TELMEX®

TELEFONOS DE MEXICO ANNUAL REPORT 1997

I N D E X

H I G H L I G H T S

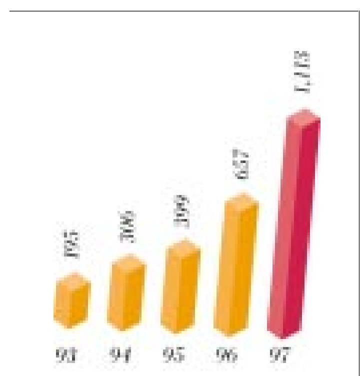
Figures in millions of pesos, unless otherwise indicated

FINANCIAL RESULTS*	1997	1996	1995	1994	1993
Total Revenues	**60,724**	61,370	61,687	65,605	59,143
Cost of Sales and Services	**14,192**	13,988	18,274	19,679	18,202
Commercial, Administrative and General Expenses	**11,045**	10,868	10,535	10,057	9,043
Depreciation and Amortization	**12,043**	13,151	11,126	7,965	7,180
Total Costs and Expenses	**39,694**	42,366	39,935	37,701	34,425
Operating Income	**21,030**	19,004	21,752	27,904	24,718
Net Income	**12,851**	13,424	13,753	17,654	21,644
Total Assets	**127,802**	129,239	150,189	168,970	127,179
Total Debt	**25,741**	15,456	24,341	23,732	17,236
Stockholders' Equity	**88,231**	103,240	116,780	124,060	89,068
Total Debt/Capitalization (%)	**22.6**	13.0	17.2	16.1	16.2

Communities with Telephone Service

STATISTICS	1997	1996	1995	1994	1993
Communities with Telephone Service	**24,691**	20,694	20,554	20,447	18,281
Access Lines in Service (1)	**9,254**	8,826	8,801	8,493	7,621
Cellular Customers (1)	**1,113**	657	399	306	195
Kms. of L.D. Circuits in Service (1)	**113,092**	96,493	87,428	81,956	82,491
Domestic L.D. Minutes (2)	**8,232**	7,867	7,294	6,746	5,923
International L.D. Minutes (2)	**3,768**	3,558	3,055	2,622	2,221

DATA PER SHARE (pesos)*	1997	1996	1995	1994	1993
Earnings per Share	**1.53**	1.47	1.35	1.67	2.05
Book Value	**10.87**	11.63	12.10	11.82	8.43
Market Value at Year-End	**22.75**	12.98	12.36	10.24	10.45
Nominal Dividend per Share (3)	**0.700**	0.525	0.350	0.300	0.250
Outstanding Shares (2)	**8,118**	8,875	9,654	10,499	10,566



Cellular Customers
(thousands)

(*) The 1993 to 1996 figures have been restated in accordance with the third re-expression document of Bulletin B-10, and consequently, they are expressed in pesos with purchasing power as of December 31, 1997.
(1) In Thousands
(2) In Millions
(3) Proposed for 1997

During 1997, Teléfonos de México (TELMEX) experienced an anticipated but nevertheless significant change as intense competition entered México's long distance market, in which the Company had temporarily been the exclusive operator.

The successful opening of the long distance market to competition in large part can be attributed to TELMEX's commitment to meet each of the obligations the Company accepted when it was privatized in December 1990.

México's experience with competition in the long distance market has proven that because of the efforts of TELMEX's personnel, our investments and our technological knowledge and skills, it is possible in a relatively short time to have more than seven million telephone lines operating in a competitive environment head to head with the largest transnational companies in the world.

This accelerated market transformation has no precedent in any other country. The process enabled our main competitors, supported by world leading telecommunications corporations, to gain considerable market share in the major cities in México that today are open to competition.

Results to date show that close to seventy five percent of our customers in the sixty cities with market competition decided to remain with us. We are committed to offering our customers the best products and to introduce other new, convenient and cost-effective services to continue to serve our customers well.

In addition, in 1997 we began a Company wide program to retain and recover customers through projects and activities that foster their loyalty, satisfaction and trust. This program is designed both to demonstrate our commitment to customer service and to reinforce TELMEX's market leadership.

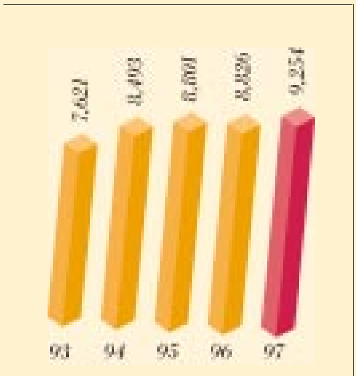
Besides offering several discount plans, we continue to diversify long distance service by launching new products, such as the LADAFÓN prepaid card. It enables our customers to place calls from any telephone, using a password.

TELMEX has complied with all the provisions established by Mexican authorities to promote and facilitate development and competition of telecommunications in México. We continue to believe that development of the market should be fostered with clear and equitable rules for all the participants. However, although rules were established for the presubscription process, it was affected by unfair commercial practices undertaken by some of the main competitors.

Several observations offer proof of TELMEX's commitment to a competitive marketplace. One is completion of the process on time according to the original schedule. The second is the significant market share the new operating companies have obtained. A third is TELMEX's preparation to offer dial around service, the next step in the opening of competition, on September 1, 1997, as scheduled. However, TELMEX was the only Company ready to provide the service at that time, and at the request of the new long distance operators, its availability date was postponed to April 1, 1998.

The success of the opening of long distance services is one of the reasons TELMEX looks to the future with confidence. We have prepared ourselves to provide integrated telecommunication services tailored to the needs of our customers, from telephony in rural communities remote from

During 1997, Line Growth Rhythm Resumed



Lines in Service
(thousands)

urban centers to multinational corporations with global communications needs.

We have invested more than thirteen billion dollars to modernize, expand and diversify the telephone service. The result of that extensive investment is the best and broadest telecommunications infrastructure in México, certified by international standards of quality and efficiency.

Our long distance network is one hundred percent digital, and ninety percent of the more than nine million local lines in México operate through digital exchanges. The quality of these achievements and our technological progress have been recognized by internationally prestigious organizations of experts, such as the Mexican Institute of Standardization and Normalization, which has granted ISO 9002 and 9001 Certificates to our National Long Distance Network Supervision Center and our Intelligent Network, respectively.

Our customer focused strategy includes a simplified rate plan and a new billing format. The rate plan and its communications are designed to help customers plan their telephone use and take full advantage of the most competitive prices in the market. The new bill was introduced in the first half of the year which is more complete and provides more information for customers, including itemized billing related to specific services.

We are aware that a technologically efficient platform in itself is not enough to assure a first class telecommunications Company. Therefore, we are transforming TELMEX to take advantage of the full range of opportunities available to us and to concentrate on reaching one fundamental objective: total satisfaction of our customers' needs.

Line growth resumed in 1997, with an increase of 4.8 percent over the previous year, when the growth in lines essentially was flat compared with the year before. In 1998, the local service market will operate under a more competitive environment.

Our digital technological platform facilitates offering numerous value added services to our customers, including Caller ID, Three Way Calling, Call Forwarding and Call Waiting. We also have launched Internet Directo Personal for residential customers, and we offer the best coverage and technology available in the market.

TELCEL, our cellular Company, increased customers 69.4 percent during 1997. At year end it had more than one million customers. TELCEL's dynamic growth in large part reflected the popularity of our prepaid plans, known as "Sistema Amigo." Almost sixty percent of our cellular customers are enrolled in prepaid plans.

We have digitized our cellular infrastructure, which expands its transmission capacity, enhances quality and facilitates making value added services available to our cellular customers.

