TELEFONOS DE MEXICO S A B DE C V
Form 20-F
May 11, 2011
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As filed with the Securities and Exchange Commission on May 11, 2011.

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 or 15 (d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 31, 2010

Commission File Number: 001-32741

Teléfonos de México, S.A.B. de C.V.

(Exact name of Registrant as specified in its charter)

Telephones of Mexico

(Translation of Registrant s name into English)

United Mexican States

(Jurisdiction of incorporation or organization)

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

(Address of principal executive offices)

Anna Domínguez González

Teléfonos de México, S.A.B. de C.V.

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Colonia Cuauhtémoc

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Tel: (52) 55 52 22 17 74

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

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

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

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

None

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

None

The number of outstanding shares of each class of capital or common stock as of December 31, 2010 was:

7,840 million	AA Shares
383 million	A Shares
9,935 million	L Shares

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

x Yes ¨ No

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

¨ Yes x No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports)

and (2) has been subject to such filing requirements for the past 90 days.

x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). N/A

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

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

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

U.S. GAAP	¨	International Financial Reporting Standards as issued by the International Accounting Standards Board	¨	Other	x

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

¨ Item 17 x Item 18

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

¨ Yes x No

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FORWARD-LOOKING STATEMENTS

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

- projections of operating revenues, net income, net income per share, capital expenditures, indebtedness levels, dividends, capital structure or other financial items or ratios;
- statements of our acquisition or divestiture plans;
- statements about the impact of our acquisition of businesses;
- statements about our plans, objectives or goals, including those relating to competition, regulation and rates;
- statements about competition in the business sectors in which we operate;
- statements about our future financial performance or the economic performance of Mexico or other countries;
- statements about interest rates, currency exchange rates and foreign securities markets;
- statements about the availability and cost of external financing for our operations, which have been affected by the stress experienced by the global financial markets;
- statements about the renewal, revocation or expropriation of our concessions, decisions of regulatory and judicial authorities, and the future impact of regulations; and
- statements of assumptions underlying such statements.

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

Forward-looking statements involve inherent risks and uncertainties. We caution you that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements. These factors, some of which are discussed under Item 3. Risk Factors beginning on page 6, include regulatory developments, economic and political conditions, which have been affected by the global economic crisis, competition, customer demand, government policies, inflation rates, exchange rates and technological changes. We caution you that the foregoing list of factors is not exclusive and that other risks and uncertainties may cause actual results to differ materially from those in forward-looking statements.

Forward-looking statements speak only as of the date they are made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information or future events or for any other reason.

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

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PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

SELECTED FINANCIAL DATA

The selected consolidated financial data set forth below have been derived from our consolidated financial statements for each of the five years in the period ended December 31, 2010, which have been audited by Mancera, S.C., a member practice of Ernst & Young Global, an independent registered public accounting firm. The selected consolidated financial data should be read in conjunction with, and are qualified in their entirety by reference to, our audited consolidated financial statements and notes thereto included elsewhere in this annual report.

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

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

Effect of Inflation Accounting

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

In December 2007, we transferred our Latin American and yellow pages directory businesses to a new, separate entity, Telmex Internacional, S.A.B. de C.V. or Telmex Internacional, in an *escisión*, or split-up. See *Item 4. Information on the Company History*. The businesses we transferred to Telmex Internacional are presented as discontinued operations for dates and periods prior to the effective date of the *Escisión*, which was December 26, 2007 under Mexican FRS and June 10, 2008 under U.S. GAAP.

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

(See footnotes on following page)

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

(1) We have not presented net income or dividends on a per ADS basis. Each L Share ADS represents 20 L Shares, and each A Share ADS represents 20 A Shares. At a regular meeting held on December 1, 2009, the stockholders agreed to declare an extraordinary cash dividend of P.0.40 per outstanding share, paid in a single payment on December 17, 2009.

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

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

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

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

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EXCHANGE RATES

The following table sets forth, for the periods indicated, the high, low, average and period-end exchange rate expressed in pesos per U.S. dollar.

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

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

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

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

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

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RISK FACTORS

Risks Relating to Our Business Generally

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

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

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

The Mexican authorities have also adopted regulations to permit cable television providers to provide voice-transmission services to local fixed-line telecommunications operators and data and broadband Internet access services to the Mexican public. As of December 31, 2010, 32 cable television providers, through more than 300 concessions, have been authorized to provide local fixed-line voice-transmission service in various cities in Mexico. Regulations have also been adopted to allow other local telephone service providers to provide paid television and audio services, but to date we have been unable to obtain authorization to do so.

