ANNUAL REPORT 1996

TELÉFONOS DE MÉXICO

INDEX

Highlights

Figures in million of pesos, unless otherwise indicated	1996	1995	1994	1993	1992
FINANCIAL RESULTS*					
Total Revenues	52,714	53,224	56,693	51,109	46,459
Cost of Sales and Services	11,768	15,709	17,005	15,729	14,131
Commercial, Administrative and General Expenses	11,598	9,104	8,691	7,815	7,071
Depreciation and Amortization	12,509	9,208	6,883	6,205	5,093
Total Expenses	35,875	34,021	32,579	29,749	26,295
Operating Income	16,839	19,203	24,114	21,360	20,164
Net Income	11,600	11,884	15,256	18,704	17,895
Total Assets	111,682	129,787	146,016	109,902	97,707
Total Liabilities	13,356	21,034	20,508	14,895	14,524
Stockholders' Equity	89,215	100,916	107,207	76,968	69,461
Total Liabilities/Capitalization (%)	13.0	17.2	16.1	16.2	17.3
Net Annual Investment	5,238	10,762	16,408	14,722	16,441
STATISTICS					
Communities with Telephone Service	20,694	20,554	20,447	18,281	15,783
Access Lines in Service (1)	8,826	8,801	8,493	7,621	6,754
Kms. of L.D. Circuits in Service (1)	96,493	87,428	81,956	82,491	83,106
Domestic L.D. Minutes (2)	7,867	7,294	6,746	5,923	5,293
International L.D. Minutes (2)	3,513	3,024	2,622	2,221	2,001
DATA PER SHARE (pesos)*					
Earnings per Share	1.27	1.17	1.45	1.77	1.69
Book Value	10.05	10.45	10.21	7.28	6.57
Market Value at Year-End	12.980	12.360	10.240	10.450	8.775
Nominal Dividend per Share	0.525 (3)	0.350	0.300	0.250	0.150
Outstanding Shares (2)	8,875	9,654	10,499	10,566	10,576

(*) The numbers from 1992 to 1995 have been updated according with the third re-expression document of Bulletin B-10 and, accordingly, they are stated in pesos with a purchasing power as of December 31, 1996.
(1) In Thousands
(2) In Millions
(3) Proposed

Letter to Our Shareholders

In 1996 Teléfonos de México achieved a significant milestone in our preparation for competition. We completed an important stage of our technological modernization process, undertaken when the company was privatized and accomplished with the support of our employees and our financial strength.

Teléfonos de México now has one of the most modern long distance telecommunications networks in the world. Our fully digitized 30,000- kilometer fiber optic network delivers our long distance service, under the trademark LADA, to 20,694 communities. If a failure occurs, the network's redundant ring state-of-the-art technological architecture resets the service in only milliseconds. In addition, our Long Distance Network National Supervision Center, located in the City of Querétaro, and the Long Distance Supervision Centers in Monterrey, Guadalajara and Puebla constantly monitor operation of the complete system.

The enormous effort made by TELMEX during the past few years, the major investments, the work done jointly with our personnel to better serve our clients, and the presence of the company throughout Mexico, all are fundamental factors in maintaining a leadership position in the market. By segmenting the market and identifying our customers' needs, we have responded to their expectations on a timely basis with better products and services and discounts on their long distance calls.

During 1996 we carried out all the work necessary for new long distance operators to establish interconnection beginning on January 1, 1997. Our process was unprecedented anywhere in the world because of the short time available to us. We invested 550 million dollars, and it required full-time participation of more than 500 company employees.

In accordance with the agreement, the country's 60 major cities will be interconnected in 1997, 100 cities in 1998 and 150 in 1999. TELMEX is committed to carrying out the opening of the telecommunications market in Mexico. Our commitment is evident in our timely compliance with the interconnection schedule and the dedication of the human and financial resources this process has demanded.

Despite the big advantages with which our competitors have entered this market — and our competitors include two of the world's major transnational communications companies — all of them use our local and long distance infrastructure even more than they originally expected to because their own investments in infrastructure have been delayed. Under the interconnection arrangement, the long distance suppliers can take advantage of the existing local service infrastructure with its high operating expenses, maintenance and investment, and they have access to it at reduced prices, significantly below what they pay in their own countries. Therefore, we have gone from a situation where, for social reasons, long distance historically subsidized local service, to the current situation, in which the subsidy in effect has been reversed and everybody helps pay for long distance, for reasons we do not understand.

We know that, in addition to technological support, quality service requires extraordinary customer service. Therefore, our old commercial offices were upgraded to turn them into modern Telecommunications Service Centers. Their integrated service concept allows customers to pay for services, ask questions about telephone bills, obtain information and contract for products and services, all at one location. Due to our customers' outstanding acceptance of these new Service Centers, we are expanding this integrated service concept in many communities and cities throughout Mexico. Our company's daily efforts to improve quality measurements based on internal indicators as well as customer satisfaction surveys are yielding good results.

In recognition of new conditions in our market, we have created specific service centers to attend to the needs of the long distance carriers. These facilities include the Telecommunications Carriers Service Center (CAT, as per initials in Spanish), in charge of installation, maintenance and consultation, and the Telecommunications Carriers Commercial Service Center (CAO, as per initials in Spanish), which handles contracting, billing, and other commercial services.

The growth rate of telephone lines continued to decrease in 1996. The demand for new lines barely exceeded the number of lines which were canceled due to lack of payment. At year's end lines in service amounted to 8'826,148, a 0.28 percent annual growth rate. The lower level of line growth reflected the economic situation of the country and citizens' reduced purchasing power. To counteract these effects, we have relaxed payment terms and conditions before we interrupt service, and we have established a partial interruption process to help reduce our customers' discomfort and problems.

TELCEL, our subsidiary which is the leader in the cellular telephone market, continued to grow. It had a net addition of 257,662 customers in 1996, which represented a 64.6 percent increase. In 1996 TELCEL introduced new programs whose innovative payment methods are very attractive to customers. Known as "Sistema Amigo" (Friend System), which features prepaid cards, and "Amigo Kit," which includes cellular phones previously programmed with specific amounts of air time, the new services allow customers to make calls over the cellular network without paying additional charges.

During 1996 TELMEX introduced other new capabilities that allow customers to take advantage of the latest developments in telecommunications. The Intelligent Network concept allows Teléfonos de México to offer new products and services such as the Virtual Private Network, which emulates a voice private network but draws on the resources of the telecommunications public network. At the end of the year, Direct Internet Service was made available to the public, together with all the business, education and entertainment possibilities offered by that wonderful worldwide network. The Yellow Pages also can be accessed through the Internet, giving customers another alternative to become acquainted with the information provided by Yellow Pages advertisers.

The TELMEX Foundation, A. C., was created in 1996, to assist us in meeting our social objectives. It is a welfare institution whose basic objectives are education, health, culture and social well-being in Mexico. The Foundation works with Asociación Carso, created more than 12 years ago.

TELMEX paid 12,607 million pesos in 1996 in taxes and assessments levied on the company and taxes withheld. Remuneration to personnel, profit sharing and welfare expenses totaled 10,378 million pesos; this is a significant contribution to Federal and States' tax revenues, as well as a significant amount of paid salaries.

