



international development

growth and coverage

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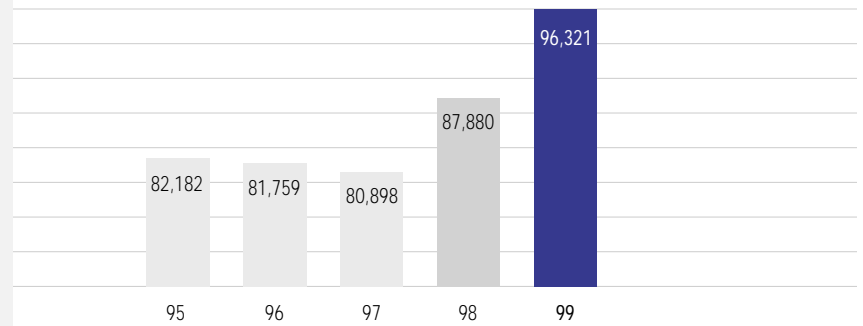
acceleration

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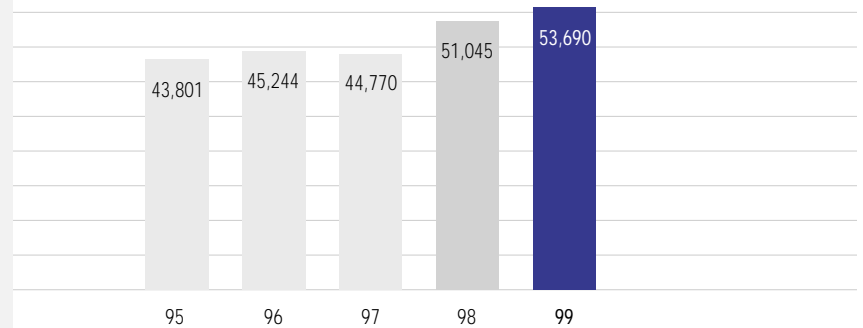
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total revenues (millions of pesos)



EBITDA (millions of pesos)



Highlights

(Figures in millions of pesos, unless otherwise indicated, with purchasing power as of December 31, 1999)

Financial Results	1999	1998	1997	1996	1995
Total Revenues	96,321	87,880	80,898	81,759	82,182
Cost of Sales and Services	23,599	19,247	18,907	18,634	24,346
Commercial, Administrative and General Expenses	19,032	17,588	17,221	17,881	14,035
Depreciation and Amortization	17,447	17,655	16,753	19,926	14,823
Total Costs and Expenses	60,078	54,490	52,881	56,441	53,204
Operating Income	36,243	33,390	28,017	25,318	28,978
EBITDA	53,690	51,045	44,770	45,244	43,801
Net Income	25,127	18,421	17,120	17,884	18,322
Total Assets	178,538	172,830	170,261	172,176	200,086
Total Debt	33,165	33,754	34,292	20,591	32,428
Stockholders' Equity	122,297	118,944	117,544	137,539	155,578
Total Debt / Capitalization (%)	21.3	22.1	22.6	13.0	17.2
Statistics					
Fixed Lines (1)	10,878	9,927	9,254	8,826	8,801
Wireless Lines (1)	5,272	2,113	1,112	657	399
Internet Access Accounts (1)	403	146	34	-	-
Equivalent Lines for Data Transmission (1)	507	371	224	93	74
Total Services	17,060	12,557	10,624	9,576	9,274
Domestic L.D. Minutes (2)	10,419	9,077	8,232	7,867	7,294
International L.D. Minutes (2) (3)	4,192	3,286	3,768	3,558	3,055
Data per Share (pesos) (4)					
Average Earnings of the Year	1.67	1.17	1.02	0.98	0.91
Book Value	8.18	7.70	7.24	7.75	8.06
Nominal Market Value at Year-End (TELMEX L)	26.50	12.20	11.38	6.49	6.18
Nominal Dividend Paid	0.388	0.350	0.263	0.175	0.150
Outstanding Shares at the End of each Year (2)	14,949	15,449	16,236	17,749	19,308

(1) Thousands

(2) Millions

(3) Includes incoming and outgoing traffic

(4) Considers in retroactive form the effect of the stock split approved since February 1, 2000

L e t t e r

t o o u r S h a r e h o l d e r s

Today's telecommunications environment characterized by a converging and global telecommunications industry is accelerating the evolution of TELMEX that began with our privatization 10 years ago.

The industry is changing so fast that the challenges and the opportunities they represent are even greater than we imagined them. Telecommunications are developing rapidly in open and competitive markets. For TELMEX to succeed in this environment and for us to help integrate Mexico in this new digital era, it is essential to develop an infrastructure with the best technical, quality and price conditions. A key component of TELMEX's strategy continues to focus on that telecommunications infrastructure.

A brief review of what TELMEX has accomplished since January 1991, when the company was privatized, provides additional perspective on the rapid pace of change in the telecommunications industry. When TELMEX began its transition to a competitive telecommunications company, the most important challenges seemed to be modernizing an existing system and expanding service across the Mexican market. More specifically, we needed to update the analog switching centers in use for more than 60 years, fill requests for service more quickly so that we eliminated what in some cases had become a 2 year waiting period, rebuild the external infrastructure and broaden geographic coverage to serve rural communities with more than 500 inhabitants, and develop efficient public telephony. Looking somewhat further into the future, we also accepted the challenges of developing wireless telephony, optimizing the network's architecture, digitizing local and long distance centers, rebalancing tariffs to eliminate cross subsidies and building a wide fiber optic network with nearly 31 thousand miles, including redundancy, that could cover the whole country. Included in our thinking were plans to install an advanced network in high-traffic areas to handle data and to prepare for globalization, starting with providing telecommunications access to most of the Mexican population (by the end of 2000, we will serve more than 98.5

percent of Mexico's population). In short, the task was to transform the company from a government monopoly with an obsolete and insufficient infrastructure to a private competitive company. We knew that we had to be ready for competition in all areas, even though by agreement the opening of the long distance market was deferred for 6 years.

The achievements of the past 10 years demonstrate how appropriate that assessment was. Here are only a few of the accomplishments: We increased teledensity to 28.2 percent of our domestic market from 6.7 percent. Availability of fixed and wireless lines per home rose from 32.9 percent to 127.3 percent. Annual per capita telephone use has increased to 930 from 339 minutes for local service, to 145.1 from 53.8 minutes for domestic long distance and to 69.3 from 15.9 minutes for international long distance. Access to telephone service has continued to expand, and a major contributor to these achievements is TELMEX's ability to continue to devise new services which recognize the needs of individual market segments. An early example, introduced in 1991, is "Ponga su Línea a Trabajar" (Put your line to work), which involves public phones operated by small businesses. Four years ago, we introduced prepaid services. Our most recent service innovation is the concept of shared phones, which allow customers in multi-family dwellings to use centrally located phones for both incoming and outgoing calls.

Other innovations have improved TELMEX's operating position, which in turn contributes to the sound financial foundation that is essential for continued progress. For example, in our fixed-line service area we have developed a process which allows us to suspend customers' ability to make outgoing calls when they fail to pay their bill. The intent of the program is to keep these customers from being totally shut off from telephone service and allow TELMEX to stay in touch with them. Eventually, when their economic condition allows them to pay their bills, we reestablish telephone service for them.

The rapid changes taking shape in our industry in the first years after TELMEX became a private company, encouraged us to go beyond our initial assumptions about the scope of our challenges and established a three-year plan. We recognized that telecommunications represent the nervous system of the new digital environment, in which technical development occurs at lightning speed, accelerating and intensifying the interaction of various economic and social trends.

Additionally, we recognized the need for continual upgrades to achieve and maintain a state-of-the-art telecommunications infrastructure. We also accepted the responsibility of contributing to the accelerated diffusion of the digital culture in our country and in Latin America.

To accomplish this, TELMEX actively supports education by training teachers, providing equipment and expanding an education network that includes public libraries in rural areas.

To sustain this development and the flow of new ideas, we initiated an agreement with MIT's Media Lab to investigate new ways and equipment to accelerate the diffusion of the digital culture.

Also, we are searching and evaluating new economical alternatives for Internet access through means like Web TV, mobile phones and Web phone. TELMEX recognizes that the Internet will play a significant role in global economic development, and we are committed to making sure that the Mexican population has computer equipment to access this critical communications tool.

TELMEX's internationalization, though recent, has been intense. Our initial efforts have focused on Latin America and the Hispanic market in the United States. We have operations in Puerto Rico and are increasing our presence in Brazil, Ecuador and Guatemala. Additionally, along with Microsoft, we have begun development of

the "T1msn" portal for Latin America. It will introduce a new content concept by including a growing number of general and local content developers to enrich its editorial offering. Through this portal, Spanish-speaking users will be able to take advantage of online applications, information services, advanced search options and online shopping.

The same kind of efforts we have described as applying to our markets in Mexico are central to our objectives for markets throughout Latin America.

Telecommunications is a changing, challenging industry. If anything, communications and the use of telecommunications networks will continue to escalate. People will always communicate among themselves, their family, friends and members of their local communities. Increasingly, telecommunications takes people into the global community, following the paths of commerce and personal interests. The challenge for TELMEX is to accompany our customers as they reach across boundaries. We are committed to the continued development of value-added telecommunications products and services that fit their needs.

Elsewhere in this report you will read about TELMEX's operating and financial results. They are the result of the efforts and dedication of all TELMEX employees. Their talent, experience, vision and commitment converge in a single purpose that of carrying out the company's strategy, which in turn allows us to look at the future with confidence.

Carlos Slim Helú
Chairman of the Board

Jaime Chico Pardo
Chief Executive Officer

Growth

and Coverage

TELMEX helps make phone service a daily part of the personal and business life of our customers by offering products and services that satisfy their expectations.

To identify and eliminate the barriers that keep people from having access to telecommunications, has been TELMEX's business pattern. Making telecommunications services more accessible to all population segments is an important contributor to TELMEX's growth.

At the end of 1999, TELMEX had 10,878,155 fixed lines in service. During the year, 1,425,346 installations and 474,070 disconnections occurred for a net increase of 951,276 lines, or 9.6 percent. The total number of value-added services in effect, such as call waiting, three-way calling, call forwarding and caller ID, was 2,070,133, or 65.4 percent higher than in 1998.

Several changes were made in local service during 1999. In February, the process of updating local call dialing began. In July, local service areas were consolidated including restructuring several existing switching centers to make the infrastructure more efficient.

Another major change during 1999 was the introduction of competition in local telephony. Once again, TELMEX completed the preparations on time and in line with the requirements regulators established for the process, just as was the case when the Mexican telecommunications market was opened to long distance competition.

In 1999, international long distance traffic rose to 4,192 million minutes, reflecting an increase of 27.6 percent over the previous year. The growth trend for this service is negatively affected by the illegal transit

of traffic known as "by-pass," whereby competitors fail to follow the rules regarding the agreed-upon role TELMEX is to play in transmitting long distance calls.

In the first half of 1999, TELMEX reached an agreement on settlement rates with the North American long distance operators which have entered the competitive Mexican market. This agreement set a settlement rate for 1998 of US \$0.37 per minute. Additionally, the settlement rate agreed to for the first half of 1999 was US \$0.31 per minute and for the second half of 1999 and the year 2000, US \$0.19 per minute.

Domestic long distance traffic amounted to 10,419 million minutes, an annual growth rate of 14.8 percent in 1999. The incremental traffic resulted from the record number of lines in service, a higher volume of calls and impact of "by-pass," which effectively shifts certain calls from international to domestic long distance.