In 1997, we participated in radio spectrum frequency auctions of point-to-point and point-to-multipoint access, Personal Communication Services (PCS) and fixed wireless telephony. Our participation in these auctions demonstrates TELMEX's interest in broadening our infrastructure and offering a wider range of services to satisfy our customers' demands and specific requirements. In keeping with that objective, we have México's largest public data transmission network, capable of handling large volumes of information. During 1997 we acquired a seventy percent stake in Kb/TEL, a developer of wireless communication systems, and the remaining fifty percent of shares in RED UNO, which develops, markets and provides technological support for private network platforms.

Public telephony represents another excellent business opportunity for TELMEX and another important area of customer service. We offer prepaid LADATEL cards to help customers easily access our domestic public telephony network. The network features highly advanced microchip technology, which benefits both customers and TELMEX by offering easier access, better quality and fewer maintenance requirements.

A long term strategy for TELMEX is participation in international telecommunications markets. A fundamental objective is to participate in the U.S. market, focusing our attention on the Hispanic population.

In February 1997, we filed an application with the U.S. Federal Communications Commission (F.C.C.) to operate long distance services in the U.S. through our strategic alliance with Sprint. The F.C.C. approved that application in October.

During 1997, TELMEX also continued to demonstrate our commitment to be a major participant in the economic activity of our country. The Company paid 16.8 billion pesos in taxes, assessments and tax withholding and an additional 12.9 billion pesos in salaries, employee profit sharing contributions and social security expenses.

Without a doubt, the most dynamic period in TELMEX's history has been the time since privatization. We have created an advanced telecommunications network and a firm foundation for customer satisfaction. We have achieved this while maintaining a solid financial structure. These are quite satisfactory results. Just as importantly, our employees are prepared to work and to achieve goals in this new competitive environment.

Our customers have recognized this major change in TELMEX. We follow up on our customers' opinions through periodic national surveys, the first and broadest in the telecommunications sector in México. Through these surveys, we learn what customers think about TELMEX and our discount plans, rates and quality of service so that we can better direct our resources to enhance their satisfaction.

We know that total integration of telecommunications services is becoming a market reality. Our customers want to have the complete range of services from the same supplier. That is something TELMEX can provide with quality and on a timely basis.

Our Company is in an excellent position with leading-edge infrastructure, undeniable leadership in our various markets, financial flexibility and, above all, the support of our personnel to sustain our growth in the future.

Our mission for the new millennium is to maintain solid technological development and carry out investments that will allow us to offer more and better services, increase our productivity and expand our markets.

Carlos Slim Helú
Chairman of the Board of Directors

Jaime Chico Pardo
Chief Executive Officer

Financial Results

Comments on the Operating Results
and the Financial Position

Consolidated Financial Statements
as of December 31, 1997 and 1996
with the Independent Auditors Report

COMMENTS ON THE OPERATING RESULTS AND THE FINANCIAL POSITION

Teléfonos de México, S. A. de C. V., and its subsidiaries and associated companies (TELMEX), provide the broadest range of national and international telecommunication services, to customers in all economic activities. TELMEX is the largest and most diversified telecommunications provider in México and ranks among the seventeen largest telecommunications companies in the world, as measured by the number of lines in service.

During 1997, TELMEX continued as an innovator in its market, introducing a series of new services and products that enabled it to maintain its front-ranking position in the telecommunications industry.

Operating Results

During 1997, TELMEX had a net increase of 427,567 access lines. At year end, total lines in service were 9,253,715, representing an increase of 4.8 percent over 1996. In 1997, 986,246 new lines were installed and 558,679 were disconnected.

Domestic long-distance minutes billed increased to 8,232 million, 4.6 percent over 1996, while international long-distance traffic increased 5.9 percent compared with the prior year, reaching 3,768 million minutes billed.

Financial Results

The following comments on the financial results of TELMEX should be analyzed together with the consolidated financial statements and the accompanying notes thereto, which comprise an integral part of this Annual Report.

The consolidated financial statements were prepared in conformity with generally accepted accounting principles in México. As required by Bulletin B-10 of the Mexican Institute of Public Accountants, the figures shown in the consolidated financial statements and in the accompanying notes thereto are expressed in pesos with purchasing power as of December 31, 1997.

Reclassifications

Revenues have been reclassified by type of service to comply with accounting requirements. Long-distance access and circuit rentals previously included in basic rent, which is part of local service, were reclassified as part of domestic and international long-distance services.

The following tables first show revenues, costs and expenses and operating income of TELMEX and then provides a breakdown of operating income from cellular telephony, already included in the consolidated figures.

TELMEX

Years ended December 31

	1997		1996	
	Million pesos	**% of operating revenues**	Million pesos	% of operating revenues
Operating Revenues:				
Long-Distance Service:				
International	**11,455**	**18.9**	16,848	27.5
Domestic	**15,149**	**24.9**	19,155	31.2
Local Service	**30,663**	**50.5**	23,226	37.8
Interconnection Service	**695**	**1.1**	174	0.3
Other	**2,762**	**4.6**	1,967	3.2
Total Revenues	**60,724**	**100.0**	61,370	100.0
Operating Costs and Expenses:				
Cost of Sales and Services	**14,192**	**23.4**	13,988	22.8
Commercial, Administrative and General Expenses	**11,045**	**18.2**	10,868	17.7
Depreciation and Amortization	**12,043**	**19.8**	13,151	21.4
Special Charges	**2,414**	**4.0**	4,359	7.1
Total Costs and Expenses	**39,694**	**65.4**	42,366	69.0
Operating Income	**21,030**	**34.6**	19,004	31.0

CELLULAR TELEPHONY

Years ended December 31

	1997		1996	
	Million pesos	**% of operating revenues**	Million pesos	% of operating revenues
Operating Revenues (*)	**4,125**	**100.0**	3,558	100.0
Operating Costs and Expenses:				
Cost of Sales and Services (*)	**1,971**	**47.8**	2,006	56.4
Commercial, Administrative and General Expenses	**1,921**	**46.6**	1,667	46.8
Total Costs and Expenses	**3,892**	**94.4**	3,673	103.2
Operating Income	**233**	**5.6**	(115)	(3.2)

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

Presubscription Process

The presubscription process started in 1997 with more than 7 million telephone lines installed in the 60 major cities in México. At the end of the year, TELMEX had retained nearly 75 percent of the lines in markets where competition had been introduced.

Revenues from International Long-Distance Service

Revenues from international long-distance service declined as a percentage of total revenues to 18.9 percent in 1997 compared with 27.5 percent in 1996. This was the result of a 32.0 percent decline in revenues from international long-distance service in 1997 compared to 1996, which in turn, reflected a 1.1 percent reduction compared to 1995 revenues. Minutes billed increased 5.9 percent during 1997 compared to the previous year and 16.5 percent in 1996 compared to 1995.

The share of revenues from settlement agreements with foreign carriers and administrations, mainly from the United States of America, was 10.2 percent of total revenues and 54.1 percent of international long-distance revenues in 1997.

The reduced revenues from international long-distance service in 1997 reflected discounts offered to customers; changes in settlement rates from U.S. 48.5 cents and U.S. 32.0 cents per minute in 1996 for incoming and outgoing traffic, respectively, to a single rate of U.S. 39.5 cents per minute in 1997; the impact of rate reductions measured in real terms and, especially, the effect of competition and the resulting loss of market share. In 1996, higher traffic volume and the positive impact of foreign exchange adjustments on the settlement rates were offset by customer discounts in long-distance billing, and by reductions in settlement rates agreed with U.S. carriers, resulting in reduced revenues from international long-distance service.

Revenues from Domestic Long-Distance Service

Revenues from domestic long-distance service decreased 20.9 percent during 1997, following a 7.4 percent increase in 1996. Consequently, domestic long-distance service contributed 24.9 percent of total revenues in 1997 compared to 31.2 percent in 1996.

The volume of minutes billed in 1997 was 4.6 percent higher than the prior year, but under the 7.9 percent growth rate achieved in 1996.