The various steps we have taken strengthen our confidence that TELMEX will continue to be the leader in the Mexican telecommunications market. At the same time, we intend to benefit from developing opportunities, such as access to the United States long distance market, for the time being, where we plan to reach the Spanish-speaking users of that important region.

We are ready to compete. We have made investments that will allow us to have a state-of-the-art technological platform, and we know how to meet the fundamental objective of completely satisfying the telecommunications needs of our customers as a group and individually.

The outlook for our company is promising. Our entrepreneurial philosophy encourages us to regard each challenge we face as an opportunity to improve. We are confident because we trust the skills and commitment of Teléfonos de México personnel to reach the objectives we have set.

Carlos Slim Helú
Chairman of the Board of Directors

Jaime Chico Pardo
Chief Executive Officer

Financial Results

Comments on the Operating Results and the Financial Position

Financial Statements

Consolidated as of December 31, 1996 and 1995 with the Auditors Report

Comments on the Operating Results and the Financial Position

Teléfonos de México, S.A. de C.V. and its subsidiaries and associated companies (TELMEX), provide the broadest range of telecommunication services at national and international levels to customers in practically all economic activity areas. TELMEX is the most important telecommunications company in Mexico, and one of the largest in the world, measured by its lines in service. It is ranked among the seventeen major telecommunication companies in the world.

Operating Results

During 1996, TELMEX had a net increase of 25,118 lines in service and by the end of the year reached a total of 8'826,148 lines in service. This reduced rate of growth was due to the lower rate of new contracts and the cancellation of lines because of lack of payment, which to a large extent was generated by the country's economic situation.

Domestic long distance traffic was 7,867 million minutes billed, which meant a 7.9 per cent growth versus the volume registered the previous year. International long distance traffic was 3,513 million minutes billed, a 16.2 percent increase versus 1995.

In 1996 new products were launched into the market, including "Internet Directo" for residential use and the availability of the Yellow Pages Directory through the Internet.

Financial Results

The following comments on the main financial results obtained by TELMEX during 1996 are based on the consolidated financial statements and their notes included in this Annual Report. The consolidated financial statements were prepared in accordance with Generally Accepted Accounting Principles. In accordance with Bulletin B-10 of the Mexican Institute of Public Accountants, A. C., the financial information in this report has been restated in pesos with purchasing power of December 31, 1996.

The following charts first show income, expenses and operating income of TELMEX and then the breakdown of the operating income for cellular telephony.

TELMEX
Years ended December 31

	1996		1995	
	Million pesos	% of operating revenue	Million pesos	% of operating revenue
OPERATING REVENUES				
Long Distance Service:				
International	14,387	27.3	14,285	26.8
Domestic	15,483	29.4	14,621	27.5
Local Service	21,465	40.7	22,463	42.2
Other	1,379	2.6	1,855	3.5
Total Revenues	52,714	100.0	53,224	100.0
OPERATING COSTS AND EXPENSES				
Cost of Sales and Services	11,768	22.3	11,006	20.7
Commercial, Administrative and General Expenses	9,392	17.8	9,104	17.1
Depreciation and Amortization	10,948	20.8	9,208	17.3
Telephone Tax			4,703	8.8
Special Cost and Expenses	3,767	7.2		
Total Costs and Expenses	35,875	68.1	34,021	63.9
OPERATING INCOME	16,839	31.9	19,203	36.1

WIRELESS OPERATIONS
Years ended December 31

	1996		1995	
	Million pesos	% of operating revenue	Million pesos	% of operating revenue
REVENUES*	3,075	100.0	3,007	100.0
COSTS AND OPERATING EXPENSES				
Cost of Sales and Services*	1,446	47.0	1,057	35.1
Commercial, Administrative and General Expenses	1,728	56.2	1,797	59.8
Total Costs and Expenses	3,174	103.2	2,854	94.9
OPERATING INCOME	(99)	(3.2)	153	5.1

* Including Long Distance income and/or associated costs

Income From International Long Distance Service

Revenues from this service depend on traffic volume, the rates charged to customers and the rates collected by each party in accordance with settlement agreements with carriers and administrations abroad, mainly in the United States of America. During 1996, the contribution of settlement rates to the operating income accounted for 13.5 percent of total revenues and 49.5 percent of international long distance revenues.

The minutes billed increased 16.2 percent in 1996 and 15.3 percent in 1995. Long distance revenues increased 0.7 percent in 1996 and 24.1 percent in 1995. In 1996, the traffic volume increase and the peso's strong value on net settlement revenues were offset by billing discounts offered to long distance customers and reductions in the settlement rates agreed upon with USA carriers. In 1995, the effect of the devaluation of the peso and the increase in traffic volume resulted in a revenue increase, partially offset by reductions in the settlement rates.

Revenues From Domestic Long Distance Service

Revenues for domestic long distance service depend on rates and traffic volume. These revenues increased 5.9 percent during 1996, while in 1995 they decreased 15.6 percent. The volume of minutes billed increased 7.9 percent in 1996 and 8.1 percent in 1995. In 1996, the increase in the traffic volume was partially offset by the reduction in the actual rates, while in 1995 it was more than offset.

Revenues from Local Service

Revenues from local service include charges to customers for the installation of new lines, the monthly bill and measured service. This amount depends on the number of lines in service and the volume of local calls. Local service revenues also include other charges, especially those made to cellular companies for interconnection with the TELMEX network. Beginning in 1997, revenues derived from interconnecting competitors also will be included in local service revenues.

During 1996 and 1995, these revenues decreased 4.4 and 12.6 percent, respectively, basically due to lower actual rates.

Other Revenues

Other income decreased 25.7 percent in 1996 and 14.3 percent in 1995. Economic problems led to lower revenues from advertising in the Yellow Pages and lower profits from the sale of materials.

Sales and Service Costs

During 1996 sales and service costs increased 6.9 percent, compared with a decrease of 9.0 percent in 1995. The increase in 1996 was partly due to higher salaries and related costs, and costs of personnel associated with construction supervision were charged to operating results. Also, beginning in the third quarter of 1996, telephone plant rehabilitation costs that were previously capitalized became maintenance costs and were charged to operating results.

The decrease registered in 1995 was partially due to an 11.4 percent reduction in salaries and related costs. The 3.1 percent decrease in other costs reflected expense-control efforts and higher utilization of the installed infrastructure. The costs of personnel associated with supervision of construction, which were no longer capitalized after the fourth quarter of 1995, amounted to 286 million pesos.

Commercial, Administrative and General Expenses

In 1996 commercial, administrative and general expenses grew 3.2 percent compared with 4.8 percent in 1995. The 1996 increase was due to an increase in bad accounts, which amounted to 1,673 million pesos for the year, and to an increase in advertising expenses.

The 1995 increase reflected higher expenses associated with the implementation of systems to improve billing and to an increase in the bad accounts provisions.