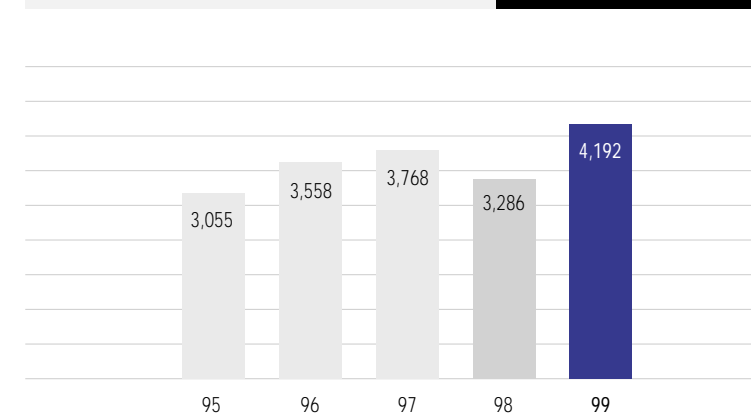
In accordance with the program to introduce competition to Mexico's long distance market, 50 more cities were added in 1999, bringing the total to 150 cities. In these cities, competition accounts for 83 percent of TELMEX's fixed lines and approximately 90 percent of long distance minutes. Market research conducted by NCS, an independent company that verifies changes in long distance providers, showed that 85 percent of customers in the cities covered by competition have selected a long distance provider and have initiated switches among providers 13,973,045 times in the 1997-1999 period.

As part of the strategy to raise Mexico's telephone service to world-class levels, TELMEX introduced "Ladafon Shared Phone" in 1999. This service is composed by fixed or wireless telephony supported by the Intelligent Network and is installed in

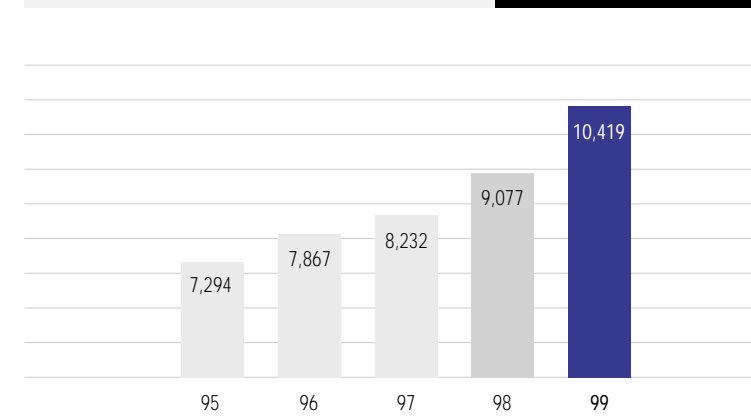
multi-dwelling units to accept incoming calls as well as outgoing calls. The service is based on a prepaid program, and there are no installation charges or monthly fees for users.

In 1999, the number of shared phones installed rose to 470,859, of which 168,592 were fixed shared telephones and 302,267 were wireless. In addition to extending telephone access, this initiative has made it possible to update public service previously provided through some residential phones.

ILD minutes (millions)



DLD minutes (millions)



Our commitment

is to be part of our customers

life through products and services

that fit their needs.

customer-made telecommunications.



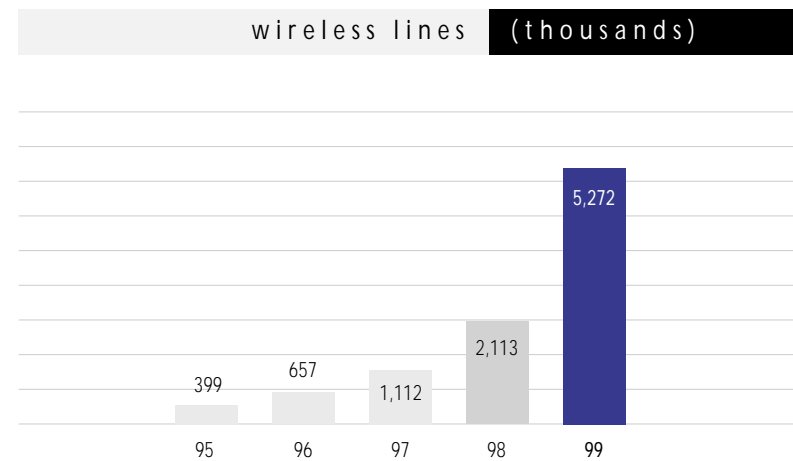
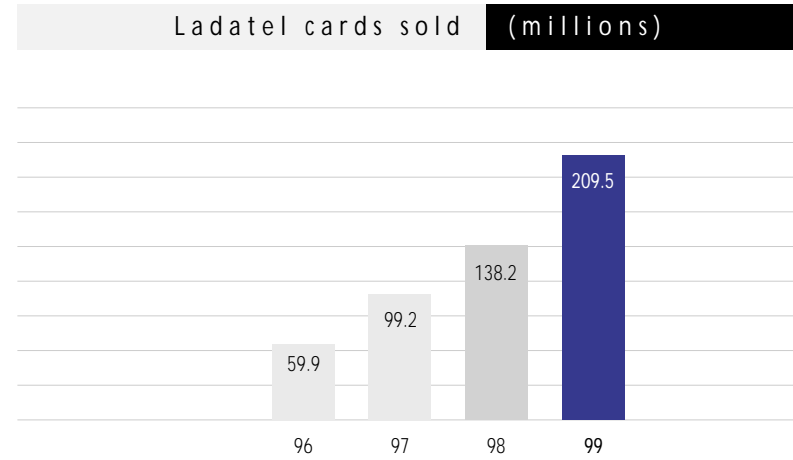
TELMEX has continued to upgrade the public telephony network. By the end of 1999, 8.5 percent of the network, or 251,480 public phones, had been equipped with chip technology. During 1999, TELMEX sold 209 million 455 thousand prepaid LADATEL cards, which customers can use to make calls on the public phones. That total was 51.4 percent more than in 1998, a strong indicator of the program's appeal.

To further broaden communications opportunities in Mexico and enhance the competitive environment, TELMEX provided the necessary support for the operations of several companies that offer public telephony services. In December 1999, these companies had 7,225 public phones in operation.

Also, TELMEX increased public telephony coverage in the most remote communities of the country with programs like "Ponga su Línea a Trabajar" (Put your line to work), shared telephony and an expanded public rural telephony platform. During 1999, the number of rural public phones increased 51.6 percent to 76,721. Including all these programs, the total number of public telephones in operation during 1999 was 854,941, or 9.4 phones per one thousand inhabitants.

Wireless Telephony Among the services with especially high growth potential for TELMEX is wireless telephony, which is delivered through TELCEL. As a result, expansion and modernization of TELCEL's infrastructure is a high priority in TELMEX's strategic planning, with particular emphasis on improving customer service.

At the end of December 1999, TELCEL served 5,271,957 subscribers, an increase in the customer base of 149.5 percent compared with the previous year. TELCEL's market share also increased to 68 percent of Mexico's cellular customers, compared with 64 percent in 1998. During 1999, 3,513 million minutes of air time were billed, an annual increase of 96.9 percent. In May 1999, "Calling Party Pays" was introduced. Along with the increase in national coverage, it was a major factor in TELCEL's growth.



TELCEL's revenues were 13.035 billion pesos in 1999, for a year-over-year increase of 47.6 percent. TELCEL represented 13.5 percent of TELMEX's total revenues for the year. Its operating income increased to 2.814 billion pesos, 45.6 percent higher than in 1998. The operating margin was 21.6 percent.

At the end of 1999, TELCEL reached a density of 57.8 cellular telephones per one thousand inhabitants and its coverage extended to 97,251 communities. That translates to 93.4 percent of the country's population having access to wireless phone service.

Internet and Data Transmission Over time, TELMEX has transformed itself from a company concentrating on voice transmission services to one providing multimedia options. In addition, TELMEX has carried out an Internet strategy, extending its capability to satisfy the growing demands of access and content.

TELMEX offered Internet access service to 402,754 customers at the end of 1999, achieving an annual growth rate of 175.1 percent with 256,374 new users added during the year.

In June 1999, the "Prodigy Internet Plus" package was launched. This package gives customers unlimited access to the Internet for 2 years, a personal Web page, an e-mail account and a multimedia-equipped personal computer. During 1999, customers bought 109,047 Prodigy Plus packages. In other words, 42.5 percent of all new customers chose this option.

At the same time, a larger number of cities gained Internet access. During 1999, 42 cities were added to the existing 75 cities with coverage, bringing the total to 117 cities and representing an increase of 56.0 percent compared with the cities covered in 1998.

In 1999, data transmission revenues represented 5.6 percent of TELMEX's total revenues. Compared with 1998, revenues increased

21.2 percent to 5.411 billion pesos, and equivalent lines for data transmission grew 36.8 percent, reaching 506,921 in service at year-end.

Taking another step to contribute actively in the development of a digital culture, TELMEX signed an agreement with the Media Laboratory of the Massachusetts Institute of Technology (MIT) to carry out research and develop technology; to establish a testing laboratory focused on projects with applications for Mexico and Latin America, (TELMEX Lab); to have access to all the information on projects being carried out at MIT's Media Labs, and to train researchers and technology developers to serve Mexico and Latin America.

	1995	1996	1997	1998	1999
Fixed Lines	8,801	8,826	9,254	9,927	10,878
Wireless Lines	399	657	1,112	2,113	5,272
Internet Access Accounts	-	-	34	146	403
Equivalent Lines for Data Transmission	74	93	224	371	507
Total	9,274	9,576	10,624	12,557	17,060

Y2K As planned, TELMEX's network and all its components worked normally before, during and after the technology transition to the year 2000. This reflected the dedicated work that TELMEX's Year 2000 group (TA2K) carried out since 1997 to guarantee the continuity of customer service throughout the country. TELMEX's investment in the process was close to 33 million dollars.



Continue

Modernization

Between privatization in 1990 and year-end 1999, TELMEX invested almost 18 billion dollars in consolidating its telecommunications infrastructure. That investment recognizes that the infrastructure is the base from which we serve our customers and offer them world-class products and services. The strategy to maintain our network at the highest quality levels also recognizes that corporate and residential customers seek more than just a provider. They also look for a telecommunications partner which communicates effectively with them and supports contact among themselves and with the world.

TELMEX has constantly invested in its infrastructure and systems, as well as in training and developing personnel, to transform that platform into products and services that satisfy the diverse telecommunications needs of its customers. As a result, between 1990 and year-end 1999, TELMEX digitized its local and long distance networks to 99.6 percent and 100 percent, respectively.

In addition, an Intelligent Network platform has been incorporated to support value-added services such as 800 and 900 services, phone cards (TelCard and LADAFon), Código LADA and Precisa, among others.

As a result of the quality and dependability of TELMEX's processes and infrastructure, the company has received various quality certificates from the Mexican Institute of Normalization and Certification, A.C. In 1997, that recognition was given to the National Supervision Center of the Long Distance Network in ISO 9002; in 1998, to the Intelligent Network and the Signaling System for Common Channel No. 7 in ISO 9001 and to the Management of Development of the World and International Network in ISO 9002; and in 1999, to the Telecorp Corporate Market Attention Center and the Area of Operation and Maintenance of the Long Distance Network in ISO 9002. TELMEX

continues to emphasize meeting these criteria in how we supervise operations and serve customers.

Voice Solutions Even as data transmission becomes an increasingly important part of the services TELMEX provides, the company continues to upgrade voice transmission as well. The Virtual Private Network (VpNET) offers abbreviated dialing, competitive tariffs and traffic management functions as well as ReD-SI, a digital network of integrated voice, data and video services, digital trunks and high-capacity traffic access in switchboard intercommunication.

Data Solutions Data transmission's commercial strategy has focused on facilitating the migration of private networks to virtual networks. The advantage to the customer comes from the ability to add new functions and services: to develop total solutions that integrate access, service and equipment, and to develop multi-service products with TELMEX's Universal Network. Among the main products are LADA Enlaces (LADA Links from 9.6 Kbps to 34 Mbps), Frame Relay, IP, dedicated and switched, corporate Internet and extended port, as well as data transport services through UniNet, the data network with the best coverage and reliability in the country.

Service Integration To help corporate customers integrate telecommunications products and achieve the best network solutions for their own businesses, TELMEX offers several options to help customers choose the best product. The leading service in this regard is Si@na, a diverse online consulting and analysis tool. Second is redundancy and diversity in security solutions and recovery capability, to protect voice and data traffic in critical applications. Third is maintenance contracts, to offer preventive and corrective attention for customers' equipment.