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

Regulatory developments could hurt our business by limiting our ability to pursue competitive and profitable strategies

Our business is subject to extensive government regulation, and it can be adversely affected by changes in law, regulation or regulatory policy that limit our ability to modify our business strategy. In particular, the regulatory developments described below could adversely affect us.

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

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

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

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

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

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

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

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

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

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

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

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

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

We will need to continue to provide our users with reliable service over our network. Some of the risks to our network and infrastructure include physical damage to our network, natural disasters such as hurricanes, earthquakes, floods and storms, among others, and other disruptions beyond our control. Although we carry casualty insurance against loss and we have implemented redundancy in our network and installed backup technologies, disruptions may cause interruptions in service or reduced capacity for customers, either of which could cause us to lose customers and revenues or incur additional expenses.

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

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

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

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amounts based on fixed interest rates and receive amounts based on variable interest rates) and forward exchange contracts (in which we generally agree to use pesos to purchase U.S. dollars at a future date).

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

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

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

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

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

Substantially all of our business operations and assets are located in Mexico. Our financial performance may be affected by general economic, political and social conditions in Mexico. In the past, Mexico has experienced both prolonged periods of weak economic conditions and deterioration in economic conditions that have had a negative impact on our company. Mexico has also experienced high levels of inflation and high domestic interest rates in the past, which significantly lowered the purchasing power of consumers and businesses. Mexico began to enter a recession in the fourth quarter of 2008, during which GDP fell by approximately 1.6%. GDP fell by an additional 6.5% in 2009. By 2010, GDP rose by 5.5%. If the Mexican economy experiences a downturn or if inflation and interest rates increase significantly, our business, financial condition and results of operations could suffer material adverse consequences because, among other things, demand for telecommunications services may decrease and consumers may find it difficult to pay for the services we offer.

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Our corporate restructuring may affect our stock price

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

Risks Relating to Our Controlling Shareholder and Capital Structure

We are controlled by one shareholder

A majority of the voting shares of our company (74.1% as of February 24, 2011) is owned by América Móvil, S.A.B. de C.V., or América Móvil, indirectly through Carso Global Telecom, S.A.B. de C.V., or Carso Global Telecom. América Móvil has the effective power to designate a majority of the members of our Board of Directors and to determine the outcome of other actions requiring a vote of the shareholders, except in very limited cases that require a vote of the holders of L Shares. América Móvil may be deemed to be controlled by Carlos Slim Helú and members of his immediate family, who, taken together, own a majority of the common stock of América Móvil.

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

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

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

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

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

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

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

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

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

You may not be entitled to preemptive rights

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

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

Our bylaws restrict the acquisition of shares in some circumstances

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

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

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

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

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

Item 4. Information on the Company

GENERAL

Overview

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

We have developed a multi-service network in which 94.7% of our lines have the capacity to provide simultaneous transmission of voice and data through a broadband connection. Our network capability allowed us to increase the number of customers of our broadband Internet access service by 12.8% in 2010 to 7.4 million. At the same time, we are extending our voice and Internet access services to remote areas.

In 2010, we continued our efforts to grow voice and data service revenues by offering multiple-service products. In addition, we have made investments to increase our service offerings and to update the telecommunications platform in rural areas where we are the sole telecommunications carrier. We plan to continue expanding our multiple-service offerings in the future and to take advantage of technological advances in order to provide our customers with packages that combine voice, data and eventually video.

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

Substantially all of our operations are now conducted in Mexico. Our strategy is to increase the value of our lines by capitalizing on our extensive and modern infrastructure and our technical capabilities to provide high-quality services to our customers across Mexico, pursuing growth in the broadband and data businesses, introducing and promoting packaged service offerings combining broadband with voice services at attractive prices, and maintaining our focus on customer service. In Mexico s major population centers, data is a source of growth, and we are well positioned to deliver Internet access and meet the demands of the growing data market. We plan to continue selling computer equipment at our Telmex stores and increase the Internet penetration rate in Mexico.

We are a Mexican corporation headquartered in Mexico City, Mexico. Our legal name is Teléfonos de México, S.A.B. de C.V., and we frequently refer to ourselves commercially as Telmex. Our principal executive offices are located at Parque Vía 190, Colonia Cuauhtémoc, 06599 México, D.F., México. Our telephone number at this location is (52) 55 5222 1774. Our website can be accessed at www.telmex.com.