Depreciation and Amortization

Depreciation and amortization increased 18.9 percent in 1996 and 33.8 percent in 1995. The increase in both years in part can be attributed to the replacement value of telephone assets in peso terms and to new investments. In 1996, TELMEX increased its depreciation rate on a significant portion of its equipment to reflect advancements in technology, which translated into an increase of 1,085 million pesos in depreciation.

Special Costs and Expenses

In 1996, TELMEX registered special costs and expenses amounting to 3,767 million pesos, due to three separate items:

- Anticipated write-off of the remaining goodwill amounting to 1,561 million pesos, attributable to the purchase of a microwave network from a government agency and investments made in 1995 in Empresas Cablevisión, S.A. de C.V. and in Consorcio Red Uno, S.A. de C.V.
- A charge to expenses of 895 million pesos, representing a portion of the expenses incurred in 1996 for changes in the network and other expenses related to the opening of the long distance market in Mexico.
- The initial contribution of 1,311 million pesos to create the TELMEX Foundation, A.C., which is a non-profit organization to promote education and health in Mexico.

Operating Income

In 1996, operating income decreased 12.3 percent due to the reduction in revenues and the increase in operating costs and expenses and the special charges, which resulted in an operating margin of 36.1 percent in 1995 and 31.9 percent in 1996.

Integral Financing Cost (Income)

In 1996, this account reflected a net income of 2,100 million pesos, while in 1995 it reported a net cost of 4,731 million pesos.

During 1996, interest income decreased 67.3 percent, due to lower interest rates in México and a lower average level of interest bearing assets. Interest income increased 129.0 percent during 1995, basically due to higher interest rates compared with the prior year.

Interest expense decreased 48.4 percent during 1996 due to lower foreign interest rates and a lower indebtedness level. Interest expense increased 83.0 percent in 1995, due to the effect of the peso devaluation on foreign currency debt.

The relative stability of the peso to the US dollar during 1996 and the appreciation of the peso against other currencies translated into net exchange income. The significant devaluation of the peso against other currencies in 1995 generated severe exchange losses on TELMEX's debts in foreign currencies.

In 1996 and 1995, the monetary liabilities average exceeded the average of monetary assets, resulting in net gains in the monetary position in both years. The 1995 to 1996 increase was due to the higher level of monetary liabilities versus monetary assets, and this compensated for the decrease in inflation.

Net Income

Net consolidated income in 1996 amounted to 11,600 million pesos, which meant a 2.4 per cent reduction versus 1995 net income.

Investments

TELMEX's consolidated investments amounted to 5,238 million pesos during 1996.

Financial Structure

TELMEX's financial structure is still sound, as can be seen in the total debt to capitalization ratio at year-end 1996, when it was 13.0 percent compared with 17.2 percent a year earlier.

Stock Repurchase

During 1996, TELMEX repurchased 779 million of its shares, equal to 8.0 percent of the capital stock of the company at the beginning of the year. In December of that year, 845 million company shares were canceled and the program to repurchase 800 million additional shares was approved. At the close of 1996, TELMEX had 8,874.5 million shares outstanding, made up of 2,163.0 million serie "AA" shares, 279.5 million serie "A" shares and 6,432.0 million serie "L" shares.

Opinion of the Statutory Auditor

To the Stockholders of
Teléfonos de México, S.A. de C.V.

In my capacity as statutory auditor, I am pleased to submit the following report on the year ended December 31, 1996.

I myself, or, in my absence, the alternate statutory auditor, attended all the meetings of the Board of Directors of Teléfonos de México, S.A. de C.V., and I obtained all of the information on the Company's operations that I considered necessary.

I reviewed, to the extent I considered necessary in the circumstances, the unqualified audit report of the independent auditors dated March 7, 1997, derived from their examination performed in accordance with auditing standards generally accepted in Mexico, of the consolidated financial statements at December 31, 1996, prepared by the Company's management. In my opinion, based on the work performed:

a) The accounting and reporting policies followed by the Company are adequate and sufficient in the circumstances and were applied on a basis consistent with that of the prior year.

b) The above-mentioned audited financial statements reflect fairly the consolidated financial position of Teléfonos de México, S.A. de C.V. at December 31, 1996, and the consolidated results of its operations, changes in its stockholders' equity, and changes in its financial position for the year then ended, in conformity with accounting principles generally accepted in Mexico. Consequently, I submit them for consideration by the stockholders.

C.P. Victor Aguilar
Statutory Auditor

Mexico City, Mexico
March 7, 1997

Report of Independent Auditors

Mancera, S.C.
Ernst & Young

To the Stockholders of
Teléfonos de México, S.A. de C.V.

We have audited the accompanying consolidated balance sheets of Teléfonos de México, S.A. de C.V. and subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of income, changes in stockholders' equity and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Mexico. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement and are prepared in conformity with accounting principles generally accepted in Mexico. An audit includes examining, on a test basis, evidence supporting the amounts and the disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Teléfonos de México, S.A. de C.V. and subsidiaries at December 31, 1996 and 1995, and the consolidated results of their operations, changes in their stockholders' equity, and changes in their financial position for the years then ended in conformity with accounting principles generally accepted in Mexico.

Mancera, S. C.
a Member of
Ernst & Young International

C.P. Alberto Tiburcio

Mexico City, Mexico,
March 7, 1997

Consolidated Statements of Income
(Thousands of Mexican pesos with purchasing power at December 31, 1996)

	Year ended December 31 1996	1995
Operating revenues:		
Long-distance service:		
International	Ps. 14,387,336	Ps. 14,284,862
Domestic	15,483,004	14,621,441
Local service	21,464,971	22,463,339
Other	1,378,626	1,854,704
	52,713,937	53,224,346
Operating costs and expenses:		
Cost of sales and services	11,768,080	11,006,057
Commercial, administrative and general	9,391,806	9,103,653
Depreciation and amortization (Note 3)	10,948,221	9,208,415
Telephone service tax (Note 13)		4,702,719
Special charges (Note 7)	3,767,308	
	35,875,415	34,020,844
Operating income	16,838,522	19,203,502
Comprehensive financing (income) cost:		
Interest income	(2,394,674)	(7,318,153)
Interest expense	1,852,083	3,586,207
Exchange (gain) loss, net (Note 8)	(214,928)	9,140,770
Monetary effect	(1,342,640)	(677,419)
	(2,100,159)	4,731,405
Income before income tax and employee profit sharing	18,938,681	14,472,097
Provisions for (Notes 12 and 13):		
Income tax	5,531,823	1,077,759
Employee profit sharing	1,450,882	1,169,674
	6,982,705	2,247,433
Income before equity in results of affiliates	11,955,976	12,224,664
Equity in results of affiliates and amortization of goodwill (Note 2)	355,577	340,248
Net income	Ps. 11,600,399	Ps. 11,884,416
Weighted average common shares outstanding (in millions)	9,154	10,150
Net income per share (in Mexican pesos)	Ps. 1.267	Ps. 1.171

See accompanying notes.

