago is arranged in a ring structure, the total length of which is 1,200 kilometers, and which is distributed through nodes located in the primary industrial and commercial districts of Santiago. In 2005, we introduced the first commercial 10 gigabit Metro Ethernet network in Santiago, which enables our network to offer integrated Internet Protocol, or IP, services to the corporate market. Our 10 gigabit Metro Ethernet network provides data transmission over a secure virtual private network that allows our customers to vary on demand the amount of bandwidth they require, from 10 Kbps to 10 Gbps, on specific days or at specific times of the day.

Of our revenues from Chilean operations in 2006, 63.9% was attributable to voice services, 33.8% to data and Internet access services and the remainder to other services. In 2006, Telmex Corp. and Telmex Chile together had a market share of 31.4% in the domestic long distance market and 16.6% in the international long distance market in Chile.

The General Telecommunications Law of 1982, as amended, established the legal framework for the provision of telecommunications services in Chile. The law established the rules for granting concessions and permits to provide telecommunications services and for the regulation of rates and interconnection. The main regulatory agency of the Chilean telecommunications sector is the Ministry of Transportation and Telecommunications, which acts primarily through the Undersecretary of Telecommunications, or Subtel. We hold licenses to provide local, domestic long distance and international long distance service, data services and value-added services.

In December 2005, Subtel assigned to Telmex Servicios Empresariales S.A., through a public bid, a national public local wireless telephony license in the 3.4 to 3.6 Ghz frequency band. This license will allow us to offer Next Generation IP integrated services using WiMax technology on a broader basis to small and medium-sized corporations in Chile.

We face strong competition in all of our business segments and we compete with Telefónica CTC Chile (the ultimate parent of which is Telefónica S.A.), Entel S.A. and five other carriers. This competition has been vigorous mainly in the corporate telecommunications market and in the international and domestic long distance public markets since the implementation of the multicarrier system, which requires local telephone companies to provide facilities that allow long distance carriers to access the local telephone network on an equal access basis.

Colombia

Through Telmex Colombia S.A., we provide data and Internet access services to corporate clients in Colombia through a metropolitan and inter-city fiber optic network. Of our Colombian operations for 2006, over 85% was attributable to data and Internet access services and the remainder was attributable to other services. We hold licenses to provide data and Internet access services, cable television services, local, domestic long distance and international long distance service, mobile telephone service, value-added services and video conferencing.

The main telecommunications regulatory authorities in Colombia are, with respect to cable and broadcast television, the National Television Commission and, with respect to other telecommunications services, the Communications Ministry and the Telecommunications Regulatory Commission. Our main competitors in Colombia are Telefónica Telecom, ETB and UNE, which offer fixed-line, Internet access and data services, as well as other companies that compete with us in specific geographic and product markets.

Table of Contents

In 2006, we launched telephony services in the cities of Bogota and Cali, beginning with 5,000 lines for corporate customers and continuing with the expansion of our metropolitan fiber optic network in 20 large cities. We also acquired a network with national capacity that interconnects the major cities in Colombia and permits outflow to submarine cables.

In October 2006, we entered the cable television business with our U.S.$37.0 million acquisition of 99.2% of Superview Telecomunicaciones S.A., or Superview, a cable television provider in Bogota. In April 2007, we acquired 100% of each of TV Cable S.A. and TV Cable Comunicaciones S.A. E.S.P. (together, TV Cable) for U.S.$123.0 million. TV Cable offers cable television, Internet access and, recently, voice services in Bogota and Cali. In April 2006, we also acquired 100% of Medellin-based TV Cable Pacifico S.A. E.S.P., or Cable Pacifico, a cable television and broadband Internet access provider with operations in nine departments of Colombia, for U.S.$100.0 million plus a U.S.$30.0 million payment to obtain a national license.

In March 2007, we agreed to acquire 100% of the assets of Union de Cableoperadores del Centro, Cablecentro S.A., or Cablecentro, for approximately U.S.$245 million, and of Satelcaribe S.A., or Satelcaribe, for approximately U.S.$28 million, subject to regulatory approvals and a purchase price adjustment based on the number of customers at closing. Both companies offer cable television and Internet access services in more than 50 cities, including Bogota, Cucuta, Bucaramanga, Ubaque and Neiva through Cablecentro and in more than 15 cities, including Cartagena, Santa Marta, Valledupar, Sincelejo and Monteria through Satelcaribe. In February 2007, we agreed to acquire the assets of Teledinámica, S.A., a cable television and Internet access provider in Barranquilla, for U.S.$28 million. The integration of the licenses and operations of our newly acquired cable television subsidiaries will allow us to introduce a package consisting of paid television, broadband Internet access and voice services in Colombia.