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

History

We were formed in 1947 under private foreign ownership to acquire the Mexican telephone business of a wholly owned subsidiary of the LM Ericsson group of Sweden. In 1950, we acquired the Mexican telephone business of a wholly owned subsidiary of the International Telephone and Telegraph Company, which operated the only other national telephone network in Mexico at that time. In 1972, the Mexican federal government acquired the majority of our capital stock. In December 1990, the Mexican government sold shares representing voting control of our company. The Mexican government sold the balance of its shares in a series of transactions beginning in May 1991.

In September 2000, we transferred our Mexican wireless business and our foreign operations at the time to América Móvil in an *escisión*, or split-up. Beginning in 2004, we expanded our operations outside Mexico through a series of acquisitions in Brazil, Argentina, Chile, Colombia, Peru, Ecuador and the United States. In December 2007, we transferred our Latin American and yellow pages directory businesses to a new, separate entity, Telmex Internacional, in a second *escisión*, or split-up (the *Escisión*). In an *escisión*, an existing company is divided, creating a new company to which specified assets and liabilities are allocated. The shares of the new company are issued to the shareholders of the existing company, pro rata to their share ownership in the existing company. This procedure differs from the procedure by which a spin-off is typically conducted in the United States, where a parent company distributes to its shareholders shares of a subsidiary.

The *Escisión* was approved by our shareholders on December 21, 2007. The establishment of Telmex Internacional became effective on December 26, 2007. As of the effective date of the *Escisión*, each holder of Telmex shares became the owner of an equal number of Telmex Internacional shares of the corresponding class, and each Telmex ADS represented an equal number of Telmex and Telmex Internacional shares. On June 10, 2008, the shares and ADSs of Telmex Internacional began trading separately from our shares and ADSs on the Mexican Stock Exchange and the New York Stock Exchange.

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

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

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

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

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

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

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

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

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Significant Subsidiaries and Investees

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

Name of Company	Jurisdiction of establishment	Percentage of ownership and voting interest	Description
Subsidiaries			
Integración de Servicios TMX, S.A. de C.V.	Mexico	100%	Intermediate holding company.
Alquiladora de Casas, S.A. de C.V.	Mexico	100%	Real estate company owning our facilities.
Compañía de Teléfonos y Bienes Raíces, S.A. de C.V.	Mexico	100%	Real estate company owning our facilities.
Consorcio Red Uno, S.A. de C.V.	Mexico	100%	Supplier of telecommunications network integration services and information systems.
Teléfonos del Noroeste, S.A. de C.V.	Mexico	100%	Fixed-line public network concessionaire for the state of Baja California Norte and the San Luis Rio Colorado region of the state of Sonora.
Uninet, S.A. de C.V.	Mexico	100%	Provider of corporate networks and Internet access services to Telmex and corporate customers.
Telmex USA, L.L.C.	Delaware	100%	Authorized long-distance service re-seller, provider of prepaid telephone cards and payment collection services for lines in Mexico (installation and monthly rental), and authorized by the FCC to provide facility-based long-distance services, data transmission and cross-border data transit services.
Affiliated companies			
Grupo Telvista, S.A. de C.V.	Mexico	45%	Provider of telemarketing services in the United States and Mexico.

OPERATIONS

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

Overview

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

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

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

(2) Includes incoming and outgoing traffic.

Local Service

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

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

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

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

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telecommunications services that include a certain number of local calls and/or minutes for domestic long-distance. In 2010, we did not increase rates for local telephone service. We have had lower rates in real terms for every year since March 2001.

Domestic Long-distance Service

Our nationwide domestic long-distance transmission network consists of 31.2 thousand kilometers of optical fiber connecting Mexico s major cities, and includes secondary branches and additional transmission rings throughout Mexico designed to avoid network congestion.

Domestic long-distance traffic decreased 7.8% in 2010 and increased 0.8% in 2009, reaching a total of 18,292 and 19,837 million minutes, respectively. The decrease in domestic long-distance traffic in 2010 was primarily due to the decrease in traffic delivered by mobile operators and other long distance operators to us for completion.

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

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

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

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

International Long-distance Service

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

In 2010, incoming international long-distance traffic increased by 21.2%, for a total of 7,482 million minutes, and outgoing international long-distance traffic increased by 3.9% for a total of 1,405 million minutes.