In 1997, notwithstanding the increase in minutes billed in domestic long-distance service, revenues declined as result of rate reductions in real terms, discounts granted to customers and loss of market share.

In 1996, revenues from domestic long-distance service increased 7.4 percent, reflecting a 7.9 percent increase in traffic, offset in part by the rate reduction in real terms.

Revenues from Local Service

Revenues from local service increased 32.0 percent in 1997 after a decline of 5.5 percent in 1996. The improvement during 1997 resulted from rate rebalancing, increased local traffic and more lines in service.

Revenues from local service declined in 1996 compared to 1995. In that period, the number of lines in service increased only 0.3 percent. Moreover, the rate rebalancing process during the year was not enough to make up for the lag in rates.

Revenues from Interconnection Service

Revenues from interconnection service include revenues from connecting both long-distance system carriers (which started in 1997) and cellular system companies to the local TELMEX system. The percentage of these revenues in relation to total Company revenues increased from 0.3 percent in 1996 to 1.1 percent in 1997. Revenues from interconnecting long-distance system carriers accounted for 0.8 percent of total revenues.

Other Revenues

Other revenues increased 40.4 percent in 1997 compared to a decrease of 12.3 percent in 1996. The 1997 increase reflected México's improved economy and the acquisition of the remaining 50 percent of capital stock of Consorcio Red Uno, S. A. de C. V. (Red Uno) in June 1997, consolidating its results.

Revenues from Yellow Pages and the sale of equipment showed a 47.4 percent increase in 1997 after declining 19.7 percent in 1996. Revenues from the sale of materials showed a 39.9 percent decrease in 1997 compared to 9.4 percent in 1996.

Cost of Sales and Services

The cost of sales and services increased 1.5 percent in 1997, after advancing 9.0 percent in 1996. The increase in 1997 reflected the higher cost of spare parts, the cost of materials that were not capitalized, and salary and fringe benefit increases. The 1996 increase in expenses was attributable primarily to higher salaries and related costs, including personnel costs for the supervision of constructions, which were charged to operating expenses. In addition, certain costs associated with the rehabilitation of the telephone plant that previously had been capitalized, were charged to operations.

Commercial, Administrative and General Expenses

During 1997, commercial, administrative and general expenses increased 1.6 percent, reflecting an extensive Customer Service Center modernization program, higher advertising expenses, and a change in accounting for commissions of cellular distributors. In 1997, Radio Móvil Dipsa, S. A. de C.V. (Telcel) began expensing distributor commissions at the time a new cellular customer was activated instead of deferring the commissions as was the practice in 1996. These higher costs were partially offset by a smaller reserve for bad debts. The 3.2 percent increase in expenses in 1996 compared to 1995 reflected higher levels of bad debts and increased advertising expenses.

Depreciation and Amortization

Depreciation and amortization expense decreased 8.4 percent in 1997 after an 18.2 percent increase in 1996. The level of 1997 charges reflects an increase in depreciation of 170 million pesos as a result of the alternate method defined in the fifth amendment to Bulletin B-10, as revised, and the absence of goodwill charges. In 1996, TELMEX adjusted the depreciation rate of a large part of its telephone plant to write off old technology. This resulted in an increase of 1,256 million pesos in depreciation expense.

Special Charges

In 1997, special charges decreased 44.6 percent compared to the prior year. Costs for opening the long-distance market to competition were 943 million pesos in 1997, 9.0 percent below the prior year. Contributions to Fundación TELMEX, A.C. were 939 million pesos, 38.1 percent less than in 1996. Goodwill amortization was 532 million pesos, related to the 1997 acquisition of the remaining 50 percent equity interest in Red Uno and the 70 percent equity interest in Kb/TEL Telecomunicaciones, S. A. de C. V.

Operating Income

Operating income increased 10.7 percent over the prior year, because the reduction in operating costs and expenses was greater than the reduction in revenues. As a result, the operating margin rose to 34.6 percent in 1997 compared to 31.0 percent in 1996.

Comprehensive Financing Income

In 1997, as in the previous year, there was comprehensive financial income, although the total of 401 million pesos was significantly less than the 2,430 million pesos generated in 1996.

Interest income increased 5.2 percent in 1997, basically due to a higher average level of treasury funds. In 1996, interest income decreased 67.3 percent due to lower interest rates in México and a lower average level of treasury funds. Interest expense in 1997 increased 49.0 percent, due to a higher indebtedness in foreign currencies and in Mexican pesos, and higher domestic interest rates. In 1996, interest expense declined 48.4 percent because of lower interest rates abroad and lower levels of indebtedness.

In 1997, the marginal depreciation of the peso relative to the U.S. dollar at the end of the year and the appreciation of the peso relative to other currencies generated a net foreign exchange gain. In 1996 there was also a net foreign exchange gain, reflecting the relative stability of the peso in relation to the U.S. dollar and the appreciation of the peso relative to other currencies.

In both 1997 and 1996, average monetary liabilities exceeded average monetary assets, so there was a net monetary position gain in both years. The decrease in 1997 reflected the reduction in net average monetary liabilities and a lower rate of inflation.

Net Income

Consolidated net income of 12,851 million pesos in 1997 represented a decline of 4.3 percent compared to 1996.

Investments

Consolidated investments of TELMEX were 8,881 million pesos in 1997 compared to 6,061 million pesos in 1996. Capital expenditures on the telephone plant were 7,759 million pesos in 1997, compared to 5,987 million pesos in 1996.

Financial Structure

During 1997, TELMEX obtained credits and issued debt instruments to provide financing flexibility, and the Company's financial structure continues to be sound. At the end of 1997, the ratio of total debt to capitalization rose to 22.6 percent from 13.0 percent the year ago.

Stock Repurchase

During 1997, TELMEX repurchased a total of 756 million shares, or 8.5 percent of the capital stock of the Company at the beginning of the year. At the end of the year, TELMEX had 8,118.1 million shares outstanding, which included 2,163.0 million series "AA", 234.9 million series "A" and 5,720.2 million series "L" shares. In March 1998, shareholders approved cancellation of 853 million shares and an additional repurchase program of up to 800 million shares.

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, 1997, 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. at December 31, 1997, the consolidated results of its operations, changes in its stockholders' equity and changes in its financial position for the year then ended in conformity with accounting principles generally accepted in Mexico.

As explained in Note 3 to the accompanying consolidated financial statements, effective January 1, 1997, the Company adopted the fifth amendment to Bulletin B-10 and, accordingly, changed the method that it had been using to value plant, property and equipment.

V. Aguilar V.

C.P. Víctor Aguilar Villalobos
Statutory Auditor

Mexico City, Mexico
March 5, 1998

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, 1997 and 1996, 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, 1997 and 1996, 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.

As explained in Note 3 to the accompanying financial statements, effective January 1, 1997, the Company adopted the fifth amendment to Bulletin B-10 and, accordingly, changed the method that it had been using to value plant, property and equipment.