In June 2007, the Colombian antitrust authority announced that it had begun an investigation of our acquisition of Superview, TV Cable and Cable Pacifico. We believe we have complied with all applicable Colombian laws and regulations relating to these acquisitions.

Peru

Through Telmex Perú, S.A., we provide data, Internet access, fixed-line telephony (including domestic and international long distance), public telephony, and Internet hosting services to corporate customers and residential customers in Lima and the interior of Peru through a fiber optic network and a last-mile wireless network, in the 3.5 Ghz band. In 2006, we extended our yellow pages directory operations to Peru. Of the revenues from our Peruvian operations in 2006, 61.7% of was attributable to voice services, 32.5% to data and Internet access services, and the remainder to other services.

The main telecommunications regulatory authorities in Peru are the Regulatory Body for Private Investment in Telecommunications (*Organismo Regulador de la Inversión Privada en Telecomunicaciones*, or OSIPTEL) and the Ministry of Transport and Communications (*Ministerio de Transportes y Comunicaciones*). Telefónica del Peru S.A., is our main competitor in fixed-line telephony, public telephony, data and Internet access services. Americatel Peru S.A., an affiliate of Telecom Italia, also competes with us in the fixed-line long distance market.

In 2006, we acquired concessions to provide wireless access services in the 3.5 Ghz band in Lima and eight provinces in Peru. We implemented 85% of the wireless access platform and began offering the services during the fourth quarter of 2006. In five provinces, the platform functions in the 10.5 Ghz band, providing point-to-point access capabilities. This platform allows us to broaden our service offerings to small and medium-sized business customers and expand our metropolitan network coverage.

Table of Contents

In 2006, we also completed our local Ethernet Metro Network installation plan, with 13 access nodes in Lima and seven outside of Lima, of which two in the Amazon region, enabling us to offer higher data transport service quality as well as managed and value-added services to our customers. In addition, we completed the SDH Network for Metropolitan Transport in Lima, consisting of one main and five secondary rings. In July 2006, we began the installation of last generation Softswitch technology which will allow high quality, IP protocol based management of voice communication.

We have also invested in the construction of a national transport network, the *Costera Dorsal*, which began in 2006. This investment will enable us to optimize voice and data transport at a national level through our own infrastructure and to realize significant cost reductions.

In March 2007, we acquired 100% of Boga Comunicaciones S.A., a cable television provider with operations in the cities of Lima and Chiclayo. This acquisition allows us to introduce a package consisting of paid television, broadband Internet access and voice services in Peru.

United States

In April 2003, the U.S. Federal Communications Commission, or FCC, granted to our U.S. subsidiary, Telmex USA LLC, or Telmex USA, a facilities-based authorization 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. As a result of the acquisition of the assets of AT&T Latin America and of Embratel, we also hold two infrastructure and sales authorizations in the United States.

Acquisition of Interest in 2Wire Inc.

In December 2005, we agreed with Alcatel and AT&T International (formerly SBC International, Inc. and 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%, valued at approximately U.S.$62 million.

Acquisition of Sección Amarilla USA (formerly Cobalt Publishing, LLC)

In October 2006, Telmex acquired an 80% interest in Cobalt Publishing LLC from Blue Equity LLC for U.S.$26.5 million. Subsequent to the acquisition, Cobalt Publishing LLC was renamed Sección Amarilla USA L.L.C., or Sección Amarilla USA. Sección Amarilla USA publishes *Enlace*, the Spanish-language telephone directory with the largest circulation in the United States, distributed in 19 states and through the Internet.

Ecuador

In March 2007, we acquired 100% of Ecuador Telecom S.A., or Ecutel, for U.S.$24 million. Ecutel holds a concession to offer fixed-line telephony (including long distance), public telephony and data transmission services as well as a license to use the 3.5 GHz frequency band, which allows the deployment of WiMax technology.