Consolidated Statements of Changes in Financial Position
(Thousands of Mexican pesos with purchasing power at December 31, 1996)

	Year ended December 31 1996	1995
Operating activities :		
Net income	Ps. 11,600,399	Ps. 11,884,416
Add: Items not requiring the use of resources:		
Depreciation	10,745,153	9,046,646
Amortization	1,763,023	161,769
Equity in results of affiliates and amortization of goodwill	355,577	340,248
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts due from subscribers	(785,668)	2,197,080
Other accounts receivable	(1,397,621)	2,499,616
Prepaid expenses	(277,739)	191,810
Trust fund contribution		604,181
Increase (decrease) in:		
Employee pensions and seniority premiums:		
Reserve	2,154,508	2,361,220
Contributions to trust fund	(1,870,390)	(1,662,480)
Payments to employees	(943,920)	(918,100)
Monetary effect of reserve	(99,094)	(465,453)
Accounts payable and accrued liabilities	1,064,615	(839,990)
Taxes payable	1,125,322	59,917
Deferred credits	(165,484)	(402,630)
Resources provided by operating activities	23,268,681	25,058,250
Financing activities :		
New loans	6,417,478	3,893,508
Repayment of loans	(9,513,069)	(3,473,837)
Effect of exchange difference and of inflation on debt	(4,582,518)	106,935
Application of advances on sale of receivables		(1,568,016)
Decrease in capital stock and retained earnings due to purchase of Company's own shares	(10,821,506)	(12,167,028)
Cash dividends paid	(3,382,652)	(4,163,684)
Resources used in financing activities	(21,882,267)	(17,372,122)
Investing activities :		
Investment in telephone plant	(5,173,336)	(9,075,967)
Reduction in telephone plant inventories	11,101	468,968
Investment in subsidiary company	(75,577)	
Investment in affiliated companies		(2,154,908)
Resources used in investing activities	(5,237,812)	(10,761,907)
Net decrease in cash and short term investments	(3,851,398)	(3,075,779)
Cash and short-term investments at beginning of year	8,938,485	12,014,264
Cash and short-term investments at end of year	Ps. 5,087,087	Ps. 8,938,485

See accompanying notes.

Consolidated Balance Sheets
(Thousands of Mexican pesos with purchasing power at December 31, 1996)

	December 31	
	1996	1995
Assets		
Current assets:		
Cash and short-term investments	**Ps. 5,087,087**	Ps. 8,938,485
Accounts receivable:		
Subscribers	**9,214,072**	8,428,404
Net settlement receivables	**1,624,448**	952,445
Other	**1,730,586**	1,004,333
	12,569,106	10,385,182
Prepaid expenses	**1,501,456**	1,263,504
Total current assets	**19,157,649**	20,587,171
Plant, property and equipment, net (Note 3)	**90,820,122**	104,782,528
Inventories, primarily for use in construction of the telephone plant	**1,205,030**	1,746,366
Equity investment in affiliates (Note 2)	**496,606**	532,609
Goodwill, net (Note 2)		1,329,077
Other assets (Notes 3 and 5)	**3,007**	808,914
Total assets	**Ps. 111,682,414**	Ps. 129,786,665

	December 31	
	1996	1995
Liabilities and stockholders' equity		
Current liabilities:		
Current portion of long-term debt (Note 4)	**Ps. 3,551,867**	Ps. 6,088,131
Accounts payable and accrued liabilities	**5,589,719**	4,518,722
Taxes payable	**2,847,840**	1,722,359
Total current liabilities	**11,989,426**	12,329,212
Long-term debt (Note 4)	**9,804,362**	14,946,207
Reserve for employee pensions and seniority premiums (Note 5)	**9,622**	765,676
Deferred credits (Note 6)	**663,970**	829,454
Total liabilities	**22,467,380**	28,870,549
Stockholders' equity (Note 11):		
Capital stock:		
Historical	**887,456**	965,387
Restatement increment	**33,403,890**	33,414,919
	34,291,346	34,380,306
Premium on sale of shares	**5,920,459**	5,920,459
Retained earnings:		
Unappropriated earnings of prior years	**60,393,798**	62,624,580
Net income for the year	**11,600,399**	11,884,416
	71,994,197	74,508,996
Deficit from restatement of stockholders'equity	**(22,990,968)**	(13,893,645)
Total stockholders' equity	**89,215,034**	100,916,116
Total liabilities and stockholders' equity	**Ps. 111,682,414**	Ps. 129,786,665

See accompanying notes.

Consolidated Statements of Changes in Stockholders' Equity
(Thousands of Mexican pesos with purchasing power at December 31, 1996, except for dividends per share)

	Capital stock	Premium on sale of shares	Legal reserve
Balance at December 31, 1994	Ps. 34,502,501	Ps. 5,920,459	Ps. 5,674,429
Appropriation of earnings approved at stockholders' meeting held on April 21, 1995:			
Cash dividends paid, at Ps. 0.30 per share			
Increase in legal reserve			781,794
Increase in reserve for purchase of Company's own shares			
Cash purchase of Company's own shares	(122,195)		
Deficit from holding nonmonetary assets			
Net income			
Balance at December 31, 1995	34,380,306	5,920,459	6,456,223
Appropriation of earnings approved at stockholders' meeting held on April 19, 1996:			
Cash dividends paid, at Ps. 0.35 per share			
Increase in legal reserve			**631,777**
Increase in reserve for purchase of Company's own shares			
Cash purchase of Company's own shares	**(88,960)**		
Deficit from holding nonmonetary assets			
Net income			
Balance at December 31, 1996 (Note 11)	**Ps. 34,291,346**	**Ps. 5,920,459**	**Ps. 7,088,000**

See accompanying notes.

Retained earnings				
Reserve for purchase of Company's own shares	**Unappropriated**	**Total**	**Deficit from restatement of stockholders' equity**	**Total stockholders' equity**
Ps. 465,294	Ps. 72,693,374	Ps. 78,833,097	Ps. (12,048,855)	Ps. 107,207,202
	(4,163,684)	(4,163,684)		(4,163,684)
	(781,794)			
27,716,404	(27,716,404)			
(12,016,665)	(28,168)	(12,044,833)		(12,167,028)
			(1,844,790)	(1,844,790)
	11,884,416	11,884,416		11,884,416
16,165,033	51,887,740	74,508,996	(13,893,645)	100,916,116
	(3,382,652)	**(3,382,652)**		**(3,382,652)**
	(631,777)			
8,415,731	**(8,415,731)**			
(10,792,398)	**59,852**	**(10,732,546)**		**(10,821,506)**
			(9,097,323)	**(9,097,323)**
	11,600,399	**11,600,399**		**11,600,399**
Ps. 13,788,366	**Ps. 51,117,831**	**Ps. 71,994,197**	**Ps. (22,990,968)**	**Ps. 89,215,034**

1. Description of the Business and Significant Accounting Policies

I. Description of the business
Teléfonos de México, S.A. de C.V. and its subsidiaries (collectively "the Company" or TELMEX) provide telecommunication services to users of domestic and international telephone services in Mexico.

TELMEX obtains its revenues primarily from telephone services, including domestic and international long-distance and local telephone services throughout the country. The Company also obtains revenues from other activities related to its telephone operations, such as the publishing of the telephone directory.

The Company is the only authorized provider of basic local telephone service throughout the country. Beginning at the end of 1996 and gradually during 1997, the competition is allowed to provide domestic and international long distance telephone service. The competing companies offering this service are doing so basically by interconnecting with the TELMEX system.

The amended concession under which the Company operates was signed on August 10, 1990. The concession runs through the year 2026, but it may be renewed for an additional period of fifteen years. The concession defines, among other things, the quality standards for telephone service and establishes the basis for regulating rates.

II. Significant accounting policies
The significant accounting policies and practices observed in the preparation of these financial statements are described below:

a) Consolidation
The consolidated financial statements include the accounts of Teléfonos de México, S.A. de C.V. and its twenty-four subsidiaries, all of which are wholly owned, except for one subsidiary, in which the Company holds an 80% equity interest. All of the companies operate in the telecommunications sector or they provide services to companies operating in this sector. Important intercompany accounts and transactions have been eliminated in the consolidation.

b) Recognition of revenues
All service revenues are recognized as they accrue. Local service revenues are derived from new-line installation charges, monthly service fees, measured usage charges based on the number of calls made, and other service charges to subscribers. Revenues from domestic and international long-distance telephone calls are determined on the basis of the duration of the calls, the distance, and the type of service used. All these services are billed monthly, based on the rates authorized by the Ministry of Communications and Transportation.

International long-distance service revenues include the revenues earned under agreements with foreign telephone service providers or operators for the use of facilities in interconnecting international calls. These agreements define the rates for the use of these international interconnecting facilities. These service revenues represent the net settlement between the parties.

c) Recognition of the effects of inflation on financial information
The Company recognizes the effects of inflation on financial information as required by Mexican Accounting Principles Bulletin B-10 ("Accounting Recognition of the Effects of Inflation on Financial Information"), as amended, issued by the Mexican Institute of Public Accountants (MIPA). Consequently, the amounts shown in the financial statements and in these notes are expressed in thousands of Mexican pesos with purchasing power at December 31, 1996. The December 31, 1996 restatement factor applied to the financial statements at December 31, 1995 was 27.70% (corresponding to inflation for 1996).

Plant, property and equipment, and construction in progress are restated using the specific-cost method. Depreciation is calculated on the restated investment using the retirement and replacement method, based on the estimated useful lives of the assets.

Inventories are valued at average cost and are restated on the basis of specific costs. The stated value of inventories is not in excess of market.

The fifth set of amendments to Bulletin B-10, which went into effect on January 1, 1997, eliminates the use of the specific-cost method to restate inventories and plant, property and equipment, permitting restatement only by means of adjustment factors obtained from the Mexican National Consumer Price Index (NCPI). The impact that this new rule will have on the valuation of inventories, plant, property and equipment effective January 1, 1997 cannot be anticipated at this time.

Capital accounts, the premium on the sale of shares, and retained earnings are restated using adjustment factors obtained from the NCPI.

The deficit from restatement of stockholders' equity consists of the accumulated monetary position loss at the time the provisions of Bulletin B-10 were first applied (Ps. 6,493,324 at December 31, 1996) and of the result from holding nonmonetary assets, which represents the net difference between restatement by the specific-cost method and restatement based on the NCPI.

The monetary effect represents the impact of inflation on monetary assets and liabilities. The net monetary effect of each year is included in the statements of income as a part of the comprehensive financing (income) cost.

d) Short-term investments
Short-term investments, represented basically by time deposits in financial institutions, are stated at market value.

e) Equity investment in affiliates
The investment in shares of affiliates is valued using the equity method. This accounting method consists basically of recognizing the investor's equity interest in the results of operations and in the result from holding nonmonetary assets of investees at the time such results are determined (see Note 4).

f) Exchange differences
Transactions in foreign currency are recorded at the prevailing exchange rate at the time of the related transactions. Foreign currency denominated assets and liabilities are translated at the prevailing exchange rate at the balance sheet date. Exchange differences are applied directly to income of the year.

At times the Company enters into short-term foreign exchange hedges and futures contracts, as hedges for transactions denominated in currencies other than the U.S. dollar. The gains or losses on these contracts are recognized at the time they are incurred, net of the gains or losses on the liabilities covered.

g) Labor obligations
Pension and seniority premium costs are recognized periodically during the years of service of employees, based on actuarial computations (see Note 5). Termination payments are charged to income in the year in which the decision to dismiss an employee is made.

h) Income tax and employee profit sharing
Income tax and employee profit sharing are provided based on the amount paid, taking into consideration the effect of important nonrecurring temporary differences in income for financial and tax reporting purposes (deferred taxes).

2. Equity Investment in Affiliates

a) Sercotel, S.A. de C.V. (Sercotel), a subsidiary of Teléfonos de México, S.A. de C.V., acquired for Ps. 235,722 (Ps. 170,937 nominal) on September 8, 1995, 1,121,429 series "B" shares equal to 50% of the capital stock of Consorcio Red Uno, S.A. de C.V. (Red Uno), a company engaged in integrating telecommunication and information service systems. This purchase gave rise to goodwill of Ps. 120,900, of which Ps. 3,023 was amortized in 1995. It was decided to amortize the remainder in 1996.

b) In December 1994, Sercotel entered into an agreement to acquire a 49% interest in Empresas Cablevisión, S.A. de C.V. (Cablevisión), the parent company of subsidiaries engaged in cable TV transmission. The specified price was approximately U.S.$ 211 million. This acquisition was subject to the necessary government approval, which was obtained on July 5, 1995, at which time the transaction was considered consummated for financial purposes.

Goodwill of Ps. 1,614,933 was recognized for the difference between the purchase price and the book value of the shares of this affiliate at the purchase date. This goodwill was to be amortized over a four-year period. However, in the final quarter of 1996, the Company decided not to make an offer to acquire the remaining 51% of Cablevisión and, at the same time, to act conservatively and write off the unamortized goodwill (see Note 7).

At the time the Company acquired the shares of Cablevisión, it recognized a deferred tax liability of Ps. 290,706 that would reverse over the same period of time in which the goodwill was to be amortized. This liability for deferred taxes was reversed together with the related goodwill.

c) In 1996, TELMEX credited to income Ps. 60,535 and charged to stockholders' equity Ps. 96,538, corresponding to its equity interest in the net income and in the result from holding nonmonetary assets of affiliates, respectively (credits in 1995 of Ps. 66,507 and Ps. 47,027, respectively). Both the equity in the net income of affiliates and the scheduled amortization of goodwill are presented in the caption "Equity in results of affiliates and amortization of goodwill." The scheduled amortization prior to the 1996 write off mentioned in the preceding paragraphs, which is included in this caption, was Ps. 416,112 in 1996 and Ps. 406,755 in 1995.

3. Plant, Property and Equipment

a) Plant, property and equipment consist of the following:

		1996		1995
Investments	**Ps.**	**130,088,516**	Ps.	136,137,385
Less accumulated depreciation		**42,817,710**		39,882,485
Net		**87,270,806**		96,254,900
Construction in progress and advances to equipment suppliers		**3,549,316**		8,527,628
	Ps.	**90,820,122**	Ps.	104,782,528

b) Items comprising the telephone plant are restated based on the acquisition date and cost, applying the factors derived from the specific indexes determined by the Company and validated by an independent expert appraiser registered with the National Banking and Securities Commission.

c) Because of the important progress and technological changes in telecommunications equipment, the Company makes a periodic assessment of the estimated useful lives of its telephone plant and equipment, adjusting annual depreciation whenever it believes this to be appropriate. In 1996, the Company increased the annual depreciation rates of a large part of its telephone plant and equipment so as to better reflect in accounting the technological advances in telecommunications equipment.

As a result of this increase in depreciation rates, depreciation expense for 1996 was increased by approximately Ps. 1,100,000.

Depreciation of the telephone plant has been calculated at annual rates ranging from 3.3% to 16.7%. The other assets are depreciated at rates ranging from 3.3% to 20%. Depreciation charged to income was Ps. 10,745,153 in 1996 and Ps. 9,046,646 in 1995.

d) In December 1990, the Company purchased the Federal Microwave Network from Telecomunicaciones de México, a decentralized agency of the Mexican Government. The Company paid U.S.$ 300 million or, based on the prevailing exchange rate at the purchase date, Ps. 883,716 (Ps. 2,636,833 constant pesos at December 31, 1996). The Ps. 1,617,580 difference between the purchase price of the Federal Microwave Network and the appraised value of the assets acquired was included in other assets and was being amortized over a ten-year period.

At the end of 1996, the Company decided to charge to income the unamortized excess cost on this acquisition (Ps. 646,990), recognizing a deferred tax asset of Ps. 245,378.

4. Long-Term Debt

The long-term debt consists of the following:

	1996 average interest rate*	Maturities from 1997 through	Balance at December 31 1996	1995
Debt denominated in foreign currency:				
Banks	**6.5%**	**2006**	**Ps. 2,989,941**	Ps. 5,534,443
Fiduciary debt instruments	**6.0%**	**1997**	**561,865**	
Mexican Government	**6.4%**	**2006**	**226,859**	301,870
Suppliers' credits	**6.9%**	**2021**	**9,352,141**	14,439,863
Financial leases	**10.8%**	**2000**	**199,272**	411,766
Total			**13,330,078**	20,687,942
Debt denominated in Mexican pesos:				
Banks	**35.5%**	**1999**	**26,151**	43,027
Debentures				297,625
Financial leases				5,744
Total			**26,151**	346,396
Total debt			**13,356,229**	21,034,338
Less current portion of long-term debt			**3,551,867**	6,088,131
Long-term debt			**Ps. 9,804,362**	Ps. 14,946,207

* Net of taxes, subject to variances in international and local rates.

An analysis of the foreign currency denominated debt at December 31, 1996 is as follows:

	Foreign currency (in thousands)	Exchange rate at December 31, 1996 (in units)	Mexican peso equivalent
U.S. dollar	1,271,459	Ps. 7.8509	Ps. 9,982,119
Japanese yen	40,260,079	0.0675	2,717,555
French franc	339,203	1.5089	511,823
German mark	14,148	5.0929	72,054
Swiss franc	7,959	5.8458	46,527
Total			Ps. 13,330,078

At December 31, 1996, the Company has unused lines of credit from certain banks of approximately Ps. 3,220,000, at a floating interest rate of approximately LIBOR plus 0.8 points when the Company draws on them.

Long-term debt maturities at December 31, 1996 are as follows:

Year		Amount
1998	Ps.	2,052,778
1999		1,584,370
2000		1,368,955
2001		1,108,320
2002 and beyond		3,689,939
	Ps.	9,804,362

5. Employee Pensions and Seniority Premiums

Substantially all the Company's employees are covered under defined retirement and seniority premium plans.

Pension benefits are determined on the basis of compensations of employees in their final year of employment, their seniority, and their age at the time of retirement.

In 1990, the Company set up an irrevocable trust fund to cover the payment of these obligations. It adopted the policy of making annual contributions to the fund, which totaled Ps. 1,870,390 in 1996 and Ps. 1,662,480 in 1995. These contributions are deductible for Mexican corporate income tax purposes.

The Company recognizes these labor obligations on the basis of independent actuarial calculations, using the projected unit-credit method, in accordance with Mexican Accounting Principles Bulletin D-3, "Labor Obligations," which defines the accounting treatment of pensions and seniority premiums.

The related charge to income of the year ended December 31, 1996 was Ps. 2,154,508 (Ps. 2,361,220 in 1995). An analysis of basic actuarial assumptions considered in the pension plan calculations for the years ended December 31, 1996 and 1995, is as follows:

Analysis of the net period cost:

		1996		1995
Labor cost	**Ps.**	**746,300**	Ps.	797,862
Financial cost of projected benefit obligations		**4,650,290**		2,025,189
Return on plan assets		**(3,644,988)**		(1,216,873)
Amortization of past service costs		**402,906**		547,085
Amortization of variances in assumptions				207,957
Net period cost	**Ps.**	**2,154,508**	Ps.	2,361,220

Reserve for employee pensions and seniority premiums:

		1996		1995
Projected benefit obligations	**Ps.**	**19,805,053**	Ps.	17,469,673
Plan assets		**(15,024,933)**		(12,440,989)
Transition liability		**(2,927,026)**		(4,187,196)
Past service costs		**(40,460)**		(56,734)
Actuarial loss		**(1,806,019)**		(19,243)
Net projected liability		**6,615**		765,511
Additional liability		**3,007**		165
Reserve for employee pensions and seniority premiums	**Ps.**	**9,622**	Ps.	765,676
Accumulated benefit obligations	**Ps.**	**11,524,543**	Ps.	10,816,799
Intangible asset	**Ps.**	**3,007**	Ps.	165

The transition liability, the past service cost and the variances in assumptions will be amortized over a twelve-year period.

The rates used in the actuarial study were:

	1996	1995
Discount of labor obligations:		
First year	**27.0%**	31.8%
Long-term average	**14.8%**	13.9%
Increase in salaries:		
First year	**19.0%**	16.8%
Long-term average	**10.5%**	9.6%
Annual returns from the fund:		
First year	**27.0%**	31.8%
Long-term average	**14.8%**	13.9%

Select nominal rates were used to compute 1996 and 1995 labor obligations. Select nominal rates are based on rates that vary annually through a certain year and that remain constant thereafter.

Based on the requirements of Circular 50 issued by the MIPA, the effective date of which is January 1, 1997, actuarial valuations must be based on financial hypotheses net of inflation. This change in financial assumptions is not expected to have a significant impact on 1997 results of operations.

The employee pension and seniority premium obligations at December 31, 1996, determined on the basis of financial assumptions net of inflation, are as follows:

Accumulated benefit obligations	Ps.	18,703,704
Projected benefit obligations	Ps.	19,805,053

6. Deferred Credits

Deferred credits consist of the following at December 31, 1996 and 1995:

	1996		1995	
Advances from subscribers	**Ps.**	**646,995**	Ps.	691,703
Other		**16,975**		137,751
	Ps.	**663,970**	Ps.	829,454

In prior years, the Company entered into various agreements denominated in U.S. dollars for the sale of accounts receivable that would be realized in the future and that would derive from long-distance traffic between Mexico and the United States.

Deferred revenue, which was restated on the basis of the NCPI, was amortized against income on a straight-line basis and the related costs were recognized based on the amount of the accounts receivable sold.

In the year ended December 31, 1995, the Company completed the amortization of this deferred revenue, amortizing Ps. 1,568,016. The recorded cost was Ps. 2,395,205.

7. Special Charges

The Company recorded special charges for Ps. 3,767,308. This amount is comprised of:

Write off of unamortized excess cost over appraised value of Federal Microwave Netwok (see Note 3)	Ps.	646,990
Write off of unamortized goodwill derived from purchase of Cablevisión and Red Uno (see Note 2)		913,788
Portion of the costs incurred in 1996 related to network changes and other expenses related to opening of long-distance market in Mexico		895,335
Initial contribution to set up Fundación Telmex, A.C., a non-profit social welfare organization		1,311,195
	Ps.	3,767,308

8. Foreign Currency Position and Transactions

a) At December 31, 1996, the Company has a net foreign currency liability position of U.S.$ 1,490,992 thousand (net liability monetary position of U.S. $ 2,014,499 thousand at December 31, 1995).

The net exchange gain for the year ended December 31, 1996 was Ps. 214,928 (net exchange loss of Ps. 9,140,770 in 1995). In both years these amounts were applied to income.

The prevailing exchange rate at December 31, 1996 was Ps. 7.85 per U.S. dollar (Ps. 7.68 per U.S. dollar at December 31, 1995). At March 7, 1997, which is the date of issuance of these financial statements, the exchange rate of the Mexican peso relative to the U.S. dollar was Ps. 8.04 per U.S. dollar.

b) In the years ended December 31, 1996 and 1995, the Company had the following transactions denominated in foreign currencies. Currencies other than the U.S. dollar, were translated to dollars using the average exchange rate for the year.

	Thousands of U.S. dollars			
	1996		1995	
Net settlement revenues	**U.S.$**	**846,310**	U.S.$	877,874
Interest expenses		**154,353**		166,116
Operating expenses		**240,573**		122,476

9. Commitments and Contingencies

a) At December 31, 1996, the Company has noncancelable commitments, primarily for the purchase of equipment, in the approximate amount of Ps. 300,000 (Ps. 830,000 in 1995).

b) At December 31, 1996, there are outstanding letters of credit in the approximate amount of Ps. 80,000 (Ps. 204,000 in 1995), which were issued to foreign suppliers for the purchase of materials and supplies.

c) In December 1995 a competitor that provides cellular telephone services reported Teléfonos de México, S.A. de C.V. and a subsidiary to the Federal Fair Practices Commission for alleged monopolistic practices.

The Company's independent lawyers believe that the probabilities are great that the complaint will be declared unfounded. Although the accusation makes reference to different amounts of damages, there is no mention of the total amount of the claim. Also, the Commission is only empowered to impose fines, the total amount of which cannot be determined at the present time. Accordingly, the financial statements do not include any provision for this contingency.

d) Teléfonos de México, S.A. de C.V. has been sued by a former employee, for the alleged illegal use of a system the latter calls the "High Traffic System", which the former employee claims to have created. The suit does not specify the exact amount of the indemnization sought. The Company's independent lawyers feel that Teléfonos de México, S.A. de C.V., will prevail in this matter.

10. Related Parties

In the years ended December 31, 1996 and 1995, the Company had the following important transactions with related parties:

	1996		1995	
Purchase of materials, inventories and fixed assets	**Ps.**	**1,135,887**	Ps.	1,189,482
Payment of insurance premiums and fees for administrative and operating services		**1,021,013**		961,001
Sale of materials, inventories and fixed assets		**156,529**		127,769
Discount on sale of doubtful accounts receivable		**446,922**		

11. Stockholders' Equity

a) Capital stock is represented by 8,875 million common shares issued and outstanding with no par value (9,654 million shares in 1995). An analysis is as follows:

		1996		1995
2,163 million series "AA" shares	**Ps.**	**16,635,406**	Ps.	16,635,406
280 million (342 million in 1995) series "A" shares		**2,246,735**		2,729,756
6,432 million (7,149 million in 1995) series "L" shares		**15,409,205**		15,015,144
	Ps.	**34,291,346**	Ps.	34,380,306

b) At the stockholders' meeting held in April 1994, it was resolved to establish a reserve of Ps. 891,250 (nominal) (Ps. 1,851,548 restated to December 31, 1996) for the purchase of the Company's own shares.

At stockholders' meetings held in 1995, resolutions were adopted to increase by Ps. 27,716,404 the reserve for the purchase of up to 1,750 million of the Company's own shares. In the year ended December 31, 1995, the nominal value of the shares purchased was Ps. 8,459,344 (Ps. 12,138,860 restated to December 31, 1996). The shares purchased were 844,867,456 series "L" shares.

At a stockholders' meeting held in 1996, it was resolved to increase by Ps. 8,415,731 the reserve for the purchase of the Company's own shares to acquire up to an additional 800 million shares. In the year ended December 31, 1996, the Company acquired 779,314,789 series "L" shares for Ps. 10,881,358 (Ps. 9,534,050 nominal).

c) In conformity with the Securities Trading Act, the Company's fixed capital was modified at a stockholders' meeting held on December 5, 1995. This modification involved the cancellation of 880,000 of the Company's own series "A" and 818,961,939 series "L" treasury shares that the Company finished acquiring on December 4, 1995.

At a stockholders meeting held on December 10, 1996, it was decided to cancel 844,794,306 of the Company's own series "L" treasury shares that Teléfonos de México, S.A. de C.V. had acquired in terms of the Securities Trading Act. This cancellation reduced the Company's fixed capital.

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

e) In conformity with the Mexican Corporations Act, at least 5% of net income of the year must be appropriated to increase the legal reserve. This practice must be continued each year until the legal reserve reaches 20% of capital stock issued and outstanding.

f) Cash dividends paid from the so-called "net tax profit" (i.e., from earnings on which corporate income taxes have already been paid) will be exempt from taxation. Dividends paid from sources other than the net tax profit will be subject to Mexican income tax, which is payable by the Company, so that the stockholder will receive the net equivalent of 66% of the dividend paid.

12. Income Tax and Asset Tax

a) The Ministry of Finance and Public Credit authorized TELMEX to consolidate for tax purposes starting January 1, 1995. The subsidiaries Instituto Tecnológico de Teléfonos de México, S.C., Fundación Telmex, A.C. and Aerofrisco, S.A. de C.V. and the affiliated companies, are excluded from this tax consolidation.

b) The asset tax for the years ended December 31, 1996 and 1995 was Ps. 1,128,278 and Ps. 1,140,107, respectively. In both years these amounts were credited against income tax, and in 1995 against the telephone service tax.

c) The most important differences between book and tax results relate primarily to the difference in depreciation expense for book and tax purposes, the amortization of goodwill, tax losses of subsidiaries and other nondeductible expenses, and in 1995 the deduction of the telephone service tax (see Note 13).

13. Telephone Service Tax

Through the year ended December 31, 1995, the Company was subject to payment of a 29% telephone service tax on all revenues obtained from telephone related services. Sixty-five percent (65%) of this tax could be credited against investments in fixed assets during the year. In the year ended December 31, 1995, the telephone service tax was Ps. 13,436,340, and the creditable portion of the tax was Ps. 8,733,621 so that the net amount charged to income was Ps. 4,702,719. This amount was included in operating costs and expenses.

For income tax purposes, the telephone service tax was deductible in its entirety. The telephone service tax was eliminated effective January 1, 1996.

14. Generally Accepted Accounting Principles in the United States Reconciliation

The Company's consolidated financial statements are prepared in conformity with Mexican GAAP, which differ in certain significant respects from Accounting Principles Generally Accepted in the United States ("U.S. GAAP").

The principal differences between Mexican GAAP and U.S. GAAP, as they relate to the Company, consist of the accounting for pension plan costs and deferred income taxes and deferred employee profit sharing (deferred taxes). Other differences are the accounting for interest on assets under construction, accrued vacation costs, the financing costs on deferred income, the acquisition of a microwave network, and the employee stock purchase trust.

The reconciliation to U.S. GAAP does not include the reversal of the adjustments to the financial statements for the effects of inflation required under Mexican GAAP (Bulletin B-10), because the application of Bulletin B-10 represents a comprehensive measure of the effects of price level changes in the Mexican economy and, as such, is considered a more meaningful presentation than historical cost-based financial reporting for both Mexican and U.S. accounting purposes.

A summary of the net income and total stockholders' equity between Mexican and U.S. GAAP, is as follows:

	1996	1995
Net income as reported under Mexican GAAP	**Ps. 11,600,399**	Ps. 11,884,416
Total approximate U.S. GAAP adjustments, net	**1,047,703**	(2,006,490)
Approximate net income under U.S. GAAP	**Ps. 12,648,102**	Ps. 9,877,926
Weighted average common shares outstanding (in millions)	**9,154**	10,150
Approximate net income per share under U.S .GAAP (in Mexican pesos)	**Ps 1.382**	Ps. 0.973
Total stockholders' equity under Mexican GAAP	**Ps. 89,215,034**	Ps. 100,916,116
Total approximate U.S. GAAP adjustments, net	**(15,630,274)**	(18,958,762)
Approximate total stockholders' equity under U.S. GAAP	**Ps. 73,584,760**	Ps. 81,957,354

Proposal to the Meeting

(Thousands of Mexican pesos with purchasing power at December 31, 1996, except for dividends per share)

With respect to the dividends payment for the 1996 fiscal year, and based on Clause forty-five of the by-laws of Teléfonos de México, S.A. de C.V., the following amounts are available to the Shareholders:

	Amount
Prior year's unappropriated earnings	Ps. 30,920,391
Net income for the year	10,736,449
Total	Ps. 41,656,840

It is proposed that the balance of Ps. 41,656,840 made available to the shareholders to be allocated as follows:

	Amount
To increase the legal reserve 5% of the net income for the year	Ps. 536,822
To pay the cash dividend of Ps. 0.525 per share, coming from the Net Fiscal Profit (1)	4,471,647
To the retained earnings account	36,648,371
Total	Ps. 41,656,840

The cash dividend proposed to the Shareholders' Meeting shall be Ps. 0.525 per share, payable in three equal payments of Ps. 0.175 each; the first, as of June 19, 1997, the second as of September 18, 1997 and the third as of December 18, 1997, for all outstanding shares which make up the capital stock of the Company, against coupons 01, 02 and 03, respectively. While such balance is not allocated to the shareholders, it shall continue in the Company's retained earnings account.

(1) Figure estimated considering a total of 8,517,422,131 outstanding shares.

Significant Results Obtained from Rendering Local and Long Distance Telephone Services

From January 1 to December 31,1996.

Based on Transitory Article Eight of the Federal Telecommunications Law; on Transitory Item One of the Administrative Resolution through which the Ministry of Communications and Transports institutes the Tariff Regulations applicable to the interconnection services of Telecommunications public networks authorized to render long distance services dated April 26, 1996; on Article 136 of the Telecommunications Regulations and also Condition 7-5 of the Amendments to the Concession Title, the commitment to present independent accounting records for local and long distance services is established. Based on these provisions, the main financial figures as of December 31, 1996, of local and long distance service are shown separately.

Local service includes: the Monthly Rent (basic monthly fee of the local telephone service); Measured Service (amount of calls that exceed the number of calls allowed); Installation Charges (work carried out in installing the telephone service); Interconnection of Long Distance Carriers and of Cellular Companies (this revenue is received by the company for allowing the interconnection of long distance carriers and the cellular service), and other such as Digital Service and Caller ID Service.

Long distance service includes: Domestic Long Distance (switched traffic between communities in Mexican Territory); International Long Distance (switched traffic through authorized long distance exchanges such as international ports); International Settlements (net result of the settlement rate between Telephone Administrations for carrying international long distance calls); Private Circuits and Data Network (voice, data and video transmission to integrate links between points at different speeds through digital means designed in accordance with customer needs); Public Telephony (service through which the customers may place telephone calls using intelligent telephone sets activated by prepaid Ladatel cards) and other services such as Rural Telephony, Satellite Transmission, Videolink, 800 and 900 number services and Access to Internet.

Significant Results Obtained from Rendering Local and Long Distance Telephone Services
(Figures in millions of Mexican pesos with purchasing power at December 31, 1996)

	Local Service	Long Distance Service
Operating Revenues:		
Access, Rent, Measured Service and Others	17,682	1,105
Domestic Long Distance		15,616
International Long Distance		14,388
Interconnection	10,041	
Total Operating Revenues	**27,723**	**31,109**
Operating Cost and Expenses:		
Cost of Sales and Services	7,477	2,916
Commercial, Administrative and General	7,034	2,672
Depreciation and Amortization	8,390	2,744
Interconnection		9,736
Total Operating Cost and Expenses	**22,901**	**18,068**
Operating Income	**4,822**	**13,041**
Integral Financing (Income) Cost	(465)	866
Income before Income Tax and Employee Profit Sharing	**5,287**	**12,175**
Income Tax and Employee Profit Sharing	2,484	4,141
Net Income	**2,803**	**8,034**
Investment (gross)	**104,697**	**25,489**

The chart above shows information on the revenues, costs, expenses and net income for the year ended December 31, 1996, separated in local and long distance services.

This information varies from the information shown in the basic financial statements because of the following reasons:

a) Together with Teléfonos de México, S.A. de C.V., the consolidated financial information includes only three out of the twenty four subsidiary companies of Telmex, which are directly involved in rendering local and long distance telephone service: Teléfonos del Noroeste, S.A. de C.V., Compañía de Teléfonos y Bienes Raíces, S.A. de C.V., and Alquiladora de Casas, S.A. de C.V.

b) The information on local service includes the revenues that would have been received by allowing the long distance carrier to interconnect to the local network; and the information on long distance service includes the allocated interconnection cost.

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