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

C.P. Alberto Tiburcio Celorio

Mexico City, Mexico
March 5, 1998

CONSOLIDATED STATEMENTS OF INCOME

(Thousands of Mexican pesos with purchasing power at December 31, 1997)

	Year ended December 31	
	1997	1996
Operating revenues:		
Long-distance service:		
International	**Ps. 11,454,775**	Ps. 16,847,800
Domestic	**15,149,372**	19,155,357
Local service	**30,662,844**	23,226,170
Interconnection service	**694,428**	174,093
Other	**2,762,452**	1,966,761
	60,723,871	61,370,181
Operating costs and expenses:		
Cost of sales and services	**14,191,580**	13,987,636
Commercial, administrative and general	**11,044,607**	10,868,198
Depreciation and amortization (Notes 3 and 4)	**12,043,182**	13,150,806
Special charges (Note 9)	**2,414,337**	4,359,529
	39,693,706	42,366,169
Operating income	**21,030,165**	19,004,012
Comprehensive financing income:		
Interest income	**(2,914,369)**	(2,771,117)
Interest expense	**3,193,182**	2,143,230
Exchange gain, net (Note 10)	**(200,542)**	(248,715)
Monetary effect	**(479,520)**	(1,553,703)
	(401,249)	(2,430,305)
Income before income tax and employee profit sharing	**21,431,414**	21,434,317
Provisions for:		
Income tax (Note 14)	**6,569,368**	6,401,425
Employee profit sharing	**2,051,921**	1,678,961
	8,621,289	8,080,386
Income before equity in results of affiliates	**12,810,125**	13,353,931
Equity in results of affiliates (Note 4)	**40,488**	70,051
Net Income	**Ps. 12,850,613**	Ps. 13,423,982
Weighted average common shares outstanding (in millions)	**8,406**	9,154
Net income per share (in Mexican pesos)	**Ps. 1.529**	Ps. 1.466

See accompanying notes.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION
(Thousands of Mexican pesos with purchasing power at December 31, 1997)

	Year ended December 31	
	1997	1996
Operating activities:		
Net income	**Ps. 12,850,613**	Ps. 13,423,982
Add: Items not requiring the use of resources:		
Depreciation	**11,951,949**	12,434,291
Amortization	**623,336**	2,522,647
Equity in results of affiliates	**(40,488)**	(70,051)
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Accounts due from subscribers	**117,347**	(909,175)
Other accounts receivable	**730,403**	(1,617,327)
Prepaid expenses	**1,437**	(322,352)
Increase (decrease) in:		
Employee pensions and seniority premiums:		
Reserve	**2,275,749**	2,493,197
Contributions to trust fund	**(1,056,508)**	(2,164,415)
Payments to employees	**(1,262,315)**	(1,092,304)
Monetary effect of reserve		(114,672)
Accounts payable and accrued liabilities	**(311,861)**	1,231,972
Taxes payable	**(1,889,892)**	1,302,223
Deferred credits	**419,477**	(191,498)
Resources provided by operating activities	**24,409,247**	26,926,518
Financing activities:		
New loans	**48,123,270**	7,426,305
Repayment of loans	**(34,766,113)**	(11,008,523)
Effect of exchange difference and of inflation on debt	**(3,210,327)**	(5,302,891)
Decrease in capital stock and retained earnings due to purchase of Company's own shares	**(13,573,000)**	(12,522,646)
Cash dividends paid	**(4,491,603)**	(3,914,405)
Capital reimbursement and dividends received from affiliate	**103,490**	
Resources used in financing activities	**(7,814,283)**	(25,322,160)
Investing activities:		
Investment in telephone plant	**(7,758,923)**	(5,986,584)
(Investment) reduction in telephone plant inventories	**(327,244)**	12,846
Investment in subsidiary companies	**(638,232)**	(87,458)
Investment in affiliated company	**(12,635)**	
Investment in other assets	**(143,762)**	
Resources used in investing activities	**(8,880,796)**	(6,061,196)
Net increase (decrease) in cash and short-term investments	**7,714,168**	(4,456,838)
Cash and short-term investments at beginning of year	**5,886,777**	10,343,615
Cash and short-term investments at end of year	**Ps. 13,600,945**	Ps. 5,886,777

See accompanying notes.

CONSOLIDATED BALANCE SHEETS

(Thousands of Mexican pesos with purchasing power at December 31, 1997)

	December 31 1997	December 31 1996
Assets		
Current assets:		
Cash and short-term investments	**Ps. 13,600,945**	Ps. 5,886,777
Accounts receivable, net (Note 2):		
Subscribers	**10,545,177**	10,662,524
Net settlement receivables	**1,028,775**	1,879,811
Other	**2,272,952**	2,002,634
	13,846,904	14,544,969
Prepaid expenses	**1,718,891**	1,737,485
Total current assets	**29,166,740**	22,169,231
Plant, property and equipment, net (Note 3)	**91,672,661**	105,097,045
Inventories, primarily for use in construction of the telephone plant	**1,455,331**	1,394,461
Equity investment in affiliates (Note 4)	**392,696**	574,672
Intangible asset (Note 5)	**4,970,812**	3,480
Other assets (Note 6)	**143,762**	
Total assets	**Ps. 127,802,002**	Ps. 129,238,889

	December 31	
	1997	1996
Liabilities and stockholders' equity		
Current liabilities:		
Current portion of long-term debt (Note 7)	**Ps. 12,323,568**	Ps. 4,110,220
Accounts payable and accrued liabilities	**6,282,835**	6,468,423
Taxes payable	**1,423,952**	3,295,520
Total current liabilities	**20,030,355**	13,874,163
Long-term debt (Note 7)	**13,417,473**	11,345,608
Reserve for employee pensions and seniority premiums (Note 5)	**4,935,393**	11,135
Deferred credits (Note 8)	**1,187,823**	768,346
Total liabilities	**39,571,044**	25,999,252
Stockholders' equity (Note 13):		
Capital stock:		
Historical	**811,811**	887,456
Restatement increment	**38,280,715**	38,794,490
	39,092,526	39,681,946
Premium on sale of shares	**6,851,155**	6,851,155
Retained earnings:		
Unappropriated earnings of prior years	**65,836,502**	69,887,703
Net income for the year	**12,850,613**	13,423,982
	78,687,115	83,311,685
Deficit from restatement of stockholders' equity	**(36,399,838)**	(26,605,149)
Total stockholders' equity	**88,230,958**	103,239,637
Total liabilities and stockholders' equity	**Ps. 127,802,002**	Ps. 129,238,889

See accompanying notes.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Thousands of Mexican pesos with purchasing power at December 31, 1997, except for dividends per share)

	Capital stock	Premium on sale of shares	Legal reserve
Balance at December 31, 1995	Ps. 39,784,890	Ps. 6,851,155	Ps. 7,471,141
Appropriation of earnings approved at stockholders' meeting held on April 19, 1996:			
Cash dividens paid, at Ps. 0.35 per share			
Increase in legal reserve			731,093
Increase in reserve for purchase of Company's own shares			
Cash purchase of Company's own shares	(102,944)		
Deficit from holding nonmonetary assets			
Net income			
Balance at December 31, 1996	39,681,946	6,851,155	8,202,234
Appropriation of earnings approved at stockholders' meeting held on April 29, 1997:			
Cash dividens paid, at Ps. 0.525 per share			
Increase in legal reserve			**670,708**
Cash purchase of Company's own shares	**(589,420)**		
Deficit from holding nonmonetary assets			
Net income			
Balance at December 31, 1997 (Note 13)	**Ps. 39,092,526**	**Ps. 6,851,155**	**Ps. 8,872,942**

See accompanying notes.

Retained earnings				
Reserve for purchase of Company's own shares	Unappropriated	Total	Deficit from restatement of stockholders' equity	Total stockholders' equity
Ps. 18,706,176	Ps. 60,044,493	Ps. 86,221,810	Ps. (16,077,726)	Ps. 116,780,129
	(3,914,405)	(3,914,405)		(3,914,405)
	(731,093)			
9,738,684	(9,738,684)			
(12,488,963)	69,261	(12,419,702)		(12,522,646)
			(10,527,423)	(10,527,423)
	13,423,982	13,423,982		13,423,982
15,955,897	59,153,554	83,311,685	(26,605,149)	103,239,637
	(4,491,603)	**(4,491,603)**		**(4,491,603)**
	(670,708)			
(12,907,023)	**(76,557)**	**(12,983,580)**		**(13,573,000)**
			(9,794,689)	**(9,794,689)**
	12,850,613	**12,850,613**		**12,850,613**
Ps. 3,048,874	**Ps. 66,765,299**	**Ps. 78,687,115**	**Ps. (36,399,838)**	**Ps. 88,230,958**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1997 and 1996
(Thousands of Mexican pesos with purchasing power at December 31, 1997)

1. Description of the Business and Significant Accounting Policies

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

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.

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

Beginning at the end of 1996 and gradually during 1997, the competition was allowed to provide domestic and international long-distance telephone service. The competing companies offering this service are doing so basically by interconnecting with the TELMEX system. In the second half of 1997 the competition was allowed to start providing basic local telephone services.

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-seven 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.

Important intercompany accounts and transactions have been eliminated in the 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, and other service charges to subscribers. Revenues from domestic and international long-distance telephone calls are determined on the basis of the duration of the calls, the distance, and the type of service used. All these services are billed monthly, based on the rates authorized by the Ministry of Communications and Transportation.

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

Interconnection service revenues are obtained from connecting long-distance system carriers and cellular system companies to the local TELMEX system.

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, 1997. The December 31, 1997 restatement factor applied to the financial statements at December 31, 1996 was 15.72% (corresponding to inflation for 1997).

Plant, property and equipment, and construction in progress are restated as described in Note 3. Depreciation is calculated on the restated investment using the retirement and replacement method, based on the estimated useful lives of the assets.

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

Capital accounts, the premium on the sale of shares, and retained earnings are restated using adjustment factors obtained from the Mexican National Consumer Price Index (NCPI).

The deficit from restatement of stockholders' equity consists of the accumulated monetary position loss at the time the provisions of Bulletin B-10 were first applied (Ps. 7,514,075 at December 31, 1997) and 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 (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.

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

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

f) Exchange 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 options contracts, as hedges for transactions denominated in currencies other than the U.S. dollar. The gains or losses on these contracts are recognized at the time they occur, net of the gains or losses on the liabilities covered.

g) Labor obligations

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

h) Income taxes 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).

i) Reclassifications

Certain amounts shown in the 1996 statement of income have been reclassified for uniformity of presentation with 1997.

2. Accounts Receivable

Accounts receivable are stated net of the allowance for doubtful accounts, which is Ps. 552,590 at December 31, 1997 (Ps. 717,758 in 1996).

3. Plant, Property and Equipment

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

		1997		1996
Telephone plant and equipment	**Ps.**	**114,896,527**	Ps.	123,809,365
Land and buildings		**15,448,297**		14,779,412
Other assets		**12,749,760**		11,949,654
		143,094,584		150,538,431
Less:				
Accumulated depreciation		**55,769,664**		49,548,654
Net		**87,324,920**		100,989,777
Construction in progress and advances to equipment suppliers		**4,347,741**		4,107,268
Total	**Ps.**	**91,672,661**	Ps.	105,097,045

b) Through December 31, 1996, items comprising 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 expert appraiser registered with the National Banking and Securities Commission.

Since the fifth amendment (as revised) to Bulletin B-10, the effective date of which is 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, 1997:

- The December 31, 1996 appraised value of the imported telephone plant was 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 fixed assets of domestic origin at December 31, 1996 was restated based on the NCPI. The cost of additions in the current year were restated based on the afore mentioned procedure, depending upon the assets origin.
- The appraised value of land, buildings and other fixed assets at December 31, 1996, and the cost of additions in the current year were restated based on the NCPI.

At December 31, 1997, approximately 60% of the value of the plant, property and equipment has been restated using specific indexation factors.

As a result of the procedural changes described in the preceding paragraphs, the value of plant, property and equipment at December 31, 1997 and depreciation expense for the year then ended increased by approximately Ps. 2,000,000 and Ps. 170,000, respectively, compared to the amounts that would have been shown had the Company continued to use the previous procedure.

Following are the figures on plant, property and equipment at December 31, 1997, restated on the basis of the NCPI (starting with the appraised values at December 31, 1996) to meet National Banking and Securities Comission disclosure requirements with respect to the restatement of fixed assets based on specific indexation factors:

Telephone plant and equipment	Ps.	126,781,759
Land and buildings		15,448,297
Other assets		13,532,060
		155,762,116
Less:		
Accumulated depreciation		60,995,979
Net		94,766,137
Construction in progress and advances to equipment suppliers		4,500,978
Total	Ps.	99,267,115

c) Because of the important progress and technological changes in telecommunications equipment, the Company makes a periodic assessment of the estimated useful lives of its telephone plant and equipment, adjusting annual depreciation whenever it believes this to be appropriate. In 1997, the Company increased by one year the useful life of its analogue telephone exchanges, PCM's and main cable lines. The effect of this change was a decrease of Ps. 485,000 in depreciation expense for the year ended December 31, 1997.

Depreciation of the telephone plant has been calculated at annual rates ranging from 3.3% to 16.7%. The other assets are depreciated at rates ranging from 3.3% to 20%. Depreciation charged to income was Ps. 11,951,949 in 1997 and Ps. 12,434,291 in 1996.

d) In December 1990, the Company purchased the Federal Microwave Network from the Mexican Government. The Company paid U.S.$ 300 million or, based on the prevailing exchange rate at the purchase date, Ps. 883,716 (Ps. 3,051,343 constant pesos at December 31, 1997). The Ps. 1,871,864 difference between the purchase price and the appraised value of the assets acquired was included in other assets and was being amortized over a ten-year period, at the annual rate of 10%. At the end of 1996, the Company decided to charge to income the unamortized excess cost on this acquisition (Ps. 748,697), recognizing a deferred tax asset of Ps. 245,378 (nominal) corresponding to the related pending tax deduction. The deferred tax asset balance at December 31, 1997 is Ps. 184,034.

4. Equity Investment in Affiliates and Subsidiaries

I Investment in affiliates

a) An analysis at December 31, 1997 and 1996 is as follows:

		1997		1996
Empresas Cablevisión, S.A. de C.V.	Ps.	391,043	Ps.	434,656
Consorcio Red Uno, S.A. de C.V.				140,016
Telmex/Sprint Communications, L.L.C.		1,653		
	Ps.	392,696	Ps.	574,672

b) Further information on these investments is as follows:

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

Goodwill of Ps. 1,868,800 was recognized for the difference between the purchase price and the book value of the shares of this affiliate at the purchase date. This goodwill was to be amortized over a four-year period. However, in the final quarter of 1996, the Company decided not to make an offer to acquire the remaining 51% of Cablevision and, at the same time and to act conservatively, to write off the unamortized goodwill.

At the time the Company acquired the shares of Cablevision, it recognized a deferred tax liability of Ps. 336,405 that would reverse over the same period of time in which the goodwill was to be amortized. This liability for deferred taxes was reversed in 1996 together with the related goodwill.

In 1996, the scheduled Ps. 467,250 amortization before the write-off mentioned in the preceding paragraphs was included in the caption depreciation and amortization. The write-off of the unamortized goodwill was included in the caption special charges (see Note 9).

ii) On September 8, 1995, Sercotel paid Ps. 272,777 (Ps. 170,937 nominal) to acquire 1,121,429 shares, equivalent to 50% equity interest in Consorcio Red Uno, S.A. de C.V. (Red Uno), a company engaged in integrating telecommunication and information service systems. This purchase gave rise to goodwill of Ps. 139,905, of which Ps. 3,498 was amortized in 1995. It was decided to amortize the remainder in 1996.

In 1996, the scheduled Ps. 14,275 amortization before the write-off mentioned in the preceeding paragraph was included in the caption depreciation and amortization. The write-off of the unamortized goodwill was included in the caption special charges (see Note 9).

On June 6, 1997, Sercotel decided to acquire the remaining 50% equity interest in Red Uno for Ps. 383,448. This purchase gave rise to goodwill of Ps. 266,409 which, consistent with the procedure observed the previous year, was charged to results of operations of the year ended December 31, 1997 (see Note 9). The financial statements of Red Uno were first consolidated in June 1997. No further information is provided on the impact of the acquisition of all of the outstanding shares of Red Uno due to the relatively minor importance of this acquisition from the standpoint of the consolidated financial statements taken as a whole.

iii) In 1997, TELMEX credited to income Ps. 40,488 (Ps. 70,051 in 1996) corresponding to its equity interest in the net income of affiliates. At the same time, TELMEX charged to stockholders' equity Ps. 14,589 in 1997 (Ps. 111,714 in 1996) corresponding to its equity interest in the result from holding nonmonetary assets of affiliates.

II. Investment in subsidiaries

During 1997, the Company paid Ps. 317,247 to acquire shares of Kb/TEL Telecomunicaciones, S.A. de C.V. (Kb/TEL) and other companies, giving rise to goodwill of Ps. 265,694, which the Company decided to charge to results of operations of the year (see Note 9). No further information is provided on the acquisition of these shares due to the relatively minor importance of such acquisition from the standpoint of the consolidated financial statements taken as a whole.

5. Employee Pensions and Seniority Premiums

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

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

In 1990, the Company set up an irrevocable trust fund to cover the payment of these obligations. It adopted the policy of making annual contributions to the fund, which totaled Ps. 1,056,508 in 1997 and Ps. 2,164,415 in 1996. These contributions are deductible for Mexican corporate income tax purposes.

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

In 1997, the Accounting Principles Committee of the MIPA issued circular No. 50, which specifies that actuarial computations of labor obligations must be based on actuarial assumptions net of inflation. Through December 31, 1996, labor obligations were computed on the basis of select nominal rates, which are based on variable nominal rates through a specific year and thereafter using a rate that remains constant in time.

The above-mentioned change in rates did not have an important impact on 1997 results of operations. In the balance sheet as of December 31, 1997, it was necessary to include an intangible asset and an additional liability of Ps. 4,970,812, because as a result of the change from nominal rates to real rates, projected benefit obligation, accumulated benefit obligation and the transition liability at January 1, 1997 had to be recalculated. The transition liability, past services and variances in assumptions will be amortized in a period of twelve years, which is the estimated average remaining working lifetime of Company employees.

The related charge to income of the year ended December 31, 1997 was Ps. 2,275,749 (Ps. 2,493,197 in 1996). An analysis of basic actuarial assumptions considered in the pension plan computations for the years ended December 31, 1997 and 1996, is as follows:

Analysis of the net period cost:

	1997		1996	
Labor cost	Ps.	**1,072,194**	Ps.	863,618
Financial cost of projected benefit obligation		**1,897,088**		5,381,316
Return on plan assets		**(1,363,271)**		(4,217,980)
Amortization of past service costs		**669,738**		466,243
Net period cost	**Ps.**	**2,275,749**	Ps.	2,493,197

Reserve for employee pensions and seniority premiums:

	1997		1996	
Projected benefit obligation	**Ps.**	**28,913,246**	Ps.	22,918,407
Plan assets		**(22,327,907)**		(17,386,852)
Transition liability		**(7,467,489)**		(3,387,154)
Past service costs				(46,821)
Actuarial gain (loss)		**846,731**		(2,089,925)
Net projected (asset) liability		**(35,419)**		7,655
Additional liability		**4,970,812**		3,480
Reserve for employee pensions and seniority premiums	**Ps.**	**4,935,393**	Ps.	11,135
Accumulated benefit obligation	**Ps.**	**27,263,300**	Ps.	13,336,201
Intangible asset	**Ps.**	**4,970,812**	Ps.	3,480

The rates used in the actuarial study were:

	1997	1996
Discount of labor obligation:		
First year	**6.9%**	27.0%
Long-term average	**4.9%**	14.8%
Increase in salaries:		
First year	**0.9%**	19.0%
Long-term average	**1.4%**	10.5%
Annual returns from the fund:		
First year	**6.9%**	27.0%
Long-term average	**4.9%**	14.8%

At December 31, 1997, 50% (51% in 1996) of plan assets were invested in variable-income securities and 50% (49% in 1996) in fixed-income securities.

6. Other Assets

In December 1997, Teléfonos de México, S.A. de C.V. and Radiomóvil Dipsa, S.A. de C.V. acquired from the Mexican Government concessions to operate radio spectrum wave frequencies for point-to-point and point-to-multipoint microwave communications, at a cost of Ps. 143,762. This cost will be amortized in a period of time yet to be determined, starting in 1998.

7. Long-Term Debt

The long-term debt consists of the following:

	1997 average interest rate*	Maturities from 1998 through	Balance at December 31 1997		1996	
Debt denominated in foreign currency:						
Banks	**6.5%**	**2007**	**Ps.**	**11,297,666**	Ps.	3,459,960
Suppliers' credits	**6.3%**	**2021**		**8,153,137**		10,822,298
Mexican Government	**6.6%**	**2006**		**223,160**		262,521
Financial leases	**10.7%**	**2000**		**19,683**		230,597
Fiduciary debt instruments						650,190
Total				**19,693,646**		15,425,566
Debt denominated in Mexican pesos:						
Medium-term notes	**20.0%**	**2000**		**4,133,000**		
Banks	**20.8%**	**2000**		**1,705,251**		30,262
Commercial paper	**20.2%**	**1999**		**135,180**		
Financial leases	**20.4%**	**2000**		**73,964**		
Total				**6,047,395**		30,262
Total debt				**25,741,041**		15,455,828
Less current portion of long-term debt				**12,323,568**		4,110,220
Long-term debt			**Ps.**	**13,417,473**	Ps.	11,345,608

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

An analysis of the foreign currency denominated debt at December 31, 1997 is as follows:

	Foreing currency (in thousands)	Exchange rate at December 31, 1997 (in units)	Mexican peso equivalent
U.S. dollar	2,161,014	Ps. 8.0833	Ps. 17,468,125
Japanese yen	28,970,406	0.0621	1,799,062
French franc	304,421	1.3489	410,633
Swiss franc	2,856	5.5414	15,826
Total			Ps. 19,693,646

At December 31, 1997, the Company has unused lines of credit from certain banks of approximately Ps. 2,270,000, at a floating interest rate of approximately LIBOR plus 0.7 points.

Long-term debt maturities at December 31, 1997 are as follows:

Year	Amount
1999	Ps. 2,725,865
2000	5,688,653
2001	1,266,935
2002	1,132,612
2003 and beyond	2,603,408
	Ps. 13,417,473

8. Deferred Credits

Deferred credits consist of the following at December 31, 1997 and 1996:

	1997	1996
Advances from subscribers	**Ps. 1,176,108**	Ps. 748,703
Other	**11,715**	19,643
	Ps. 1,187,823	Ps. 768,346

9. Special Charges

The Company recorded special charges of Ps. 2,414,337 and Ps. 4,359,529 in 1997 and 1996, respectively. An analysis is as follows:

	1997	1996
Expenses related to opening of long-distance market in Mexico	**Ps. 943,174**	Ps. 1,036,082
Contribution to Fundación TELMEX, A.C., a non-profit social welfare organization	**939,060**	1,517,315
To next column	**1,882,234**	2,553,397
From previous column	**1,882,234**	2,553,397
Goodwill resulting primarily from acquisition of Red Uno and Kb/TEL in 1997. In 1996, write-off of unamortized goodwill resulting from acquisition of Cablevision and Red Uno. (see Note 4).	**532,103**	1,057,435
Write-off of unamortized excess cost over appraised value of Federal Microwave Network, as explained in Note 3.		748,697
	Ps. 2,414,337	Ps. 4,359,529

10. Foreign Currency Position and Transactions

a) At December 31, 1997, the Company has a net foreign currency short position of U.S.$ 2,309 million (net foreign currency short position of U.S. $ 1,491 million at December 31, 1996).

The net exchange gain for the year ended December 31, 1997 was Ps. 200,542 (Ps. 248,715 in 1996). In both years these amounts were applied to income.

The prevailing exchange rate at December 31, 1997 was Ps. 8.08 per U.S. dollar (Ps. 7.85 per U.S. dollar at December 31, 1996). At March 5, 1998, which is the date of issuance of these financial statements, the exchange rate of the Mexican peso relative to the U.S. dollar was Ps. 8.53 per U.S. dollar.

b) In the years ended December 31, 1997 and 1996, the Company had the following transactions denominated in foreign currencies. Currencies other than the U.S. dollar, were translated to dollars using the average exchange rate for the year.

	Millions of U.S. dollars	
	1997	1996
Net settlement revenues	**U.S.$ 758**	U.S.$ 846
Interest expenses	**217**	154
Operating expenses	**209**	241

11. Commitments and Contingencies

a) At December 31, 1997, the Company has noncancelable commitments, primarily for the purchase of equipment, in the approximate amount of Ps. 800,000 (Ps. 350,000 in 1996).

b) At December 31, 1997, there are outstanding letters of credit in the approximate amount of Ps. 45,000 (Ps. 93,000 in 1996), which were issued to foreign suppliers for the purchase of materials and supplies.

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

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

d) 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. The Company's independent lawyers feel that Teléfonos de México, S.A. de C.V. will prevail in this matter.

e) 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 Cablevision, S.A. de C.V.

In defense, TELMEX maintains that the suit is unfounded and, in the opinion of the Company's independent lawyers handling this matter, TELMEX will prevail.

12. Related Parties

In the years ended December 31, 1997 and 1996, the Company had the following important transactions with related parties:

		1997		1996
Purchase of materials, inventories and fixed assets	**Ps.**	**1,683,530**	Ps.	1,314,448
Payment of insurance premiums and fees for administrative and operating services		**1,232,938**		1,181,516
Discount on sale of doubtful accounts receivable		**439,189**		517,178
Sale of materials, inventories and fixed assets		**354,053**		181,135

13. Stockholders' Equity

a) Capital stock is represented by 8,118 million common shares issued and outstanding with no par value (8,875 million shares in 1996). An analysis is as follows:

		1997		1996
2,163 million series "AA" shares	**Ps.**	**19,250,492**	Ps.	19,250,492
235 million (280 million in 1996) series "A" shares		**2,201,638**		2,599,922
5,720 million (6,432 million in 1996) series "L" shares		**17,640,396**		17,831,532
	Ps.	**39,092,526**	Ps.	39,681,946

b) 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.

c) In 1994, TELMEX initiated a program to purchase its own shares. For this purpose, in terms of 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. At December 31, 1995, the purchase of 1,820 million shares had been approved and the Company had acquired on the open market 922 million shares. The balance of the reserve for the purchase of the Company’s own shares at December 31, 1995 was Ps. 18,706,176. The stockholders approved the cancellation of 820 million treasury shares purchased through December 31, 1995.

In 1996, the stockholders approved an increase of Ps. 9,738,684 in the reserve for the purchase of the Company’s own shares to acquire up to 800 million additional shares to those previously authorized. In such year the Company purchased 779 million series “L” shares for Ps. 12,591,907 (historical cost of Ps. 9,534,050). On December 10, 1996, the stockholders approved the cancellation of 845 series “L” treasury shares.

In 1997, the Company purchased 756 million series “L” shares for Ps. 13,496,443 (historical cost of Ps. 12,597,794) so that at December 31, 1997, the balance of the reserve for the purchase of the Company’s own shares was Ps. 3,048,874.

On March 3, 1998, the stockholders authorized the cancellation of 853 million previously acquired series “L” treasury shares. They also approved an increase in the reserve for the purchase of the Company’s own shares in order for the reserve to reach a total of Ps. 19,120,000, to purchase up to 800 million shares.

d) 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.

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

14. Income Tax and Asset Tax

a) The Ministry of Finance and Public Credit authorized TELMEX to consolidate for tax purposes starting January 1, 1995. The Instituto Tecnológico de Teléfonos de México, S.C., Fundación Telmex, A.C., the subsidiaries acquired in 1997 and the affiliated companies are excluded from this tax consolidation.

b) The asset tax for the years ended December 31, 1997 and 1996 was Ps. 1,864,932 and Ps. 1,644,754, respectively. In both years these amounts were credited against income tax.

c) 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 other nondeductible expenses.

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 the acquisition of a microwave network.

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

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

	1997	1996
Net income as reported under Mexican GAAP	**Ps. 12,850,613**	Ps. 13,423,982
Total approximate U.S. GAAP adjustments, net	**(608,812)**	1,212,402
Approximate net income under U.S. GAAP	**Ps. 12,241,801**	Ps. 14,636,384
Weighted average common shares outstanding (in millions)	**8,406**	9,154
Approximate net income per share under U.S. GAAP (in Mexican pesos)	**Ps. 1.456**	Ps. 1.599
Total stockholders' equity under Mexican GAAP	**Ps. 88,230,958**	Ps. 103,239,637
Total approximate U.S. GAAP adjustments, net	**(9,551,310)**	(18,087,353)
Approximate total stockholders' equity under U.S. GAAP	**Ps. 78,679,648**	Ps. 85,152,284

PROPOSAL TO THE MEETING

(Thousands of Mexican pesos with purchasing power at December 31, 1997, except for dividends per share)

Regarding dividend payments for the 1997 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 balance at December 31, 1997	Ps.	43,077,551
Less: Separation for one dividend payment in cash to shareholders beginning March 26,1998, for the amount of Ps. 0.175 per share, dictated by the Shareholders'Meeting held on March 3, 1998, by presenting coupon 04.		1,408,548
Less: Increase in the reserve for the purchase of the Company's own shares, according to the Shareholders' Meeting held on March 3, 1998.		19,101,845
		22,567,158
Net income for the year		11,041,738
Total	Ps.	33,608,896

It is proposed that the balance of Ps. 33,608,896 made available to the shareholders to be allocated as follows:

		Amount
To increase the legal reserve 5% of the net income for the year	Ps.	552,087
To pay three installments of Ps. 0.175 per share each, as cash dividends coming from the Net Fiscal Profit		4,210,910 (1)
To the retained earnings account		28,845,899
Total	Ps.	33,608,896

The cash dividends proposed to the Shareholders' Meeting will be paid starting June 25, 1998, September 24, 1998 and December 23, 1998, for all outstanding shares which make up the capital stock of the Company, by presenting coupons 05, 06 and 07, respectively. 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 8,020,781,091 outstanding shares.

SIGNIFICANT RESULTS OF ACCOUNTING SEPARATION OF LOCAL AND LONG-DISTANCE TELEPHONE SERVICES
For the years ended December 31
(Millions of Mexican pesos with purchasing power at December 31, 1997)

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 1996 and 1997.

	Local Service		Long-Distance Service	
	1997	1996	**1997**	1996
Operating Revenues				
Access, Rent, Measured Service and Others	**Ps. 33,356**	Ps. 26,950	**Ps. 2,612**	Ps. 1,664
Domestic Long-Distance			**12,706**	17,635
International Long-Distance			**11,246**	16,709
LADA Interconnection	**10,109**	11,266		
Interconnection with Long-Distance Carriers	**474**			
Interconnection with Cellular Companies	**389**	370		
Total Revenues	**44,328**	38,586	**26,564**	36,008
Operating Costs and Expenses				
Cost of Sales and Services	**9,315**	9,202	**3,896**	3,656
Commercial, Administrative and General	**7,628**	8,525	**7,551**	8,150
Depreciation and Amortization	**9,184**	9,733	**2,304**	3,152 *
Interconnection			**10,109**	11,266
Total Operating Costs and Expenses	**26,127**	27,460	**23,860**	26,224
Operating Income	**Ps. 18,201**	Ps. 11,126	**Ps. 2,704**	Ps. 9,784
Gross Telephone Plant	**Ps. 113,416**	Ps. 121,155	**Ps. 28,871**	Ps. 29,496
Personnel	**42,885**	42,635	**11,873**	12,835

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

a) For its elaboration, the information that was considered was only the one corresponding to the following companies that are directly involved in rendering local and long-distance telephone service: 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.

b) Revenues from local service as well as costs and expenses of the long-distance service include the corresponding imputations.

c) The information for 1996 incorporates the 1997 assignation and imputation criterion.