Table of Contents

CAPITAL EXPENDITURES

The following table sets forth, in constant pesos as of December 31, 2006, our capital expenditures, before retirements, for each year in the three-year period ended December 31, 2006:

	Year ended December 31, 2006	2005	2004
	(in millions of constant pesos as of December 31, 2006)		
Data, connectivity and transmission network	P. 9,082	P. 10,187	P. 4,055
Internal plant	1,149	5,752	9,208
Outside plant	6,685	5,592	5,895
Systems	1,047	1,168	923
Other	3,574	2,919	2,279
Total capital expenditures	P. 21,537	P. 25,618	P. 22,360

Our capital expenditures decreased by 15.9% in 2006 due to lower investments in Mexico. In 2006, our consolidated capital expenditures totaled P.21.5 billion (U.S.$2.0 billion). Of our consolidated capital expenditures, our Mexican operations represented 58.1% (P.12.5 billion or U.S.$1.2 billion), our Brazilian operations represented 33.4% (P.7.2 billion or U.S.$672 million) and the remainder of our Latin American operations represented 8.5% (P.1.8 billion or U.S.$170 million).

We have budgeted capital expenditures in an amount equivalent to approximately P.24.7 billion (U.S.$2.2 billion) for the year 2007, including P.13.9 billion (U.S.$1.2 billion) in Mexico, P.7,901 million (U.S.$693 million) in Brazil, which includes P.1,847 million (U.S.$162 million) for investment in satellites, and P.2,897 million (U.S.$254 million) for our other operations in Argentina, Chile, Colombia, Peru and the United States. Budgeted capital expenditures for 2007 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.

OTHER MATTERS

Investments

We occasionally make investments and 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 August 2006, we acquired 20.7 million common shares in Portugal Telecom, SGPS S.A., or Portugal Telecom, for P.2,850 million (U.S.$252.3 million) and subsequently sold approximately 3.7 million shares during 2006 and 2007. In April 2007, Portugal Telecom spun off its subsidiary PT Multimédia Serviços de Telecomunicações e Multimédia, SGPS S.A., or PT Multimedia, through the distribution of all ordinary shares of PT Multimedia to the existing shareholders of Portugal Telecom. As a result, we now own approximately 2.7 million shares of PT Multimedia. As of May 31, 2007, our interests in Portugal Telecom and PT Multimedia represented approximately 1.6% of the total capital stock of each company.

Table of Contents

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 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.8,334 million) for our 25.6 million MCI shares in May 2005. We recognized a gain of P.534 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. Outside Mexico, we hold additional facilities and offices in Brazil, Argentina, Chile, Colombia and Peru.

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 prepared in accordance with Mexican FRS, which differ in certain respects from 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 operating income, net income and total stockholders equity; and a condensed statement of cash flows under U.S. GAAP.

Mexican FRS requires that the financial statements recognize certain effects of inflation. In particular:

- nonmonetary assets (excluding plant, property and equipment of non-Mexican origin) and stockholders equity are restated for inflation based on the Mexican National Consumer Price Index;

plant, property and equipment of non-Mexican origin are restated based on the rate of inflation in the country of origin and converted into Mexican pesos using the prevailing exchange rate at the balance sheet date;

gains and losses in purchasing power from holding monetary assets and liabilities are recognized in income; and

all financial statements are restated in constant pesos as of December 31, 2006, based on weighted average factors that take into account the inflation rate and exchange rate fluctuations in each of the countries in which we operate. The weighting of the factors is determined according to the contribution to total revenues of our operations in each country.

We have not reversed the effect of inflation accounting under Mexican FRS in the reconciliation to U.S. GAAP of our net income and stockholders equity, except with respect to the methodologies for restatement of plant, property and equipment of non-Mexican origin and for restatement of financial statements of prior years. See Note 18 to our audited consolidated financial statements.

Our financial statements are presented in constant pesos, so all financial information is restated in pesos with purchasing power as of December 31, 2006. We refer to constant-peso figures as being real, as opposed to nominal. If nominal revenues or income do not increase by at least the rate of inflation, they decrease in real terms.

Overview

Total consolidated revenues grew 0.9% in 2006, primarily due to growth in corporate networks, Internet access and domestic long distance revenues by 11.7%, 11.1% and 2.2%, respectively, as well as a 12.6% increase in other revenues. In contrast, interconnection, international long distance and local service revenues decreased by 6.2%, 5.6% and 2.9%, respectively. Revenues from our non-Mexican operations accounted for 26.7% of total revenues in 2006, compared to 23.5% of total revenues in 2005.