Universal Network TELMEX's universal network represents the essential technological platform to provide the Mexican market with the new generation of services required for further corporate development. It integrates voice, data, video and Internet services that TELMEX provides and offers its customers the necessary capacity to develop new applications to meet the demands of the commercial environment and customer service.

The competitiveness of TELMEX's universal network is based on the application of leading-edge technology for data transmission to the national fiber optic network, to integrate the largest diversity of fixed or wireless access means and multiple broadband options. This network incorporates an entire range of communication protocols and offers high capacity to support all types of applications. Likewise, it guarantees readiness, quality and security of operations.

Human Resources The Technological Institute of Teléfonos de México, (INTELMEEX) was created in 1991 to make sure that the learning curve of TELMEX's employees keeps pace with technological modernization. INTELMEEX established a broad training curriculum to provide basic telecommunications knowledge, aid technology transfer and develop commercial and sales abilities to support the company's competitive process.

From 1991 to 1999, INTELMEEX conducted 822,279 course hours, the equivalent of two courses per employee per year, each averaging nine days of training. This level is competitive at international standards. During 1999 alone INTELMEEX offered 15,052 courses, or the equivalent of 106,151 course hours when the number of participating employees is factored into the measurement.

As a result of the extensive personnel development within TELMEX, employees' average education level of 6 years in 1990 has increased to 14 in 1999, equivalent to the most competitive international companies.

Satisfied customers,

integrated solutions, our

constant objective at the

pace of today's world.

always ahead...
through time.

International

Development

TELMEX's international expansion intensified in 1999, often accomplished through strategic alliances with local partners to bolster our long-term objectives. In the case of the Internet, TELMEX has focused its business plan on two initiatives: access, through Prodigy Communications Corporation (Prodigy), and content, through association with Microsoft Corporation (Microsoft) in the development of a portal for the Hispanic market.

Prodigy In February 1999, Prodigy carried out a public stock offering. In conjunction with that offer, TELMEX acquired 2 million shares of common stock.

In November, to strengthen Prodigy's leadership as an Internet access provider in the United States, Prodigy and SBC Communications established an alliance focused on meeting the needs of the mass market and small businesses, which will contribute to positioning Prodigy as one of a leading US provider of DSL (Digital Subscriber Line). The project continues through the first half of 2000.

At the end of 1999, Prodigy had 1,115,933 customers in the United States, representing growth of 51.9 percent compared with year-end 1998. Total revenues increased to 188 million 885 thousand dollars in 1999, 38.7 percent ahead of the previous year.

Microsoft Another initiative was carried out in October of 1999, when TELMEX signed a co-investment agreement with Microsoft to jointly operate and create a Spanish-language portal: T1msn. The objective is to reach all Spanish-speaking users in the continent and to offer information and excellent local content. The platform of this portal includes a broad portfolio of applications to enrich users' experience.

Topp Telecom In wireless telephony, TELMEX's international development began with Topp Telecom, Inc. (Topp), with headquarters in Miami, Florida.

Through its brand name Tracfone, Topp offers national coverage in the United States, with a universal number, prepaid system and immediate activation of the service.

In 1999, the number of customers grew 54.5 percent, totaling 234,194 at year-end. In the same period revenues increased 90.1 percent to just over 81 million dollars.

Comm South In June, TELMEX acquired Comm South Companies, Inc. (Comm South), with headquarters in Dallas, Texas. It offers prepaid fixed telephony to residential customers in the United States.

At December 1999, the company served 180,765 customers, an annual growth rate of 18.6 percent. Sales in 1999 were approximately 108 million dollars, 33.0 percent higher than in 1998.

Cellular Communications of Puerto Rico With SBC Communications, TELMEX acquired Cellular Communications of Puerto Rico, Inc. (CCPR) in October. This company offers wireless, paging and long distance services in Puerto Rico and the Virgin Islands. It operates under the Cellular One brand.

CCPR had 414,485 wireless customers at the end of 1999, 37.5 percent higher than a year earlier. Revenues increased 12.2 percent over the prior year to approximately 202 million dollars.

ATL-Algar Telecom Leste In late 1999, TELMEX and SBC announced that they planned to acquire 50 percent of the Brazilian cellular company ATL-Algar Telecom Leste, S.A. (ATL). It provides services in Rio Janeiro and Bay of Espirito Santo, Brazil. The transaction was completed in January 2000.

In one year of operations, ATL had approximately 930 thousand customers and generated revenues of about 243 million dollars.

Telecomunicaciones de Guatemala During 1999, TELMEX played a significant role in helping expand local and long distance service provided by Telecomunicaciones de Guatemala, S.A. (Telgua). A work plan put into practice during the year accelerated modernization of the infrastructure and increased the nation's teledensity. The 1999 investment to meet these goals was 156 million dollars.

The program substantially reduced the lag in fixed line installations. To continue the improvement, the planned investment for 2000-2001 is approximately 350 million dollars. The strategic plan for that period focuses on broader coverage, the addition of a large number of rural communities to the network and more availability of voice and data services in the country.

Additionally, subsidiary companies were created to provide data transmission and wireless communication services using CDMA technology. Likewise, public telephony with chip technology was introduced with widely acclaimed success.

By December 1999, Telgua had 570,647 fixed lines in operation, reflecting growth of 8.2 percent in the customer base. Total revenues were 246 million dollars, 8.3 percent higher than in 1998. The wireless subsidiary in only six months of operation signed up 92,495 customers.

Williams Communications Group TELMEX and Williams Communications Group, Inc. signed a strategic alliance in May 1999 to enhance their capacity to offer international services between Mexico and the United States. By interconnecting both fiber optic networks, the two companies will be able to offer a unique platform of multimedia services in their respective markets.



Experience and

change, competitive capacity

and strategic alliances,

to satisfy customers

in a globalized world.

toward
new markets.

Social

Commitment

TELMEX's social commitment is not limited to providing the country with the best telecommunications service. The company's commitment is broad and institutional concentrating its activities through Fundación TELMEX.

Fundación TELMEX Three years after its creation, Fundación TELMEX continues to make substantial contributions in education, health, justice and cultural programs.

Education Educational activities are a high priority for Mexico's growth. To achieve this priority, Fundación TELMEX grants scholarships to outstanding students across the country. In 1999, 14,524 students benefited from these scholarships, which not only provide financial aid and school supplies but also promote communications among the scholarship recipients, to contribute to their overall development as well-rounded young adults.

Health In 1999, Fundación TELMEX through its health program sponsored 4,700 surgeries in conjunction with the Mexican government's Health Department. The surgeries concentrate on specialized medical treatments for patients who often live in smaller communities far from major health centers. The program selects specialists, coordinates doctors and nurses, transports surgical equipment and supports patient rehabilitation.

Justice The justice program of Fundación TELMEX, carried out in collaboration with the "Reintegra" program, helps free people accused of small crimes whose economic condition prevents them from meeting the conditions of bail. The Foundation in 1999 provided 2,118 bail bonds so that persons in this situation could be reinstated to their families and society in a productive manner.

Digital Culture In another step aimed at accelerating Mexico's digital transition, TELMEX, through the Foundation and in coordination with educational authorities, is providing computer

equipment and Internet access to public schools and libraries in rural areas. The objective is to offer children, teenagers, instructors and college teachers the opportunity to become familiar with the technology that is transforming the way in which human beings carry out their activities.

Natural Disasters The strong rains and earthquakes that affected several Mexican states during 1999 left considerable damage. Many communities in Hidalgo, Tabasco, Puebla and Veracruz were strongly affected by rain and flooding and in Oaxaca by earthquakes.

Fundación TELMEX delivered more than 700 tons of needed disaster assistance to 487 affected communities in those states. Coordinating its efforts with diverse public, private and civic entities, the Foundation provided direct humanitarian aid, infrastructure and logistical support through its personnel, facilities, and land and air transportation.

Unfortunately, the torrential rains also devastated Venezuela. TELMEX also lent a hand to damaged communities there through Fundación TELMEX. The humanitarian aid that Fundación TELMEX sent to the affected populations totaled almost 53 tons of medicine, serum and food. Additionally, the Foundation sent almost 4,000 boxes of water, food, medication and clothing. In terms of infrastructure support, the Foundation sent 4 tons of PVC rolls to build tents, 5 containers of posts and 2 electric plants.

TELMEX Mexico Cup To promote sports among Mexican youth, TELMEX sponsored a national soccer tournament for young men from 17 to 22 years old. In this tournament, the biggest of its kind in Latin America, nearly 10,000 teams from the 32 states of the Mexican Republic participated.

These are ways in which TELMEX extends its commitment to Mexico beyond telecommunications services, and do these things in the spirit of helping shape better people, a better society and a better country.



Comments on the Operating

Results and the Financial Position

Comments on

the Operating Results and the Financial Position

TELMEX is a corporation made up of Telefonos de México, S.A. de C.V., its subsidiaries and affiliates. Along with them, TELMEX is the leading provider of a variety of telecommunications services in the country. In addition to other services, this includes operation of the nation's most complete local network for basic telephony, domestic and international long distance, and cellular telephony. Additionally, TELMEX offers services like data transmission, Internet access, paging and interconnection service with other telecommunications operators.

Operating Results

TELMEX increased lines in service during 1999, producing an annual increase of 9.6 percent compared with the previous year. Total fixed lines rose to 10,878,155. The net increase of 951,276 new lines was the result of 1,425,346 installations and 474,070 disconnections.

In a market with competition since 1997, domestic long distance traffic increased 14.8 percent compared with the previous year, reaching 10,419

million billed minutes. International long distance service increased volume to 4,192 million billed minutes, an increase of 27.6 percent compared with 1998.

Financial Results

The financial results of TELMEX reported in the following pages should be analyzed in conjunction with the consolidated financial statements and accompanying notes, which are an integral part of this annual report.

The consolidated financial statements were prepared in conformity with generally accepted accounting principles in Mexico. Therefore, as required by Mexican Accounting Principles Bulletin B-10, as amended, issued by the Mexican Institute of Public Accountants, the figures shown in the consolidated financial statements and in the accompanying notes are expressed in pesos with purchasing power as of December 31, 1999.

TELMEX

Years ended December 31

	1999		1998	
	Million pesos	% of operating revenues	Million pesos	% of operating revenues
Operating Revenues:				
Long-Distance Service:				
International	11,547	12.0	9,738	11.1
Domestic	21,695	22.5	20,193	23.0
Local Service	51,237	53.2	50,171	57.1
Interconnection Service	5,131	5.3	2,499	2.8
Other	6,711	7.0	5,279	6.0
	96,321	100.0	87,880	100.0
Operating Costs and Expenses:				
Cost of Sales and Services	23,599	24.5	19,247	21.9
Commercial, Administrative and General	19,032	19.8	17,588	20.0
Depreciation and Amortization	17,447	18.1	17,655	20.1
	60,078	62.4	54,490	62.0
Operating Income	36,243	37.6	33,390	38.0
Comprehensive Financing (Income) Cost:				
Interest Income	(4,734)	(4.9)	(5,524)	(6.3)
Interest Expense	4,923	5.1	5,236	6.0
Exchange Loss, Net	58	0.1	4,297	4.9
Monetary Effect	(376)	(0.5)	(944)	(1.2)
	(129)	(0.2)	3,065	3.4
Income Before Income Tax and Employee Profit Sharing	36,372	37.8	30,325	34.6
Provision for:				
Income Tax	8,784	9.1	9,229	10.5
Employee Profit Sharing	2,596	2.7	2,705	3.1
	11,380	11.8	11,934	13.6
Income Before Equity in Results of Affiliates and Minority Interest	24,992	26.0	18,391	21.0
Equity in Results of Affiliates	(79)	(0.1)	30	-
Minoritary Interest	214	0.2	-	-
Majority Net Income	25,127	26.1	18,421	21.0

Revenues from International Long Distance (ILD)

In a competitive market, in 1999 consolidated international long distance revenues increased 18.6 percent, compared with reductions in the last two years.

The increase in ILD revenues in 1999 was primarily due to the recognition of 139 million dollars for international net settlements with international US operators for the period of January 1998 to February 1999. Additionally, the growth in traffic volume measured in minutes increased 27.6 percent during 1999 compared with a decrease of 12.8 percent in the prior year. As a result of these factors, 1999 ILD revenues increased their contribution to total revenues to 12.0 percent from the year-earlier 11.1 percent.

Revenues from Domestic Long Distance (DLD)

In contrast to international long distance, growth in domestic long distance again slowed, as had been the case during the previous two years. Revenues rose 7.4 percent, compared with a 0.4 percent decrease in 1998, and declined to 22.5 percent of total TELMEX revenues from the year-ago 23.0 percent.

The mixed results reflected an increase in billed traffic as well as the new competitors' line penetration. The volume of billed minutes increased 14.8 percent in 1999 compared with a 10.3 percent rise in the previous year.

Revenues from Local Service

Local service revenues rose 2.1 percent during 1999 compared with 23.1 percent in 1998. The lower rate of increase meant that local service revenues declined to 53.2 percent of total TELMEX revenues in 1999 from 57.1 percent in 1998. The increase in 1999 reflected a higher number of lines in service and higher volume of local billed traffic, in part offset by a decrease in rates in real terms. In 1998 the improvement reflected increases in local traffic and lines in service as well as rate rebalancing.

Revenues from Interconnection Service

This category includes revenues from interconnection to TELMEX's local network by competitive long distance and local service operators and cellular companies. Interconnection revenues represented 5.3 percent of total revenues in 1999 and 2.8 percent in 1998. The higher proportion primarily reflected the implementation of "calling party pays." The new program accounted for 59.8 percent of interconnection revenues in 1999. In 1998 the most significant factor in this category was revenues from interconnecting long distance operators.

Other Revenues

In 1999 and 1998 the other revenues category achieved increases of 27.1 percent and 43.5 percent, respectively, compared with the previous years. Telephone equipment, cellular handsets and Yellow Pages continue to be the main components of the other revenues category.

Costs of Sales and Services

In 1999, costs of sales and services increased 22.6 percent compared with the prior year's 1.8 percent. In both years the higher expense level primarily reflects higher sales of cellular handsets, telephone equipment and accessories. An additional factor in 1999 was expenses associated with the change to "calling party pays."

Commercial, Administrative and General Expenses

During 1999, commercial, administrative and general expenses increased 8.2 percent, primarily due to higher advertising and telephone service promotion

expenses, commissions for cellular handset sales and the sale of phone cards. Expenses in 1998 increased 2.1 percent over the previous year, reflecting increases in wages and related costs, paid commissions and uncollectable accounts.

Depreciation and Amortization

During 1999, depreciation and amortization charges decreased 1.2 percent compared with an increase of 5.4 percent in 1998 over the previous year. The lower rate reflects application of the alternative method defined in the fifth amendment to Bulletin B-10, as revised, which took into account Mexico's higher consumer price index and changes in the useful lives of some elements of external plant (cables, canalization, posts) and digital transmission equipment. The increase in 1998 reflected investments during the year and application of the alternative method defined in the fifth amendment to Bulletin B-10 as related to the useful lives of computer and transportation equipment.

Operating Income

Operating income for 1999 rose 8.5 percent compared with 1998, reflecting a 9.6 percent increase in operating revenues offset by a 10.3 percent increase in operating costs and expenses. Consequently, the operating margin decreased to 37.6 percent in 1999 from 38.0 percent in 1998.

Comprehensive Financing (Income) Cost

In 1999, TELMEX benefited from comprehensive financing income of 129 million pesos compared with comprehensive financing cost of 3.065 billion pesos in 1998.

During 1999, interest revenues decreased 14.3 percent, reflecting lower interest rates. In 1998, higher rates resulted in a 42.3 percent increase in interest revenues. In 1999, interest expenses decreased 6.0 percent due to early payment of the debt in Japanese yen and the decrease in interest rates on TELMEX's liabilities in Mexican pesos. In 1998, these expenses increased 23.1 percent, reflecting a larger debt in Mexican pesos and higher domestic interest rates.

In 1999, there was a net currency exchange loss of 58 million pesos because the peso-dollar average exchange rate during the year was 3.6 percent higher than in 1998. In 1998, a 22 percent depreciation of the peso to the US dollar generated a net exchange loss of 4.297 billion pesos. The decrease in 1999's monetary position gain was due to lower inflation and a lower net average monetary liabilities.

Net Income

Consolidated net income for 1999 reached 25.127 billion pesos, an increase of 36.4 percent compared with the previous year. In 1998, consolidated net income was 18.421 billion pesos, reflecting an increase of 7.6 percent compared with 1997.

Investments

During 1999, consolidated investments rose to 22.438 billion pesos, an increase of 36.5 percent compared with 1998, when the total was 16.434 billion pesos. The consolidated investment in telephone infrastructure in 1999 was 14.705 billion pesos compared with 1998's 13.254 billion pesos. During 1999, TELMEX invested 6.120 billion pesos in subsidiaries, affiliates and other permanent investments. In May 1998, at a cost of 2.069 billion pesos, TELMEX acquired concessions from the federal government for frequencies to offer fixed and mobile wireless telephony.

Financial Structure

The debt to capitalization ratio of 21.3 percent for 1999 shows that TELMEX's financial structure continues solid. In 1998 this ratio was 22.1 percent.

Stock Repurchase

TELMEX in 1999 repurchased 250 million shares, equivalent to 3.2 percent of outstanding shares at the beginning of the year. At year-end, TELMEX had 7,474.7 million shares outstanding, comprised of 2,163.0 million Series "AA" shares, 184.7 million Series "A" shares and 5,127.0 million Series "L" shares.

In March 1999, a program was approved to acquire up to 800 million additional shares.

Shareholders at a special meeting on December 6, 1999, approved a two-for-one stock split in "AA", "A" and "L" shares. The split took effect February 1, 2000.

Restated for the two-for-one stock split, total shares outstanding at the end of 1999 were 14,949.4 million, of which 4,326.1 million were Series "AA"

shares, 369.3 million Series "A" shares and 10,254.0 million Series "L" shares.

Cellular Telephony

At the end of 1999, cellular customers totaled 5,271,957, 149.5 percent higher than a year ago. Billed minutes reached 3,513 million, an increase of 96.9 percent compared with 1998.

Revenues were 47.6 percent higher than in 1998, totaling 13.035 billion pesos. The growth in revenues reflected the increase in the number of cellular customers, introduction of "calling party pays," a revised cancellation policy, accelerated penetration in rural areas and prices that have remained stable in nominal terms.

During 1999, operating costs and expenses were 10.221 billion pesos, 48.2 percent higher than the previous year. The growth in operating costs and expenses reflected higher commissions and costs generated by larger volume and the accompanying increase in handset sales. The operating margin in 1999 was 21.6 percent compared with 21.9 percent in 1998.

Consolidated Financial**Statements****CELLULAR TELEPHONY**

Years ended December 31

	1999		1998	
	Million pesos	% of operating revenues	Million pesos	% of operating revenues
Operating Revenues (*)	13,035	100.0	8,829	100.0
Operating Cost and Expenses:				
Cost of Sales and Services (*)	5,612	43.1	3,413	38.7
Commercial, Administrative and General	3,668	28.1	2,820	31.9
Depreciation and Amortization	941	7.2	664	7.5
	10,221	78.4	6,897	78.1
Operating Income	2,814	21.6	1,932	21.9

(*) Include revenues and/or costs associated with Long-Distance service.

Opinion

of the Statutory Auditor

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

In my capacity as statutory auditor and in compliance with Article 166 of the Mexican Corporations Act and the bylaws of Teléfonos de México, S.A. de C.V., I am pleased to submit my report on the consolidated financial statements for the year ended December 31, 1999, presented to you by the Board of Directors.

I personally (or in my absence the alternate statutory auditor) attended the Stockholders' and the Board of Directors' meetings to which I was summoned and I obtained from the board members and the Company's officers the information on the Company's operations, documentation and records that I considered necessary for examination. I conducted my review in accordance with auditing standards generally accepted in Mexico.

In my opinion, the accounting and reporting policies and criteria observed by the Company in the preparation of the consolidated financial statements that are being presented to the stockholders are adequate and sufficient and were applied on a basis consistent with that of the prior year. Consequently, it is also my opinion that the above-mentioned consolidated financial statements present fairly, in all material respects, the consolidated financial position of Teléfonos de México, S.A. de C.V. and subsidiaries at December 31, 1999, the consolidated results of their operations, changes in their stockholders' equity and changes in their financial position for the year then ended in conformity with accounting principles generally accepted in Mexico.

C.P.C. Victor Aguilar
Statutory Auditor

Mexico City, Mexico
March 3, 2000

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, 1999 and 1998, 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, 1999 and 1998, 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.C. Alberto Tiburcio

Mexico City, Mexico
March 3, 2000

Consolidated

Statements of Income

(thousands of Mexican pesos with purchasing power at December 31, 1999, except for earnings per share)

	Year ended December 31	
	1999	1998
Operating revenues:		
Long-distance service:		
International	Ps. 11,547,481	Ps. 9,738,248
Domestic	21,694,906	20,192,904
Local service	51,236,478	50,170,667
Interconnection service	5,130,638	2,498,873
Other	6,711,083	5,279,560
	<u>96,320,586</u>	<u>87,880,252</u>
Operating costs and expenses:		
Cost of sales and services	23,598,403	19,246,873
Commercial, administrative and general	19,032,115	17,588,433
Depreciation and amortization (Notes 3 to 5)	17,447,244	17,655,072
	<u>60,077,762</u>	<u>54,490,378</u>
Operating income	<u>36,242,824</u>	<u>33,389,874</u>
Comprehensive financing (income) cost:		
Interest income	(4,733,860)	(5,524,008)
Interest expense	4,922,742	5,235,766
Exchange loss, net (Note 9)	58,118	4,297,651
Monetary effect	(376,103)	(944,134)
	<u>(129,103)</u>	<u>3,065,275</u>
Income before income tax and employee profit sharing	<u>36,371,927</u>	<u>30,324,599</u>
Provisions for:		
Income tax (Note 13)	8,783,939	9,228,416
Employee profit sharing	2,596,180	2,705,355
	<u>11,380,119</u>	<u>11,933,771</u>
Income before equity in results of affiliates and minority interest	<u>24,991,808</u>	<u>18,390,828</u>
Equity in results of affiliates (Note 5)	(79,419)	30,232
Income before minority interest	<u>24,912,389</u>	<u>18,421,060</u>
Minority interest in loss of subsidiaries	214,254	
Net income	Ps. 25,126,643	Ps. 18,421,060
Net income per share (Notes 1 and 12):		
Basic	Ps. 1.665	Ps. 1.166
Diluted	Ps. 1.628	Ps. 1.166

See accompanying notes.

Consolidated

Statements of Changes in Financial Position

(thousands of Mexican pesos with purchasing power at December 31, 1999)

	Year ended December 31	
	1999	1998
Operating activities:		
Net income	Ps. 25,126,643	Ps. 18,421,060
Add (deduct) items not requiring the use of resources:		
Depreciation	16,887,967	17,470,905
Amortization	559,277	184,167
Deferred taxes	510,021	1,648,325
Equity in results of affiliates	79,419	(30,232)
Minority interest	(214,254)	
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(1,161,724)	1,668,677
Prepaid expenses	(260,347)	505,966
Increase (decrease) in:		
Employee pensions and seniority premiums:		
Reserve	3,013,232	3,048,338
Contributions to trust fund	(2,369,823)	(3,580,939)
Payments to employees	(1,984,800)	(1,765,263)
Accounts payable and accrued liabilities	4,462,551	336,394
Taxes payable	904,759	(886,676)
Deferred credits	(277,787)	(735,702)
Resources provided by operating activities	<u>45,275,134</u>	<u>36,285,020</u>
Financing activities:		
New loans	17,344,019	18,571,252
Repayment of loans	(12,882,080)	(17,938,965)
Effect of inflation and of exchange rate differences on debt	(5,431,721)	(1,171,073)
Decrease in capital stock and retained earnings due to purchase of Company's own shares	(7,852,523)	(10,602,845)
Minority interest	191,801	
Cash dividends paid	(6,035,069)	(6,621,664)
Resources used in financing activities	<u>(14,665,573)</u>	<u>(17,763,295)</u>
Investing activities:		
Investment in telephone plant	(14,704,697)	(13,254,015)
Investment in inventories	(1,612,613)	(264,571)
Investment in subsidiary companies	(2,155,833)	
Investment in affiliated companies	(2,854,229)	(846,509)
Investment in licenses		(2,068,976)
Other equity investments	(1,110,222)	
Resources used in investing activities	<u>(22,437,594)</u>	<u>(16,434,071)</u>
Net increase in cash and short-term investments	8,171,967	2,087,654
Cash and short-term investments at beginning of year	20,207,207	18,119,553
Cash and short-term investments at end of year	Ps. 28,379,174	Ps. 20,207,207

See accompanying notes.

Consolidated

Balance Sheets

(thousands of Mexican pesos with purchasing power at December 31, 1999)

	December 31	
	1999	1998
Assets		
Current assets:		
Cash and short-term investments	Ps. 28,379,174	Ps. 20,207,207
Accounts receivable, net (Note 2)	18,072,265	16,710,429
Prepaid expenses	2,271,426	1,717,396
Total current assets	48,722,865	38,635,032
Plant, property and equipment, net (Note 3)	108,736,261	119,406,471
Inventories, primarily for use in construction of the telephone plant	3,998,501	2,176,270
Licenses, net (Note 4)	2,090,906	2,203,953
Equity investments (Note 5)	4,270,388	681,239
Intangible asset (Note 6)	8,164,076	9,056,085
Goodwill, net (Note 5)	2,554,952	671,344
Total assets	Ps. 178,537,949	Ps. 172,830,394

Liabilities and stockholders' equity

	December 31	
	1999	1998
Current liabilities:		
Current portion of long-term debt (Note 7)	Ps. 9,019,529	Ps. 13,006,058
Accounts payable and accrued liabilities	13,423,772	8,706,559
Taxes payable	4,014,313	2,590,557
Total current liabilities	26,457,614	24,303,174
Long-term debt (Note 7)	24,145,004	20,748,079
Reserve for employee pensions and seniority premiums (Note 6)	4,961,801	7,988,208
Deferred credits (Note 8)	676,272	846,749
Total liabilities	56,240,691	53,886,210
Stockholders' equity (Note 12):		
Capital stock:		
Historical	747,472	772,433
Restatement increment	51,036,706	51,126,570
Premium on sale of shares	51,784,178	51,899,003
Retained earnings:		
Unappropriated earnings of prior years	9,127,297	9,127,297
Net income for the year	92,434,060	87,785,767
	25,126,643	18,421,060
Minimum pension and seniority premium liability adjustment (Note 6)	117,560,703	106,206,827
Deficit from restatement of stockholders' equity	(484,165)	(1,277,173)
	(56,361,135)	(47,011,770)
Total majority stockholders' equity	121,626,878	118,944,184
Minority interest	670,380	
Total stockholders' equity	122,297,258	118,944,184
Total liabilities and stockholders' equity	Ps. 178,537,949	Ps. 172,830,394

See accompanying notes.

Consolidated

Statements of Changes in Stockholders' Equity

(thousands of Mexican pesos with purchasing power at December 31, 1999, except for dividends per share)

Retained earnings

	Capital stock	Premium on sale of shares	Legal reserve	Reserve for purchase of Company's own shares	Unappropriated	Total	Minimum pension and seniority premium liability adjustment	Deficit from restatement of stockholders' equity	Total majority stockholders' equity	Minority interest	Total stockholders' equity
Balance at December 31, 1997	Ps. 52,080,139	Ps. 9,127,297	Ps. 11,820,778	Ps. 4,061,793	Ps. 88,946,569	Ps. 104,829,140		Ps. (48,492,866)	Ps. 117,543,710		Ps. 117,543,710
Appropriation of earnings approved at stockholders' meetings held in March and April, 1998:											
Cash dividends paid, at Ps. 0.70 per share					(6,621,664)	(6,621,664)			(6,621,664)		(6,621,664)
Increase in legal reserve			724,742		(724,742)						
Increase in reserve for purchase of Company's own shares				21,757,855	(21,757,855)						
Cash purchase of Company's own shares	(181,136)			(10,414,446)	(7,263)	(10,421,709)			(10,602,845)		(10,602,845)
Minimum pension and seniority premium liability adjustment (Note 6)							Ps. (1,277,173)		(1,277,173)		(1,277,173)
Surplus from holding nonmonetary assets								1,481,096	1,481,096		1,481,096
Net income					18,421,060	18,421,060			18,421,060		18,421,060
Balance at December 31, 1998	51,899,003	9,127,297	12,545,520	15,405,202	78,256,105	106,206,827	(1,277,173)	(47,011,770)	118,944,184		118,944,184
Appropriation of earnings approved at stockholders' meetings held in March and April, 1999:											
Cash dividends paid, at Ps. 0.775 per share					(6,035,069)	(6,035,069)			(6,035,069)		(6,035,069)
Increase in reserve for purchase of Company's own shares				24,101,804	(24,101,804)						
Increase in legal reserve			10,240		(10,240)						
Cash purchase of Company's own shares	(114,825)			(7,454,732)	(282,966)	(7,737,698)			(7,852,523)		(7,852,523)
Minimum pension and seniority premium liability adjustment (Note 6)							793,008		793,008		793,008
Minority interest										Ps. 692,833	692,833
(Deficit) surplus from holding nonmonetary assets								(9,349,365)	(9,349,365)	191,801	(9,157,564)
Net income					25,126,643	25,126,643			25,126,643	(214,254)	24,912,389
Balance at December 31, 1999 (Note 12)	Ps. 51,784,178	Ps. 9,127,297	Ps. 12,555,760	Ps. 32,052,274	Ps. 72,952,669	Ps. 117,560,703	Ps. (484,165)	Ps. (56,361,135)	Ps. 121,626,878	Ps. 670,380	Ps. 122,297,258

See accompanying notes.

Notes to

Consolidated Financial Statements

December 31, 1999 and 1998

(thousands of Mexican pesos with purchasing power at December 31, 1999, except for earnings per share)

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 telecommunications services, mainly in Mexico. Starting in 1999, the Company provides telecommunications services through its subsidiaries in the United States of America and Guatemala.

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.

At the end of 1996 and gradually during 1997, the competition was allowed to provide domestic and international long-distance telephone services. In 1999, the competition began to provide basic local telephone service.

TELMEX obtains its revenues primarily from telecommunications services, including domestic and international long-distance and local telephone services, data transmission and Internet services, as well as the interconnection of domestic long-distance operators', cellular telephone companies' and local service operators' networks with the TELMEX local network. The Company also obtains revenues from other activities related to its telephone operations, such as the publication of the telephone directory.

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 Mexican subsidiaries, all of which are wholly owned, except for two subsidiaries, in which the Company holds a 70% and an 80% equity interest. All of the companies operate in the telecommunications sector or they provide services to companies operating in this sector.

The minority interest mainly refers to foreign subsidiaries of the Mexican subsidiaries referred to above.

All significant intercompany accounts and transactions have been eliminated in consolidation.

b) Recognition of revenues

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, air time for cellular phones and other service charges to subscribers, including, among others, charges for interconnecting fixed-system users with cellular users.

Revenues from domestic and international long-distance telephone calls are determined on the basis of the duration of the calls and the type of service used. All these services are billed monthly, based on the rates authorized by the 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 specify the rates for the use of such international interconnecting facilities. These service revenues represent the net settlement between the parties.

In 1998 revenues obtained from U.S. long-distance service operators were conservatively recognized at the time payments were received because no agreement with respect to settlement rates had been reached at the end of the year. In 1999, based on the agreements reached, the Company recorded as revenue for the year, approximately U.S. \$ 131.5 million, as complement to the interconnection services provided in 1998.

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 accompanying financial statements and in these notes are expressed in thousands of Mexican pesos with purchasing power at December 31, 1999. The December 31, 1999 restatement factor applied to the financial statements at December 31, 1998 was 12.32% (which represents the annual rate of inflation for 1999) based on the Mexican National Consumer Price Index (NCPI) published by Banco de México (the central bank).

Plant, property and equipment, and construction in progress were restated as described in Note 3. Telephone plant and equipment depreciation was computed on the restated investment using the retirement-and-replacement method (composite group method). All other assets were depreciated using the straight-line method based on the estimated useful lives of the related assets.

Inventories are valued at average cost and are restated on the basis of specific indexes. The stated value of inventories is similar to replacement value, not in excess of market.

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

The deficit from restatement of stockholders' equity consists of (i) the accumulated monetary position loss at the time the provisions of Bulletin B-10 were first applied in 1984 (Ps. 10,010,457 at December 31, 1999) and, (ii) of the result from holding nonmonetary assets, which represents the net difference between restatement by the specific-cost method through 1996 and the alternate method of specific indexation (see Note 3) effective January 1, 1997, compared to 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 investments 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 incurred (see Note 5).

f) Exchange rate 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 rate differences are applied directly to income of the year.

At times the Company enters into short-term forward exchange and option contracts, as hedges for transactions denominated in currencies other than the U.S. dollar. The gains or losses on these contracts are recognized in income as 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 made by independent actuaries, using the projected unit-credit method and financial hypotheses net of inflation, as required by Mexican Accounting Principles Bulletin D-3 ("Labor Obligations," see Note 6). Termination payments are charged to income in the year in which the decision to dismiss an employee is made.

h) Income taxes, asset tax and employee profit sharing

Income taxes 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, see Note 13).

i) Basis of translation of financial statements of foreign subsidiaries

The accounting records of foreign subsidiaries, located in the U.S. and in Guatemala, which in the aggregate account for approximately 1% of consolidated net revenues and approximately 1% of total assets in 1999, are kept in the local currency of each country and are translated into Mexican pesos in conformity with Mexican Accounting Principles Bulletin B-15, ("Transactions in Foreign Currency and Translation of Financial Statements of Foreign Operations"), as follows:

- The figures reported by the subsidiaries abroad were adjusted to conform with accounting principles generally accepted in Mexico.
- All balance sheet amounts, except for capital stock and retained earnings, were translated at the prevailing exchange rate at year-end; capital stock and retained earnings were translated at the prevailing exchange rate at the time capital contributions were made and earnings were generated. The statement of income was translated at the prevailing exchange rate at the end of the reporting period. In 1999, the effects of translation are not significant and are included in the deficit from restatement of stockholders' equity account shown in the statement of changes in stockholders' equity.

j) Earnings per share

TELMEX determined earnings per share in conformity with Mexican Accounting Principles Bulletin B-14 ("Earnings per share," see Note 12).

k) Use of estimates

The preparation of financial statements requires the use of estimates and assumptions in some areas. Actual results could differ from these estimates.

l) Reclassifications

Certain amounts shown in the 1998 balance sheet and income statement have been reclassified for uniformity of presentation with 1999.

2. Accounts Receivable

Accounts receivable consist of the following:

	1999		1998	
Subscribers	Ps.	15,637,491	Ps.	15,629,562
Net settlement receivables		780,052		297,916
Other		4,490,241		2,746,374
		20,907,784		18,673,852
Less:				
Allowance for doubtful accounts		2,835,519		1,963,423
Total	Ps.	18,072,265	Ps.	16,710,429

3. Plant, Property and Equipment

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

	1999		1998	
Telephone plant and equipment	Ps.	157,967,481	Ps.	163,526,003
Land and buildings		21,477,447		21,022,969
Other assets		17,953,700		17,618,793
		197,398,628		202,167,765
Less:				
Accumulated depreciation		97,128,929		89,701,934
Net		100,269,699		112,465,831
Construction in progress and advances to equipment suppliers		8,466,562		6,940,640
Total	Ps.	108,736,261	Ps.	119,406,471

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

Since the fifth amendment (as revised) to Bulletin B-10, effective January 1, 1997, eliminated the use of appraisals to restate plant, property and equipment in the financial statements, this caption was restated as follows at December 31, 1999 and 1998:

- The December 31, 1996 appraised value of the imported telephone plant, as well as the cost of subsequent additions to such plant, were restated based on the rate of inflation in the respective country of origin and the prevailing exchange rate at the balance sheet date (i.e., specific indexation factors).
- The appraised value of land, buildings and other fixed assets of domestic origin at December 31, 1996, and the cost of subsequent additions to such assets were restated based on the NCPI.

At December 31, 1999 and 1998, approximately 53% of the value of plant, property and equipment has been restated using specific indexation factors.

Following are the figures on plant, property and equipment at December 31, 1999 and 1998, restated on the basis of the NCPI (starting with the appraised values at December 31, 1996) to meet NBSC disclosure requirements with respect to the restatement of fixed assets based on specific indexation factors:

	1999	1998
Telephone plant and equipment	Ps. 186,515,315	Ps. 176,470,102
Land and buildings	21,477,447	21,022,969
Other assets	20,134,249	18,352,121
	<u>228,127,011</u>	<u>215,845,192</u>
Less:		
Accumulated depreciation	114,256,857	96,712,335
Net	<u>113,870,154</u>	<u>119,132,857</u>
Construction in progress and advances to equipment suppliers	8,635,905	8,007,420
Total	<u>Ps. 122,506,059</u>	<u>Ps. 127,140,277</u>

c) Because of the important progress and the technological advances in telecommunications equipment, the Company makes a periodic assessment of the estimated useful lives of its fixed assets, adjusting annual depreciation whenever it believes this to be appropriate. In 1999, the Company extended the useful lives of certain assets, thereby decreasing depreciation expense for 1999, as compared to 1998, by approximately Ps. 512,000.

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 33.3%. Depreciation charged to income was Ps. 16,887,967 in 1999 and Ps. 17,470,905 in 1998.

4. Licenses

In May 1998, TELMEX acquired from the Mexican Government concessions to operate radio spectrum wave frequency bands to provide fixed and mobile wireless telephone services at a cost of Ps. 2,068,976. In December 1997, the Company also acquired from the Mexican Government concessions to operate radio spectrum wave frequency bands for point-to-point and point-to-multipoint microwave communications at a cost of Ps. 191,524. This cost will be amortized over a period of twenty years (see Note 13).

5. Equity Investments

An analysis at December 31, 1999 and 1998 is as follows:

	1999	1998
Equity investments in:		
Affiliates	Ps. 3,160,166	Ps. 681,239
Other	1,110,222	
	<u>4,270,388</u>	<u>681,239</u>
Goodwill:		
Subsidiaries	1,905,913	
Affiliates	649,039	671,344
	<u>2,554,952</u>	<u>671,344</u>
Total	<u>Ps. 6,825,340</u>	<u>Ps. 1,352,583</u>

An analysis of the equity investment in affiliated companies at December 31, 1999 and 1998, and a brief description of major acquisitions in each year is as follows:

	1999	1998
SBC International Puerto Rico, Inc.	Ps. 2,246,839	
Empresas Cablevisión, S.A. de C.V.	648,319	Ps. 607,612
Prodigy Communications Corporation	265,008	81,781
Telmex/Sprint Communications, L.L.C.		(8,154)
Total	<u>Ps. 3,160,166</u>	<u>Ps. 681,239</u>

a) In October 1999, TELMEX acquired a 50% equity interest in SBC International Puerto Rico Inc. (SBC International), the parent company of Cellular Communications of Puerto Rico, Inc., the major wireless telephone operator in Puerto Rico and the Virgin Islands. The remaining 50% equity interest in SBC International is held by SBC Communications, Inc. The goodwill of Ps. 51,876 generated on this transaction will be amortized over a period of five years. The unamortized balance of goodwill at December 31, 1999 was Ps. 50,147.

b) In July 1998, the Company acquired a 20.9% equity interest in Prodigy Communications Corporation (Prodigy), which is engaged in providing internet services in the United States. In February 1999, Prodigy made a public offering of 9,200,000 shares for approximately U.S. \$ 129 million. At the same time, TELMEX subscribed and paid a capital increase for the equivalent of 2 million shares of Prodigy. In December 1999, the Company acquired 432,600 shares of Prodigy.

As a result of these transactions, at December 31, 1999, the Company holds an 18.4% equity interest in Prodigy. The goodwill of Ps. 806,386 generated on these transactions will be amortized over a period of five years. The unamortized balance of goodwill at December 31, 1999 and 1998 was Ps. 598,892 and Ps. 671,344, respectively. In January 2000, the Company acquired an additional 171,100 shares of Prodigy.

c) Total equity investments in affiliated companies during 1999 aggregated approximately U.S. \$ 284 million (U.S. \$ 75 million in 1998).

d) TELMEX's equity interest in the results of operations and the stockholders' equity of affiliated companies represented a charge to operations of Ps. 79,419 in 1999 (credit of Ps. 30,232 in 1998) and a charge to stockholders' equity from holding nonmonetary assets of Ps. 122,339 in 1999 (credit of Ps. 13,710 in 1998).

Following is a summary of the most important equity investments in subsidiaries and other equity investments:

a) In February 1999, the Company acquired a 55.5% equity interest in Topp Telecom Inc. (Topp), which is engaged in the re-sale of prepaid cellular telephone service in the United States. In the period June through September 1999, TELMEX made additional capital contributions to Topp and, as a result, increased its equity interest in such company to 88.3%. The goodwill of Ps. 1,006,175 generated on these acquisitions will be amortized over a period of five years. The unamortized balance of goodwill at December 31, 1999 was Ps. 845,868.

b) In June 1999, the Company acquired Comm South Companies, Inc., which is engaged in the re-sale of prepaid local telephone service in the United States. The

goodwill of Ps. 711,782 generated on this acquisition will be amortized over a period of five years.

The goodwill generated on the acquisition of other subsidiaries aggregated Ps. 403,586. The unamortized portion of this goodwill at December 31, 1999 was Ps. 348,263, which will be amortized over a period of five years.

No pro forma information on the preceding acquisitions is presented because such information is considered to be relatively immaterial in relation to the consolidated financial statements taken as a whole.

c) In May 1999, the Company entered into an agreement with Williams Communications Group, Inc. (Williams), which is engaged in providing telecommunications services in the United States, to acquire approximately 1% of the shares comprising the capital stock of Williams. This transaction was consummated in October 1999. Williams and TELMEX will interconnect their fiber optics and long-distance networks in supplying international telecommunications services.

d) In 1999, total equity investments in subsidiaries and other equity investments aggregated approximately U.S. \$ 478 million.

The most important equity investments made by the Company subsequent to December 31, 1999 are as follows:

a) In the period from January 1, 2000 to the date of the audit report on these financial statements, the Company invested approximately U.S. \$ 625 million to acquire a 25% equity interest in ATL-Algar Telecom Leste S.A., which provides

Analysis of the net period cost:

Labor cost	Ps. 1,566,103	Ps. 1,532,388
Financial cost of projected benefit obligation	2,776,219	2,696,977
Return on plan assets	(2,220,099)	(2,070,480)
Amortization of past service costs	892,250	892,238
Amortization of variances in assumptions	(1,241)	(2,785)

Net period cost

Reserve for employee pensions and seniority premiums:

Projected benefit obligation	Ps. 48,107,763	Ps. 41,246,266
Plan assets	(40,557,998)	(30,958,389)
Transition liability	(8,164,076)	(9,056,085)
Actuarial loss to be amortized	(3,072,129)	(3,576,842)
Net projected asset	(3,686,440)	(2,345,050)

Additional minimum liability

Reserve for employee pensions and seniority premiums

Accumulated benefit obligation

Intangible asset included on balance sheet

Minimum pension and seniority premium liability adjustment on stockholders' equity

cellular telephone service in Rio de Janeiro and Bahia de Espirito Santo, Brazil, and a 49% equity interest in CompUSA, Inc., a computer hardware and software distributor in the United States.

b) In March 2000 the Company is in the process of negotiating the acquisition of a 79.6% equity interest in Luca, S.A., the parent company of Telecomunicaciones de Guatemala, S.A. and a 60% equity interest in Consorcio Ecuatoriano de Telecomunicaciones, S.A., which provides cellular telephone services in Ecuador.

6. Employee Pensions and Seniority Premiums

Substantially all the Company's employees are covered under defined benefits 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. 2,369,823 in 1999 and Ps. 3,580,939 in 1998. These contributions are deductible for Mexican corporate income tax purposes.

The transition liability, past services and variances in assumptions are being amortized over a period of twelve years, which is the estimated average remaining working lifetime of Company employees.

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

	1999	1998
Ps.	1,566,103	Ps. 1,532,388
	2,776,219	2,696,977
(	2,220,099)	(2,070,480)
	892,250	892,238
(	1,241)	(2,785)
Ps.	<u>3,013,232</u>	<u>Ps. 3,048,338</u>
	1999	1998
Ps.	48,107,763	Ps. 41,246,266
(	40,557,998)	(30,958,389)
(	8,164,076)	(9,056,085)
(	3,072,129)	(3,576,842)
(	3,686,440)	(2,345,050)
	<u>8,648,241</u>	<u>10,333,258</u>
Ps.	<u>4,961,801</u>	<u>Ps. 7,988,208</u>
Ps.	<u>45,519,799</u>	<u>Ps. 38,946,597</u>
Ps.	<u>8,164,076</u>	<u>Ps. 9,056,085</u>
Ps.	<u>484,165</u>	<u>Ps. 1,277,173</u>

The effect of the minimum pension and seniority premium liability adjustment on stockholders' equity represents the amount by which the additional minimum liability exceeds the intangible asset. The latter represents the unamortized transition liability, most of which arose in 1997, when, effective January 1 of such year, the MIPA required that actuarial computations be based on rates net of inflation instead of nominal rates as was the practice through December 31, 1996.

At December 31, 1999, 74% (75% in 1998) of plan assets were invested in fixed-income securities and 26% (25% in 1998) in variable-income securities.

The rates used in the actuarial studies were:

	1999	1998
Discount of labor obligations:		
First year	6.9 %	6.9 %
Long-term average	4.9 %	4.9 %
Increase in salaries:		
First year	0.9 %	0.9 %
Long-term average	1.4 %	1.4 %
Annual returns from the fund:		
First year	6.9 %	6.9 %
Long-term average	4.9 %	4.9 %

7. Long-term Debt

The long-term debt consists of the following:

	Average interest rates		Maturities from 2000 through	Balance at December 31	
	1999*	1998*		1999	1998
Debt denominated in foreign currency:					
Convertible senior debentures (1)	4.2 %		2004	Ps. 9,522,200	
Banks	7.5 %	5.8 %	2009	6,924,899	Ps. 11,732,134
Suppliers' credits	6.9 %	6.0 %	2021	4,386,558	8,549,904
Financial leases	7.2 %	10.1 %	2004	295,952	19,967
Mexican Government	7.6 %	5.9 %	2006	224,229	286,001
Total				21,353,838	20,588,006
Debt denominated in Mexican pesos:					
Medium-term notes	20.2 %	34.1 %	2001	9,716,328	11,381,385
Commercial paper	18.5 %	35.7 %	2000	1,174,395	575,740
Banks	18.8 %	36.6 %	2003	801,288	1,046,409
Financial leases	19.8 %	35.5 %	2005	118,684	162,597
Total				11,810,695	13,166,131
Total debt				33,164,533	33,754,137
Less current portion of long-term debt				9,019,529	13,006,058
Long-term debt				Ps. 24,145,004	Ps. 20,748,079

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

(1) On June 11, 1999, the Company issued U.S. \$ 1,000 million of convertible senior debentures. The debentures are convertible to common stock at the option of the holders, at any time prior to their maturity into American Depositary Shares (ADSs), each representing 20 TELMEX "L" shares. The conversion price is US\$47.46095 per ADS, after the two-for-one stock split described in Note 12, equal to a conversion ratio of US\$21.0695 per US\$1,000 principal amount of the convertible debentures, subject to adjustment under certain circumstances.

Should any person or group (other than the present controlling stockholders) acquire 50% or more of the issuer's voting shares, the holders of the convertible debentures may ask TELMEX to re-purchase the convertible debentures for 100% of the principal amount plus unpaid accrued interest through the re-purchase date.

The maturity date of the convertible debentures is June 15, 2004. The debentures bear 4.25% annual interest, payable semiannually. In 1999, accrued interest on these debentures aggregated Ps. 256,280.