We believe international long-distance traffic has been affected by, among other things, the increased use of VoIP technology, which transmits ordinary telephone calls over the Internet. For long-distance calls made through VoIP services, we do not receive the international long-distance service revenues that we would otherwise receive, such as revenues generated from billed minutes and termination fees. International long-distance traffic generated by mobile phone companies also affects our revenues.

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

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

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

The international settlement rates that U.S. carriers pay to foreign carriers have been subject to intense downward pressure due to competition and regulatory factors, including initiatives by the U.S. government.

Interconnection

We provide interconnection services pursuant to which (a) long-distance, local and mobile phone carriers operating in Mexico establish points of interconnection between their networks and our network and (b) we carry calls between the points of interconnection and our customers. When a customer of another carrier calls a local service customer of ours, we complete the call by carrying the call from the point of interconnection to the particular customer, and when a local service customer of ours who has preselected a competing long-distance carrier makes a long-distance call, we carry the call from the customer to the point of interconnection with that other long-distance carrier s network. Excluding the calling party pays service, we have only one rate for interconnecting all categories of carriers and all types of calls. As a result of Mexico s bill and keep system, under which local carriers and cable television providers do not pay interconnection fees to other local carriers, we do not receive an interconnection fee from these calls.

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

Data services

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

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

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

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

Our broadband service, Infinitum, allows our customers to use our high-capacity connectivity services with applications such as video-conferencing, file transfer, terminals and e-mail. Infinitum operates over Asymmetric Digital Subscriber Line, or ADSL, technology. In 2010, as a result of improved ADSL service packages and a price reduction that took effect in April 2007, we increased our ADSL customer base by approximately 835 thousand accounts. At year-end 2010, we had 7.4 million ADSL customer accounts, an increase of 12.8% over 2009. For *WiFi Móvil in Infinitum*, our high-speed wireless service for residential and business customers, during 2010 we increased the speed of access links. At December 31, 2010, we maintained public hot spots (more than 3,500) in over 225 cities in Mexico, provided coverage at approximately 95% of commercial airports in Mexico, and entered into international agreements to provide our customers with Internet access at over 200,000 sites worldwide.

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

Telecommunications Services Packages

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

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

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

Other Products and Services

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

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

In November 2008, we entered into several agreements with Dish México and its affiliates, which operate a direct-to-home (DTH) pay television system in Mexico. We are currently providing customary

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billing and collection services, customer equipment and access to the Telmex retail distribution network. Subject to specified authorizations, we could invest directly in a joint venture with Dish.

Telmex Stores

We use our network of 388 Telmex stores (*Tiendas Telmex*) to offer our products and services throughout Mexico. In addition to their function as customer service centers, the Telmex stores offer a wide range of computer and telecommunications equipment and accessories, which may be purchased outright or through installment payment plans. The network of Telmex stores serves not only as a focal point for interaction with our current and prospective customers but also as a growing source of revenue. Our computer sales strategy, including store financings of up to 36 months, has substantially helped increase broadband coverage in Mexico.

Billing and Customer Service

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

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

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

Public Telephony and Prepaid Phone Cards

We have several programs to meet the need for different kinds of public telephone service in different areas. We had more than 661 thousand fixed-line public telephones in operation at December 31, 2010. In the increasingly competitive market to provide telecommunications services, independent operators have installed public telephones for which we provide access. There were more than 91 thousand independently operated public telephones at December 31, 2010, an increase of 4.4% compared with 2009.

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

Operations in the United States

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

In December 2005, we agreed with Alcatel and AT&T International (one of our principal shareholders) to jointly invest in an aggregate 51% interest in 2Wire, Inc., or 2Wire, a broadband network equipment and service provider for homes and small offices in the United States. We sold our 13.0% interest in 2Wire in October 2010.

Network

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

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

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

Access Network

Our external copper network is capable of supporting conventional telephone services, as well as modern broadband services using different digital technologies such as Asymmetric Digital Subscriber Line 2 plus, or ADSL2+, which allows us to use existing telephone lines at speeds close to 20 Mbps and VDSL 2 (Very High Speed Digital Subscriber Line version 2), which allows speeds of 20 Mbps or higher. Currently we are offering high speed Internet access with speeds of up to 20 Mbps to our residential customers.

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

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

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

We also have wireless access platforms that are supported by radio direct access and multiple access systems, WLL (Wireless Local Loop) systems, Wimax systems as well as satellite systems to provide voice, data and Internet access services to customers who are geographically remote from our fiber optic infrastructure.

Switch Network

Voice processing in our network is controlled by digital local and long-distance telephone exchanges employing high levels of redundancy and load sharing to enhance network availability and service quality. We also use an Advanced Intelligent Network platform, which currently can manage close to 50 applications and value-added services with high levels of reliability. Furthermore, this platform is capable of implementing new services and applications throughout our network in a short amount of time. As part of our network evolution, we have installed a centralized control platform based on the IMS (Internet Multimedia Subsystem) model. The aim of this new platform is to offer new multimedia services to our customers.

Transport Network

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

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

In order to increase our transmission capacities, we also use Dense Wavelength Division Multiplexing, or DWDM, technology which divides the optic fiber signals into multiple wavelengths and allows us to operate our network at speeds of up to 400 Gbps over one optic fiber pair, equivalent to managing more than 4.8 million simultaneous telephone conversations.

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

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

Convergent Network

Part of our core network operates under a *Next Generation Network* architecture that uses a format of switching information packages with the following features: convergence of multimedia services, devices and network infrastructure based on centralized control designed to rapidly deliver new services to our customers; and an integrated service management structure focused on our customers needs. It allows us to provide voice, data and video services with different levels of service quality in an environment where the functions of control and creation of services are centralized and independent from the type of connection.

All of our IP-based services are offered through a multi-service IP/MPLS platform. IP/MPLS is a high-capacity, high-performance network platform based on service convergence and is designed to complement our transport network, with a feature that allows us to expand our backbone network with routes of up to 10 Gbps, maintain redundant routes and offer national coverage of our IP-based services. The technology used in our network provides the necessary flexibility to offer speeds of access from 64 Kbps to 155 Mbps for virtual private multiservice network or IP VPN s.

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

Management Network

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

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

Competition

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

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

We anticipate continued intense competition as mobile phone carriers promote mobile-to-mobile calls and text messages as less expensive alternatives to fixed-to-mobile calls. We also face increasing competition in international and domestic long-distance and local services from VoIP, a technology that transmits ordinary telephone calls over the Internet. More recently, we have begun to face competition in voice services and, to a more significant extent, Internet access services from cable television operators.

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REGULATION

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

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

General

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

Regulatory Oversight

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

Cofetel was established by the Federal Telecommunications Law as a separate administrative body that enjoys operative, budgetary and management independence from the Communications Ministry. Cofetel is charged with the regulation, promotion and supervision of the telecommunications and radio broadcasting markets in Mexico, with full autonomy to issue its own resolutions. Cofetel is headed by five commissioners appointed by the President of Mexico, one of whom serves as chairman. Many of the faculties and obligations of the Communications Ministry under the Federal Telecommunications Law and the Telecommunications Regulations were transferred to Cofetel. We regularly provide reports to Cofetel on our operations, financial performance and other matters. We are also required to publish our annual network expansion program and must inform Cofetel of the progress of our expansion program on an annual basis.

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

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right, our unions also have a right of first refusal. In addition, Mexican law permits the Mexican government to expropriate our assets in certain circumstances.

Concessions

Under the Federal Telecommunications Law and the Telecommunications Regulations, a provider of public telecommunications services must operate under a concession granted by the Communications Ministry. Such a concession may not be transferred or assigned without the approval of the Communications Ministry. A concession to provide public fixed-line local and long-distance services generally has a term of up to 30 years and may be extended for additional 30-year terms. Our Concession was granted in 1976 and amended in August 1990. Currently set to expire in 2026, our Concession may be extended for an additional 15-year term. Our subsidiary Telnor holds a separate concession in a region located in two states in northwestern Mexico, which will also expire in 2026 and may be extended for an additional 15-year term thereafter. The material terms of the Telnor concession are essentially the same as the terms of the Concession.

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

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

Termination of the Concession

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

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

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

- Failure to comply with the terms of the Concession;
- Interruption of all or a material part of the services provided by us;

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

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

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

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

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

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

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Competition

The Telecommunications Regulations and the Concession contain various provisions designed to foster competition in the provision of telecommunications services. In general, the Communications Ministry is authorized to grant concessions to other parties for the provision of any of the services provided by us under the Concession. There are currently 18 competing long-distance carriers operating in Mexico (including Telmex and Telnor), all of which also have concessions for international long-distance services.

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

With respect to international long-distance services, Cofetel rules cover matters such as the termination of international calls and mechanisms for routing calls into and out of Mexico. Currently, international traffic must be carried by Mexican concessionaires and through authorized international gateways consistent with Cofetel s international long-distance rules.