In Mexico, our revenues decreased by 1.1% in 2006 due to lower real rates and a 10.0% decrease in the calling party pays rate that applies to fixed-to-mobile local calls. We have not raised our nominal rates since 2001, and we have given discounts for some domestic long distance and connectivity services, so in real terms our prices continue to fall. The number of lines in service declined by 0.7%, primarily due to the disconnection of 1.7 million lines, including 864 thousand prepaid lines that had payment problems or were not in use. 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 Mexico. In local service, the rapid growth in mobile telecommunications has made them the principal competitor for local networks. In addition, local service faces 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 grew by 76.4% in 2006 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 75.6% of our consolidated revenues in 2006 (77.9% in 2005), while revenues from corporate networks and Internet access services represented 20.0% of our consolidated revenues in 2006 (18.1% in 2005).

Table of Contents

Operating income decreased by 6.9% in 2006, but excluding the charges related to Brazilian taxes, operating income would have increased by 1.6%. Our consolidated operating margin was 27.6% in 2006 and 29.9% in 2005, while the operating margin of our Mexican operations was 37.2% in 2006 and 36.5% in 2005. Our operating margin in Mexico increased in 2006 because the reductions in costs and expenses were larger than the reduction in revenues. Our operating margin outside of Mexico decreased in 2006 because the growth in costs and expenses was larger than the growth in revenues due to the charges related to Brazilian taxes. Without those charges, our operating margin outside of Mexico in 2006 would have been 10.5% instead of 1.1%.

We frequently review possible acquisitions or other investments, with a focus on the telecommunications sector, particularly in Latin America, which could require the commitment of capital resources in addition to our budgeted capital resources. We may make further acquisitions that may increase the diversification of our business outside Mexico.

Our future results may be affected significantly by the general economic and financial conditions in the countries where we operate, including levels of economic growth, devaluation of the local currency, inflation or high interest rates. Our performance may also be affected by new acquisitions and other investments. 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.

Effects of Acquisitions

As a result of our cash tender offer for all remaining outstanding shares of Embratel s voting and non-voting stock in 2006, we increased our interest in Embratel from 72.3% to 98.0% of the total capital stock as of June 30, 2007. In 2006, Embratel s equity interest in Net, which we acquired and transferred to Embratel in 2005, increased from 37.1% to 39.9%. We also acquired 99.2% of Superview, 80.0% of Sección Amarilla USA and 13.0% of 2Wire in 2006.

In 2004, we acquired Techtel, Chilesat, Metrored, a majority of the voting stock of Embratel and substantially all of the assets of AT&T Latin America. The consolidation of these companies affects the comparability of our 2005 results to our 2004 results, particularly since the largest of our 2004 acquisitions were not consolidated until the third quarter of 2004. Our consolidated financial statements reflect the consolidation of these companies as follows:

Telmex Argentina, Telmex do Brasil, Telmex Chile, Telmex Colombia and Telmex Perú (holding the assets of AT&T Latin America in each respective country) (since March 1, 2004),

Techtel (since May 1, 2004),

Metrored (since July 1, 2004),

Chilesat, now Telmex Corp. (since July 1, 2004),

Embratel (since August 1, 2004),

PrimeSys (since December 1, 2005),

Net (equity method since November 1, 2005),

Superview (since November 1, 2006), and

Sección Amarilla USA (since November 1, 2006).

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, provisions, equity in results of affiliates, minority interest and net income for each of the years in the three-year period ended December 31, 2006.

	Year ended December 31,					
	2006		2005		2004	
	(millions of pesos)	(percentage of operating revenues)	(millions of pesos)	(percentage of operating revenues)	(millions of pesos)	(percentage of operating revenues)
Operating revenues						
Local service	P. 60,428	34.5%	P. 62,252	35.9%	P. 62,663	40.7%
Domestic long distance service	40,205	23.0	39,335	22.7	27,390	17.8
International long distance service	13,234	7.6	14,025	8.1	13,089	8.5
Interconnection service	18,365	10.5	19,586	11.3	21,139	13.7
Corporate networks	22,693	13.0	20,324	11.7	14,602	9.5
Internet access services	12,296	7.0	11,071	6.4	8,602	5.6
Other	7,785	4.4	6,912	3.9	6,567	4.2
Total operating revenues	P. 175,006	100.0	P. 173,505	100.0	P. 154,052	100.0

Operating costs and expenses: