

TELEFONOS DE MEXICO S A B DE C V

Form 20-F

July 16, 2007

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

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006

Commission File Number: 001-32741

Teléfonos de México, S.A.B. de C.V.

(Exact name of registrant as specified in its charter)

Telephones of Mexico

(Translation of registrant's name into English)

United Mexican States

(Jurisdiction of incorporation or organization)

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

(Address of principal executive offices)

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

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing 20	New York Stock Exchange
Series L Shares, without par value (L Share ADSs)	
Series L Shares, without par value (L Shares)	New York Stock Exchange
	(for listing purposes only)
8.75% Senior Notes due 2016	New York Stock Exchange
SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:	

American Depositary Shares, each representing 20

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

Series A Shares, without par value (A Shares)

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

None

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The number of outstanding shares of each class of capital or common stock as of December 31, 2006 was:

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

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

Yes No

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

Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

Item 17 Item 18

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

Yes No

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PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

SELECTED FINANCIAL DATA

The selected consolidated financial data set forth below have been derived from our audited consolidated financial statements for each of the five years in the period ended December 31, 2006, which have been reported on by Mancera, S.C., a member of Ernst & Young Global, an independent, registered public accounting firm. The selected consolidated financial data should be read in conjunction with, and are qualified in their entirety by reference to, our consolidated financial statements and notes thereto included elsewhere in this Annual Report.

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

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

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

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

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

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

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

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

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

(see footnotes on following page)

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

- (1) We have not presented net income or dividends on a per ADS basis. Each L Share ADS represents 20 L Shares, and each A Share ADS represents 20 A Shares.
- (2) Nominal amounts. For information on dividends paid per share converted into U.S. dollars, see *Item 8. Financial Information Dividends*.
- (3) Earnings for this purpose consist of earnings before provisions for income tax and employee profit sharing, plus fixed charges during the period. Fixed charges for this purpose consist of interest expense during the period. Fixed charges do not take into account gain or loss from monetary position or exchange gain or loss attributable to our indebtedness.
- (4) Earnings for this purpose consist of earnings before provision for income tax but after provision for employee profit sharing, plus fixed charges and depreciation of capitalized interest and minus interest capitalized during the period. Fixed charges for this purpose consist of interest expense plus interest capitalized during the period. Fixed charges do not take into account gain or loss from monetary position or exchange gain or loss attributable to our indebtedness.

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

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

Period	High	Low	Average⁽¹⁾	Period End
2002	P. 9.00	P. 10.43	P. 9.66	P. 10.43
2003	10.11	11.41	10.79	11.24
2004	10.81	11.64	11.29	11.15
2005	10.41	11.41	10.87	10.63
2006	10.43	11.46	10.90	10.80
2007:				
January	10.77	11.09	10.96	11.04
February	10.92	11.16	11.00	11.16
March	11.01	11.18	11.11	11.04
April	10.92	11.03	10.98	10.93
May	10.74	10.93	10.80	10.93
June	10.71	10.98	10.83	10.79

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

On July 13, 2007, the noon buying rate was P. 10.77 to U.S.\$1.00.

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

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RISK FACTORS

Risks Relating to Our Business Generally

Increasing competition in Mexico, Brazil and the other countries in which we operate could adversely affect our revenues and profitability

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

In Mexico, competition in local service, principally from wireless service providers, has been developing since 1999. In December 2006, there were approximately 57.0 million cellular lines in service, compared with approximately 19.9 million fixed lines in service (18.3 million of which are part of our network). As of year-end 2006, licenses have been granted to 27 local carriers, including Telmex and our subsidiary Teléfonos de Noroeste, S.A. de C.V., or Telnor, mainly in Mexico City, Guadalajara, Monterrey, Puebla and other large and medium-sized cities. Of these, 23 carriers (including Telmex and Telnor) are local fixed-line concessionaires and four carriers (including Telmex) are local wireless concessionaires in the 3.4 Ghz frequency band.

We have also begun to face new competition in Mexico from cable television providers, who have been authorized by the Communications Ministry (*Secretaría de Comunicaciones y Transportes*) to provide voice-transmission services to local fixed-line telecommunications operators and data and broadband Internet access services to the Mexican public. As of December 31, 2006, cable television providers have been granted 28 licenses for the provision of local fixed-line voice-transmission service in various cities in Mexico. In addition, in April 2006, the Mexican Congress amended the Federal Telecommunications Law (*Ley Federal de Telecomunicaciones*) and the Federal Radio and Television Law (*Ley Federal de Radio y Televisión*) to allow radio and television broadcasting companies to apply for authorizations to provide telecommunications services.

The effects of competition on our business are highly uncertain and will depend on a variety of factors, including economic conditions, regulatory developments, the behavior of our customers and competitors and the effectiveness of measures we take in response to the competition we face.

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

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

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

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

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

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

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

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

Risks Relating to Our Controlling Shareholder and Capital Structure

We are controlled by one shareholder

A majority of the voting shares of our company (71.2% as of April 30, 2007) is owned by Carso Global Telecom, S.A.B. de C.V., or Carso Global Telecom. Carso Global Telecom has the effective power to designate a majority of the members of our Board of Directors and to determine the outcome of other actions requiring a vote of the shareholders, except in very limited cases that require a vote of the holders of L Shares. Carso Global Telecom is controlled by Carlos Slim Helú and members of his immediate family, who, taken t