* In 1996, the amortization for the corresponding balance for the acquisition of the Federal Microwave Network was made for the amount of Ps.749 million.

BOARD OF DIRECTORS

Carlos Slim Helú
Chairman of the Board

Pierre Fortin
President
France Tèlècom-México

Juan Antonio Pérez Simón
Vice Chairman of the Board
Teléfonos de México, S.A. de C.V.

DIRECTORS

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Vice President Senior International Operations
SBC Communications Inc.

Claude Benmussa
Vice President Accounting Control and Operations
France Tèlècom-FCR

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

Antonio Cosío Ariño
President
Cía. Industrial Tepeji del Río, S.A. de C.V.

Richard C. Dietz
President
SBC International, Inc.

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

Charles E. Foster
SBC Group President
SBC Communications, Inc.

Elmer Franco Macías
President and Director
Grupo Infra, S.A. de C.V.

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Chairman of the Board and President
Kimberly Clark de México, S.A. de C.V.

Michel Hirsch
President
France Tèlècom-FCR

David Ibarra Muñoz
Consultant

Angel Losada Moreno
Assistant President
Gigante, S.A. de C.V.

Rómulo O'Farrill Jr.
Chairman and President
Novedades Editores, S.A. de C.V.

Bernardo Quintana Isaac
President
Industries Division Grupo ICA, S.A. de C.V.

Carlos Slim Domit
President
Sanborns Hnos., S.A.

Gregory T. Hall
Head of Finance
SBC International, Inc.

STATUTORY AUDITOR

Víctor M. Aguilar Villalobos
President
Mancera, S. C.

SECRETARY

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

ALTERNATE DIRECTORS

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Executive Vice President
Gigante, S.A. de C.V.

Carlos Bernal Verea
Partner
Noriega y Escobedo, A.C.

Paul W. Cardarella
Head of Operations
SBC International, Inc.

Christian Chauvin
Vice President International Development
France Tèlècom

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Chairman of the Board
Inmobiliaria de Tepeji del Río, S.A. de C.V.

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Banco Internacional, S.A.

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President
Museo Amparo

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Tecnología Industrial Agropecuaria, S.A. de C.V.

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Chairman of the Board
Cryoinfra, S.A. de C.V.

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

Rafael Kalach Mizrahi
President
Grupo Kaltex, S.A. de C.V.

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

Federico Laffan Fano
Main Partner
Laffan, Mues y Garay

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

Denis Petonnet
General Manager
France Cables et Radio de México, S.A. de C.V.

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Senior Vice President, Treasurer and Chief Financial Officer
SBC Communications, Inc.

Xavier Péretié
Head of Finance
France Cables et Radio

Alfredo Sánchez Alcántara
President
Consorcio Red Uno, S.A. de C.V

Marco Antonio Slim Domit
President
Grupo Financiero Inbursa, 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.

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Proyección Corporativa, S.A. de C.V.

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Chairman
Consejo Coordinador Empresarial

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

Daniel Hajj Aboumrad
Chief Executive Officer
Radiomóvil Dipsa, S.A. de C.V.

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Chairman of the Board
Casa Ley, S.A. de C.V.

Gastón Luken Aguilar
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GE-Capital Bank, S.A.

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Chairman of Operations
Grupo Industrial Saltillo, S.A. de C.V.

Ricardo Martín Bringas
Chief Executive Officer
Organización SORIANA, S.A. de C.V.

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Banco Regional de Monterrey, S.A.,
Institución de Banca Múltiple

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Grupo Cementos de Chihuahua, S.A. de C.V.

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Grupo Villacero

Roberto Zambrano Villarreal
Chief Executive Officer
Desarrollo Integrado, S.A. de C.V.

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Laboratorios Pisa, S.A. de C.V.

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Arancia-CPC, S.A. de C.V.

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Chairman of the Board
Industrias Jobar, S. de R.L. de C.V.

José Berrondo Mir
Managing Director-Refrigeration
Mabe México, S. de R.L. de C.V.

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Promotora Terracasa, S.A. de C.V.

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Chairman of the Board
Grupo Industrial Martínez Garza, S.A.de C.V.

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Chairman of the Board
Grupo Jomar

Salvador Oñate Ascencio
Chairman of the Board
Banco del Bajío, S.A.

Roberto Plascencia Saldaña
Chairman of the Board
Grupo Flexi, S.A. de C.V.

Roberto Ruiz Rubio
Chairman of the Board
Fomento Queretano, S.A. de C.V.

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Chief Executive Officer
Super San Francisco de Asís, S.A. de C.V.

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Chairman of the Board
La Italiana, S.A. de C.V.

Antonio Chedraui Obeso
Chairman of the Board
Grupo Comercial Chedraui, S.A. de C.V.

Juan Manuel Diez Francos
Chairman of the Board
Diez Orizaba, S.A. de C.V.

Juan José Gutiérrez Ruiz
Chairman of the Board
Grupo Gutiérrez Embotellador, S.A. de C.V.

Armando Millet Molina
Chairman of the Board
Operadora Real Maya, S.A. de C.V.

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

Enrique Montoto Arámburo
Chief Executive Officer
C. Montoto, S.A. de C.V.

Miguel Quintana Pali
Chairman of the Board and Chief Executive Officer
Promotora XCaret, S.A. de C.V.

D I R E C T O R Y

Jaime Chico Pardo
Chief Executive Officer

Facundo Alonso García
Northeast Division

Isidoro Ambe Attar
Business Marketing

Salvador Barra Arias
Business Development

Adolfo Cerezo Pérez
Finance and Administration

Pedro Cerisola y Weber
West Metro Division

Javier Coca Muñiz
Gulf-Pacific Division

José Covarrubias Bravo
Customer Services

Arturo Elías Ayub
Commercial, Regulations and New Technologies

Javier Elguea Solís
Human Resources

Eduardo Javier Gómez Chibli
Technical and Long Distance

Gerardo Leal Garza
South Metro Division

Sergio F. Medina Noriega
Legal Affairs

Jesús Rafael Mendoza Ortiz
East Metro Division

Alejandro Montaño Martínez
Corporate Communications

José Luis Muñoz Balvanera
Technological Evaluation

Luis Nájera Valdéz
West Division

José Manuel Pacheco Gamboa
Southeast Division

Raymundo Paulín Velazco
Northwest Division

Javier Ramírez Otero
Outside Plant Engineering and Standards

Héctor Slim Seade
Procurement

Jorge Luis Suástegui Esquivel
Center Division

Andrés Vázquez del Mercado
Residential Marketing

Miguel Angel Vera García
North Division

Oscar Von Hauske Solís
Systems and Procedures

SHAREHOLDER INFORMATION

• Headquarters
Parque Vía 190
Colonia Cuauhtémoc
México, D.F.
C.P. 06599

• Investor Relations
Parque Vía 198, oficina 701
Colonia Cuauhtémoc
México D.F.
C.P. 06599
Phone 52(5) 703 3990/ 52(5) 222 5462
Fax: 52(5) 545 5550
E-Mail: gmunoz@telmex.net

• Shareholder Services
Phone 52(5) 222 1126 / 52(5) 222 5534
52(5) 222 6159
Fax: 52(5) 254 59 55
E-Mail: tcurriel@telmex.net

• Website: www.telmex.com.mx

• 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: TFONY
One ADR represents one "A" share

• Transfer and Depository Agent in the U.S.:
JP Morgan
Morgan Guaranty Trust Company
60 Wall Street
New York, NY 10260-0060
Phone: 212 648 6801
Fax: 212 648 5104

• Independent Auditors
Mancera, S.C. Ernst &Young