An analysis of the foreign currency denominated debt at December 31, 1999 is as follows:

	Foreign currency (in thousands)	Exchange rate at December 31, 1999 (in units)	Mexican peso equivalent
U.S. dollar	2,201,577	Ps. 9.5222	Ps. 20,963,857
French franc	230,731	1.4556	335,852
Guatemalan Quetzal	43,331	1.2492	54,129
Total			Ps. 21,353,838

At December 31, 1999, the Company has unused lines of credit from certain banks of approximately Ps. 6,500,000, at a floating interest rate of LIBOR plus approximately 0.9 points at the time of use.

During 1999, the Company entered into various short-term derivative transactions. At December 31, 1999, these transactions are not material.

Long-term debt maturities at December 31, 1999 are as follows:

Year	Amount
2001	Ps. 7,968,994
2002	1,922,379
2003	1,608,616
2004	10,728,258
2005 and beyond	1,916,757
Total	Ps. 24,145,004

8. Deferred Credits

Deferred credits consist of the following at December 31, 1999 and 1998:

	1999	1998
Advance billings	Ps. 662,886	Ps. 494,314
Advances from subscribers and others	13,386	352,435
Total	Ps. 676,272	Ps. 846,749

9. Foreign Currency Position and Transactions

a) At December 31, 1999, TELMEX and its Mexican subsidiaries have a net foreign currency short position of U.S.\$ 2,161 million (net foreign currency short position of U.S.\$ 1,831 million at December 31, 1998).

The prevailing exchange rate at December 31, 1999 was Ps. 9.52 per U.S. dollar (Ps. 9.87 per U.S. dollar at December 31, 1998). At March 3, 2000, 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. 9.36 per U.S. dollar.

b) In the years ended December 31, 1999 and 1998, TELMEX and its Mexican subsidiaries had the following transactions denominated in foreign currencies. Currencies other than the U.S. dollar were translated to U.S. dollars using the average exchange rate for the year.

	Millions of U.S. dollars	
	1999	1998
Net settlement revenues	U.S.\$ 534	U.S.\$ 309
Interest expense	156	175
Operating expenses	145	128

10. Commitments and Contingencies

a) At December 31, 1999, the Company has noncancelable commitments of approximately Ps. 2,120,000 (Ps. 1,750,000 in 1998) for the purchase of equipment.

b) At December 31, 1999, there are outstanding letters of credit in the approximate amount of Ps. 65,000 (Ps. 85,000 in 1998), which were issued to foreign suppliers for the purchase of materials and supplies.

c) In February 1998, the Federal Commission of Economic Competition determined that Teléfonos de México, S.A. de C.V. has substantial power in what it referred to as five telecommunications markets so that, in conformity with Article 63 of the Federal Telecommunications Act, the Federal Telecommunications Commission may impose specific obligations with respect to rates charged and quality of services and information. At the present time, it is not possible to quantify or estimate the economic consequences, if any, that may derive from this situation.

The Company's external lawyers who are handling this matter are of the opinion that this finding is unjustified. Consequently, Teléfonos de México, S.A. de C.V. filed an appeal for reconsideration by the Federal Commission of Economic Competition, which reconfirmed its initial stance, against which the Company proceeded to undertake relief proceedings and obtained the protection and shelter of the Mexican Federal Justice. This case is currently being reviewed by the Mexican Supreme Court.

d) In August 1997, a telecommunications sector company demanded from Teléfonos de México, S.A. de C.V. and from the Ministry of Communications and Transportation the rescission of the Company's concession for alleged violations of one of the terms of the concession. The same plaintiff has demanded that Teléfonos de México, S.A. de C.V. and a subsidiary nullify the transaction that such plaintiff refers to as the purchase-sale of 49% of the capital stock of Cablevisión, S.A. de C.V.

In defense, TELMEX maintains that the suit is unfounded and its inadmissibility was so declared in the first and second instances. An appeal filed by the plaintiff is currently being reviewed and, in the opinion of the Company's external lawyers who are handling this matter, TELMEX will prevail.

e) 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 Commission of Economic Competition for alleged monopolistic practices.

The Company's external 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.

f) In August 1994, Teléfonos de México, S.A. de C.V. was 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. In the opinion of the Company's external lawyers, Teléfonos de México, S.A. de C.V. will prevail in this matter.

11. Related Parties

In the years ended December 31, 1999 and 1998, the Company had the following significant transactions with related parties:

	1999	1998
Purchase of materials, inventories and fixed assets	Ps. 1,765,491	Ps. 2,983,685
Payment of insurance premiums and fees for administrative and operating services	1,036,573	777,836
Discount on sale of doubtful accounts receivable	488,647	117,091
Donations to a non-profit social welfare organization	1,003,701	875,270
Sale of materials, inventories, fixed assets and services	417,575	452,163

12. Stockholders' Equity

a) An extraordinary stockholders' meeting held on December 6, 1999 approved the increase on February 1, 2000, in the number of outstanding Series "AA," "A," and "L" shares, by means of a two-for-one stock split.

All per share and shares outstanding data in these financial statements, have been retroactively restated to reflect the two-for-one stock split.

b) At December 31, 1999, capital stock is represented by 14,949 million common shares (7,475 million prior to the stock split) with no par value, representing the fixed capital (15,449 million in 1998 and 7,724 million prior to the stock split), issued and outstanding. An analysis is as follows:

	1999	1998
4,326 million series "AA" shares (429 million in 1998)	Ps. 25,646,036	Ps. 25,646,036
369 million series "A" shares (10,254 million in 1998)	2,335,659	2,691,769
10,254 million series "L" shares (10,694 million in 1998)	23,802,483	23,561,198
Total	Ps. 51,784,178	Ps. 51,899,003

c) Series "AA" shares, which may be subscribed only by Mexican individuals and corporate entities, must represent at all times no less than 20% of capital stock and no less than 51% of the 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. The Company's bylaws contemplate the possibility of the holders of series "L" shares exchanging such shares, in certain circumstances, for series "AA" shares, commencing January 1, 2001.

d) In 1994, TELMEX initiated a program to purchase its own shares. For this purpose, in accordance with the Securities Trading Act, the Company appropriated retained earnings to set up a reserve to purchase its own shares. A charge is made to the reserve for the excess cost of the shares purchased over the portion of capital stock represented by the shares acquired.

In March 1998, the stockholders approved an increase of Ps. 21,757,855 in the reserve for the purchase of the Company's own shares to acquire up to 1,600 million shares (800 million prior to the stock split). In such year, the Company acquired 788 million series "L" shares (394 million prior to the stock split), for Ps. 10,595,582 (Ps. 8,620,261 historical). On that same date, an extraordinary stockholders' meeting approved the cancellation of 1,706 million treasury shares (853 million prior to the stock split).

In March 1999, the stockholders approved an increase of Ps. 24,101,804 in the reserve for the purchase of the Company's own shares to acquire up to 1,600 million additional shares to those previously authorized (800 million prior to the stock split). In 1999, the Company acquired 500 million series "L" shares (250 million prior to the stock split), for Ps. 7,569,557 (Ps. 7,116,910 historical).

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 at least 20% of capital stock issued and outstanding.

f) The majority earnings per share are obtained by dividing the majority net income for the year by the average weighted number of shares issued and outstanding during the period. To determine the average weighted number of shares issued and outstanding at December 31, 1999 and 1998, the Company recognized retroactively the effect of the previously mentioned two-for-one stock split that occurred on February 1, 2000.

The diluted earnings per share at December 31, 1999, were determined considering the effect of the shares that may be delivered (potentially dilutive

shares) as a result of the convertible senior debentures described in Note 7. The computation was made by deducting from the majority net income for the year, the comprehensive financing income, net of income tax and employee profit sharing, derived from the convertible debentures. The adjusted income was divided by the average weighted number of shares issued and outstanding, taking into account the number of shares that could be capitalized. At December 31, 1998, there were no instruments that could produce any dilutive effect.

An analysis is as follows:

	1999	1998
Earnings per basic share:		
Net income	\$ 25,126,643	\$ 18,421,060
Weighted average number of shares issued and outstanding (millions)	15,092	15,804
Earnings per basic share (in pesos)	\$ 1.665	\$ 1.166
Earnings per diluted share:		
Net income	\$ 25,126,643	\$ 18,421,060
Comprehensive financing income (net of income tax and employee profit sharing)	(181,103)	
Adjusted net income	\$ 24,945,540	\$ 18,421,060
Weighted average number of shares issued and outstanding (millions)	15,092	15,804
Add:		
Potentially dilutive shares	234	
Weighted average number of diluted shares issued and outstanding (millions)	15,326	15,804
Earnings per diluted share (in pesos)	\$ 1.628	\$ 1.166

Earnings per basic share before the two-for-one stock split were Ps. 3.330 and Ps. 2.331 at December 31, 1999 and 1998, respectively. Earnings per diluted share at December 31, 1999 before the two-for-one stock split were Ps. 3.255.

13. Income Tax and Asset Tax

a) The Ministry of Finance and Public Credit authorized TELMEX to consolidate the group tax returns for tax purposes starting January 1, 1995. The Instituto Tecnológico de Teléfonos de México, S.C., Fundación Telmex, A.C., and the subsidiaries acquired in 1999 are excluded from this tax consolidation.

Various changes in the tax consolidation methodology went into effect on January 1, 1999. The most important of these changes reduces the consolidation equity percentage to 60%. In 1999, these new provisions did not have a significant impact on the Company's tax results.

b) Asset tax for the years ended December 31, 1999 and 1998 was Ps. 2,938,983 and Ps. 2,924,870, respectively. In both years TELMEX credited against these amounts the income tax paid in such years.

c) Effective January 1, 1999, the corporate income tax rate was increased from 34% to 35%. However, corporate taxpayers have the option of deferring a portion, so that the tax payable for the year will represent 30% of taxable income (32% in 1999). The earnings on which there is a deferral of taxes must be controlled in a so-called "net reinvested tax profit" account ("CUFINRE"), to clearly identify the earnings on which the taxpayer has opted to defer payment of corporate income tax.

If the Company opts for this tax deferral, starting in the year 2000 earnings will be considered to be distributed first from the "CUFINRE" account, and any excess will be distributed from the "net tax profit" account ("CUFIN"), so as to pay the 5% deferred tax (3% for 1999).

Any distribution of earnings in excess of the above-mentioned account balances will be subject to payment of 35% corporate income tax.

In addition, effective January 1, 1999, cash dividends obtained by individuals or residents abroad from corporate entities in Mexico will be subject to a 5% withholding tax on the amount of the dividend multiplied by 1.5385 (1.515 for dividends paid from the determined balance of the "CUFIN" account at December 31, 1998).

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

	1999	1998
Current year	Ps. 8,273,918	Ps. 7,580,091
Deferred	510,021	1,648,325
Total	Ps. 8,783,939	Ps. 9,228,416

The most important differences between book and tax results relate to the difference in depreciation expense for book and tax purposes, the amortization of goodwill and licenses, pensions and other nondeductible expenses.

The major temporary differences on which the Company has recognized deferred taxes in terms of Mexican Accounting Principles Bulletin D-4, still in effect at December 31, 1999, are as follows:

	1999	1998
Deferred tax asset		
Excess cost over appraised value of Federal Microwave Network	Ps. 61,344	Ps. 137,804
Deferred tax liability		
Licenses	(731,817)	(771,383)
Pensions	(1,103,173)	(808,822)
	(1,834,990)	(1,580,205)
Net deferred tax (liability) asset	Ps. (1,773,646)	Ps. (1,442,401)

The deferred tax asset and liability are presented on the balance sheet in accounts receivable and accounts payable, respectively, representing basically long-term items.

A new Mexican Accounting Principles Bulletin D-4, "Accounting for Income Tax, Asset Tax and Employee Profit Sharing," went into effect on January 1, 2000. The new bulletin modifies the rules with respect to the valuation of deferred income tax. Basically, the new bulletin requires that deferred income tax be determined on virtually all temporary differences in balance sheet accounts for financial and tax reporting purposes, using the enacted income tax rate at the time the financial

statements are issued. Through December 31, 1999, deferred income tax was recognized only on temporary differences that were considered to be non-recurring and that had a known turnaround time.