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

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

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

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

Regulatory Initiatives Relating to Competition

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

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

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

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

Television and Audio Services

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

In 2003, the Communications Ministry expanded the concessions granted to cable television operators to permit them to provide bidirectional transmission of data. In 2004, the Communications Ministry began to permit cable operators to provide signal-transmission services to local fixed-line operators and data and broadband Internet access services to the Mexican public.

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

In October 2006, the Communications Ministry adopted regulations that permit paid television and audio concessionaires to provide fixed-line local telephone services and local telephone service providers like us to provide paid television and audio services. These regulations facilitate the convergence of voice, data and video services into one integrated product that could be delivered over a broadband network. The regulations allow concessionaires to provide these new services, subject to certain regulatory steps to be taken by Cofetel. As of December 31, 2010, 32 cable television providers, through more than 300 concessions, provide or have been authorized to provide local fixed-line voice-transmission and one fixed-line local service provider offers paid television services. In the case of Telmex, due to certain restrictions on our concession, additional conditions have been imposed, including the implementation of network interoperability, telephone number portability and verification of compliance with existing concession obligations, as well as the adoption of an interconnection framework. Telephone number portability was initiated in July 2008, allowing customers to change their telephone provider and keep their telephone number. We intend to provide television and audio services and we believe we have met all the requirements necessary to do so; however, to date we have been unable to obtain authorization.

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

Consolidation of Local Service Areas

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

Rates

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

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

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

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

Interconnection

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

The Concession provides that other terms of interconnection, including fees, are to be negotiated between us and each other long-distance carrier, and that, in the event the parties are unable to agree, the Communications Ministry imposes the terms. In 2002, we agreed with competing long-distance carriers to set an interconnection rate of U.S.$0.00975 per minute and per interconnection point. This rate will remain in effect so long as we and the other carriers do not agree to set a new rate.

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

In Mexico, under the calling party pays service, our fixed-line customers pay us an interconnection charge when they call a mobile telephone, and during 2010 we paid 66.2% of that amount to the mobile phone carrier that completes the call. Historically, this interconnection charge applied only to local calls. In November 2006, however, Cofetel extended the calling party pays charge to domestic and international long-distance calls, while concurrently eliminating the fee that mobile phone carriers charge their customers for receiving long-distance calls from fixed-line and mobile callers.

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

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CAPITAL EXPENDITURES

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

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

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

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

OTHER MATTERS

Investments

We occasionally make investments and enter into joint ventures in telecommunications-related businesses within and outside Mexico. We also invest in publicly traded equity securities of companies in technology and communications businesses.

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

Plant, Property and Equipment

We have transmission facilities, exchanges, outside plant and commercial and administrative offices throughout Mexico. We own most of the locations of our exchanges and offices and lease other locations. We carry casualty insurance against loss or damage to buildings, equipment contained in buildings and outside plant, including our fiber optic network.

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

The Telmex Foundation

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

Item 4A. Unresolved Staff Comments

None.

Item 5. Operating and Financial Review and Prospects

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included in this annual report.

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

Overview

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

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

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

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

Our future results may be affected significantly by the general economic and financial conditions in Mexico and the United States, including the level of economic growth, exchange rate and interest rate fluctuations and inflation. Our performance may also be affected by acquisitions and other investments we may make. Exchange rate variations on our U.S. dollar-denominated indebtedness contribute to the volatility of our financing cost, which we manage through the use of derivative instruments. Exchange gain, net, was P.394 million in 2010 and P.1,097 million in 2009.

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

Transition to IFRS

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

Effect of Inflation Accounting

Historically, Mexican FRS required that that we recognize the effects of inflation on our financial information. Upon the adoption of Mexican FRS B- 10, effective January 1, 2008, we ceased to recognize the effects of inflation on our financial information, because we currently operate in a non-inflationary economic environment for purposes of Mexican FRS. An environment is inflationary if the cumulative inflation rate equals or exceeds an aggregate of 26% over three consecutive years (equivalent to an average of 8% in each year). Accordingly, our financial statements contained in this annual report are presented without inflationary effects, except for those non-monetary items that included inflation effects through December 31, 2007. Subsequent additions are recognized at historical cost.

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

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

Changes in Mexican FRS

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

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Summary of Operating Income and Net Income

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

	Year ended December 31,					
	2010		2009		2008	
	(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. 41,007	36.1%				