The cumulative effect derived from the adoption of this bulletin at the beginning of 2000 is to be applied to stockholders' equity, without restructuring the financial statements of prior years.

At the date of issuance of these financial statements, the Company is quantifying the impact that the observance of these new requirements will have. The effect is expected to be a decrease in stockholders' equity. Also, it is expected that this bulletin will increase income tax provisions in future years.

The new bulletin does not significantly affect the accounting for employee profit sharing.

The foreign subsidiaries determine their income tax based on the individual results of each subsidiary and in conformity with the specific tax regimes of each country. The income tax provisions of these subsidiaries are not material in relation to the consolidated financial statements.

14. Segments

TELMEX operates primarily in the following segments: local telephone service, long-distance telephone service, and cellular service. Local telephone service corresponds to fixed local wired service. The long-distance service includes both domestic and international services, exclusive of the long-distance calls originated in public and rural telephones and private circuits. The cellular service represents the mobile telephone service and includes both local and long-distance services. Additional information related to the Company's operations is provided in Note 1. The following summary shows the most important segment information and has been prepared following the accounting policies described in Note 1 on a consistent basis.

(millions of Mexican pesos with purchasing power at December 31, 1999)

	Local Service	Long Distance	Cellular	Others, adjustments and eliminations	Consolidated total
At December 31, 1999					
Revenues:					
External revenues	Ps. 48,018	Ps. 24,670	Ps. 13,035	Ps. 10,598	Ps. 96,321
Intersegment revenues	10,330			(10,330)	
Depreciation and amortization	12,200	1,982	941	2,324	17,447
Operating income	23,147	8,851	2,814	1,431	36,243
Segment assets	151,194	23,328	13,171	22,171	209,864
At December 31, 1998					
Revenues:					
External revenues	48,034	23,828	8,829	7,189	87,880
Intersegment revenues	14,061			(14,061)	
Depreciation and amortization	12,938	1,948	663	2,106	17,655
Operating income	27,723	4,554	1,933	(820)	33,390
Segment assets	159,584	24,639	8,544	18,518	211,285

15. Generally Accepted Accounting Principles in the United States Reconciliation

The Company's consolidated financial statements are prepared in accordance 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, deferred income taxes and deferred employee profit sharing (deferred taxes), and the restatement of plant, property and equipment. Other differences are the accounting for interest on assets under construction, accrued vacation costs and minority interest.

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 reconciliation of net income, comprehensive income and total stockholders' equity between Mexican and U.S. GAAP, is as follows:

	1999	1998
Net income as reported under Mexican GAAP	Ps. 25,126,643	Ps. 18,421,060
Total approximate U.S. GAAP adjustments, net	(1,686,202)	(863,733)
Approximate net income under U.S. GAAP	23,440,441	17,557,327
Other comprehensive income	(720,908)	(849,056)
Approximate comprehensive income under U.S. GAAP	Ps. 22,719,533	Ps. 16,708,271
Weighted average common shares outstanding (in millions):		
Basic	15,092	15,804
Diluted	15,326	15,804
Approximate net income per share under U.S. GAAP:		
Basic	Ps. 1.553	Ps. 1.111
Diluted	Ps. 1.529	Ps. 1.111
Total stockholders' equity under Mexican GAAP	Ps. 122,297,258	Ps. 118,944,184
Total approximate U.S. GAAP adjustments, net	(9,162,364)	(14,641,231)
Approximate total stockholders' equity under U.S. GAAP	Ps. 113,134,894	Ps. 104,302,953

Proposal

to the Meeting

(thousands of Mexican pesos with purchasing power at December 31, 1999, except for dividends per share)

Regarding dividend payments for the 1999 fiscal year, and according to Clause forty-five of Teléfonos de México, S.A. de C.V. by-laws, the following amounts are available to the Shareholders:

	Amount	
Prior year's unappropriated earnings according to the unconsolidated balance at December 31, 1999	Ps.	25,609,950
Less: Separation for one dividend payment in cash to shareholders beginning March 23, 2000, of Ps. 0.10 per share by presenting coupon 12, according with the Shareholders' Meeting and the Extraordinary Shareholders' Meeting held on April 29, 1999 and December 6, 1999, respectively.		1,499,499
		24,110,451
Unconsolidated net income for the year		18,457,209
Total	Ps.	42,567,660

It is proposed that the balance of Ps. 42,567,660 made available to the shareholders to be allocated as follows:

	Amount	
There will be no increase to the legal reserve due to the fact that it has reached the 20% limit established in Article 20 of the Mexican Corporations Act		
To pay four installments of Ps. 0.115 per share each, as a cash dividend coming from the Net Tax Profit Account	Ps.	6,897,694 (1)
To the retained earnings account		35,669,966
Total	Ps.	42,567,660

The cash dividends proposed to the Shareholders' Meeting will be paid starting June 22, 2000, September 21, 2000, December 21, 2000 and March 22, 2001, for all outstanding shares which make up the capital stock of the Company, by presenting coupons 13, 14, 15 and 16, respectively. The dividend payments are subject to the corresponding withholding tax. While the amounts of the dividends are not allocated to the shareholders, they will continue in the Company's retained earnings account.

(1) Estimated figure considering a total of 14,994,987,802 outstanding shares at March 31, 2000.

Significant Results

of Accounting Separation of Local and Long-Distance Telephone Service

For the years ended December 31
(millions of Mexican pesos with purchasing power at December 31, 1999)

Based on Condition 7-5 of the Amendments to the Concession Title, the commitment to present independent accounting records for local and long-distance services is presented below for 1999, 1998 and 1997.

	Local Service			Long-Distance Service		
	1999	1998	1997	1999	1998	1997
Operating Revenues:						
Access, Rent, Measured Service and Others	Ps. 48,085	Ps. 48,191	Ps. 40,792	Ps. 15,593	Ps. 15,085	Ps. 16,345
Domestic Long-Distance				9,077	8,743	12,411
International Long-Distance						
LADA Interconnection	7,398	11,213	13,468			
Interconnection with Long-Distance Carriers	1,740	2,268	590			
Interconnection with Cellular Companies	1,125	423	552			
Total Revenues	58,348	62,095	55,402	24,670	23,828	28,756
Operating Costs and Expenses:						
Cost of Sales and Services	12,480	11,877	12,181	2,117	2,584	2,830
Commercial, Administrative and General	10,521	9,557	10,113	4,684	4,711	5,002
Depreciation and Amortization	12,200	12,938	12,122	1,982	1,948	1,624
Interconnection				7,036	10,031	11,885
Total Costs and Expenses	35,201	34,372	34,416	15,819	19,274	21,341
Operating Income	Ps. 23,147	Ps. 27,723	Ps. 20,986	Ps. 8,851	Ps. 4,554	Ps. 7,415
Estimation of Revenues due to illegal "by-pass"				Ps. 2,265	Ps. 1,689	Ps. 867
Gross Fixed Asset	Ps. 151,194	Ps. 159,584	Ps. 151,096	Ps. 23,328	Ps. 24,639	Ps. 21,689
Personnel	42,849	43,123	42,885	8,109	8,319	8,373

Notes:

This information varies to the one presented in the consolidated financial statements of this Annual Report due to:

- The information that was considered in its elaboration was only the one corresponding to companies that are directly involved in rendering local and long-distance telephone services, as follows: Teléfonos de México, S.A. de C.V.; 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.
- Local Service: Revenues for monthly rent, measured service, installation charges, equipment sales and interconnection.
- Long-Distance Service: Revenues for basic services of domestic and international long-distance, do not include rural and public telephone services, and data transmission services.
- The services being disclosed consider the corresponding imputations for interconnection, billing, collecting, leased ports, co-location and leased lines.
- Settlement revenues are recognized according to the negotiated rates for each period.
- The results of long-distance do not include the losses associated to rural telephone services of Ps. 277 million in 1999, Ps. 729 million in 1998 and Ps. 660 million in 1997.

B o a r d

o f D i r e c t o r s

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Chairman of the Board

Directors

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Executive Director of Operations
FCR/D3A

Paul W. Carderella
Director Ejecutivo de Operaciones
SBCI México, SBC International, Inc.

Jaime Chico Pardo
Chief Executive Officer
Teléfonos de México, S.A. de C.V.

Antonio Cosío Arión
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Compañía Industrial Tepeji del Río,
S.A. de C.V.

R. Allen Craft
CFO
SBC International, Inc.

Richard C. Dietz
Director
SBC Global Markets

J. Cliff Eason
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SBC International,
SBC Communications Inc.

Amparo Espinosa Rugarcía
Director
Documentación y
Estudio de Mujeres, A.C.

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France Télécom-México
(Retired Since September, 1999)

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Grupo Infra, S.A. de C.V.

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Grupo Carso, S.A. de C.V.

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Mancera, S.C.

Secretary

Sergio F. Medina Noriega
General Counsel
Teléfonos de México, S.A. de C.V.

Patrick Slim Domit
President
Grupo Carso, S.A. de C.V.

Alternate Statutory Auditor

Alberto Tiburcio Celorio
Partner
Mancera, S.C.

Assistant Secretary

Rafael Robles Miaja
Partner
Franck, Galicia, Duclaud
y Robles, S.C.

José Kuri Harfush
President
Janel, S.A. de C.V.

Federico Laffan Fano
Partner
Laffan, Mues y Garay S.C.

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Organización Soriana, S.A. de C.V.

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France Cables et Radio de México
France Télécom Group

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Chairman of the Board
and President
Grupo Financiero Inbursa, S.A. de C.V.

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Lintel, S.A. de C.V.

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Grupo Chapa, S.A. de C.V.

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Teléfonos de México, S.A. de C.V.

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Banco del Bajío, S.A.

Roberto Ruiz Rubio
President
Fomento Queretano, S.A. de C.V.

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Super San Francisco de Asís, S.A. de C.V.

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La Italiana, S.A. de C.V.

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President
Grupo Comercial Chedraui, S.A. de C.V.

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President
Grupo Diez-Fénix, S.A. de C.V.

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Grupo Farrera, S.A. de C.V.

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President
Grupo Gutiérrez Embotellador, S.A. de C.V.

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Chief Executive Officer
Operadora de Tiendas Voluntarias, S.A. de C.V.

Armando Millet Molina
President
Operadora Real Maya, S.A. de C.V.

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C. Montoto, S.A. de C.V.

Miguel Quintana Pali
Chairman of the Board and President
Promotora XCare, S.A. de C.V.

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Chief Executive Officer

Corporate Directors

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Commercial

Adolfo Cerezo Pérez
Finance and Administration

Javier Elguea Solís
Human Resources

Arturo Elías Ayub
Internet, Regulation and Communication

Eduardo Gómez Chibli
Technical and Long Distance

Daniel Hajj Aboumrad
Wireless and Affiliates

Javier Mondragón Alarcón
Legal Affairs

Héctor Slim Seade
Operational Support

Andrés Vázquez del Mercado Benshimol
Strategic Development

Oscar Von Hauske Solís
Telecommunications Operators,
Systems and Processes

Divisional Directors

Facundo Alonso García
Northeast

Javier Coca Muñiz
Gulf - Pacific

José Covarrubias Bravo
East Metro

Miguel Ángel González Arriaga
Telnor

Gerardo Leal Garza
South Metro

Jesús Rafael Mendoza Ortíz
West Metro

Leopoldo Muro Pico
West

José Manuel Pacheco Gamboa
Southwest

Raymundo Paulín Velasco
Northwest

Jorge Luis Suástegui Esquivel
Center

Miguel Ángel Vera García
North

Headquarters

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Shares Traded in Mexico

"A" : Bolsa Mexicana de Valores
Symbol: TELMEX A

"L" : Bolsa Mexicana de Valores
Symbol: TELMEX L

Shares Traded in the U.S.

ADS : New York Stock Exchange
Symbol: TMX
One ADS represents 20 "L" shares

ADR : NASDAQ

Symbol: TFOY
One ADR represents one "A" share

Transfer and Depository Agent in the U.S.

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Independent Auditors

Mancera, S.C. Ernst&Young



NYSE



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