

COMPANHIA DE SANEAMENTO BASICO DO ESTADO DE SAO PAULO-SABESP  
Form 20-F/A  
May 30, 2018

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 20 F/A**

**(Amendment No. 1)**

**o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

**o ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2017**

**OR**

**o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**OR**

**o SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Date of event requiring this shell company report \_\_\_\_\_**

**Commission file number 001 31317**

**Companhia de Saneamento Básico do Estado de São Paulo–SABESP**  
(Exact name of Registrant as specified in its charter)

**Basic Sanitation Company of the State of São Paulo SABESP**  
(Translation of the Registrant’s name into English)

**Federative Republic of Brazil**  
(Jurisdiction of incorporation or organization)

**Rua Costa Carvalho, 300**  
**05429 900 São Paulo, SP, Brazil**  
(Address of principal executive offices)

**Rui de Britto Álvares Affonso**  
**raffonso@sabesp.com.br**  
**(+55 11 3388 8247)**  
**Rua Costa Carvalho, 300 05429 900 São Paulo, SP, Brazil**

Securities registered or to be registered pursuant to Section 12(b) of the Act:

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
Common Shares, without par value	New York Stock Exchange
American Depositary Shares, evidenced by American Depositary Receipts, each representing one Common Share	New York Stock Exchange
Not for trading purposes, but only in connection with the registration of American Depositary Shares pursuant to the requirements of the Securities and Exchange Commission.	

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Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

683,509,869 Shares of Common Stock

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

Yes  No

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

Yes  No

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

Yes  No

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

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non accelerated filer, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer   
Non accelerated Filer

Accelerated Filer   
Emerging Growth Company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards† provided pursuant to Section 13(a) of the Exchange Act.

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

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

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

Item 17  Item 18

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

Yes  No

† The term “new or revised financial accounting standard” refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

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## EXPLANATORY NOTE

This Amendment No. 1 to the Annual Report on Form 20-F for the fiscal year ended December 31, 2017 of Companhia de Saneamento Básico do Estado de São Paulo – SABESP, originally filed with the Securities and Exchange Commission on April 27, 2018 (the “2017 Form 20-F”), is being filed for the purposes of adding Exhibit 101 to Item 19 “Exhibits” and furnishing the Interactive Data File disclosure as Exhibit 101 in accordance with Rule 405 of Regulation S-T. This Exhibit was not previously filed.

This Amendment No. 1 to the 2017 Form 20-F also includes the following principal updates:

- The following changes resulting from our annual shareholders’ meeting held on April 27, 2018:
  - The increase in the number of members on our board of directors from eight to ten;
  - The election of members to our board of directors to serve until our annual shareholders’ meeting in 2020. For the current composition of our Board of Directors, see “Item 6. Directors, Senior Management and Employees—A. Directors and Senior Management—Board of Directors”;
  - The election of members to our fiscal council to serve until our annual shareholders’ meeting in 2019. For the current composition of our fiscal council, see “Item 6. Directors, Senior Management and Employees—A. Directors and Senior Management—Fiscal Council (*Conselho Fiscal*)”;
  - The approval of the legal reserve, dividends and investment reserve for the fiscal year ended December 31, 2017. For more information, see “Item 10. Additional Information—B. Memorandum and Articles of Association—Reserves” and Item 8.A. Financial Statements and Other Financial Information—Dividends and Dividend Policy”;
  - The approval of R\$4.7 million in aggregate compensation payable to members of our board of directors, members of our fiscal committee and our executive officers in 2018. For more information see “Item 6. Directors, Senior Management and Employees— Directors, Senior Management and Employees—B. Compensation”;
  - Certain revisions to our bylaws in order to comply with Federal Law No. 13,303/16 and the new *Novo Mercado* requirements, and other changes in our governance structure, such as the termination of the Regulatory Affairs Committee. For more information regarding our bylaws see, “Item 10. Additional Information—B. Memorandum and Articles of Association.” For more information regarding the changes required to be implemented by June 30, 2018 under Federal Law No. 13,303/16 see, “Item 16G. Corporate Governance—Required Changes to Corporate Governance Practices of Brazilian Government Controlled Companies.” For more information regarding the changes required to be implemented by April 2021 under the new *Novo Mercado* requirements see, “Item 9.C. Markets—Trading on the Brazilian Stock Exchange—The *Novo Mercado* Segment;” and
  - The formalization of our dividend policy. For more information on our dividend policy, see “Item 8.A. Financial Statements and Other Financial Information—Dividends and Dividend Policy”;
- The election on May 14, 2018 of Karla Bertocco Trindade as our Chief Executive Officer. For more information, see “Item 4. Risk Factors—Risks Relating to Our Control by the State of São Paulo—We are controlled by the State of São Paulo, whose interests may differ from the interests of non-controlling shareholders, including holders of ADSs”; and
- The conclusion of the Second Ordinary Tariff Revision in May 2018 and our subsequent filing of a reconsideration request as well as a clarification and revision request with ARSESP on May 24, 2018. For more

information regarding this tariff revision, see “Item 4.B. Business Overview—Tariffs—Second Ordinary Tariff Revision (2017-2020)”

Other than as expressly set forth above, this Amendment No. 1 to the 2017 Form 20-F does not, and does not purport to, amend, update or restate the information in any other item of the 2017 Form 20-F, or reflect any events that have occurred after the 2017 Form 20-F was originally filed.

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## PRESENTATION OF FINANCIAL AND OTHER INFORMATION

### General

We maintain our books and records in *reais*. We prepare our financial statements in accordance with International Financial Reporting Standards, or “IFRS”, as issued by the International Accounting Standards Board, or the “IASB”. Our audited financial statements as of December 31, 2017 and 2016 and for each of the years in the three year period ended December 31, 2017 and are included in this annual report on Form 20 F.

Certain figures included in this annual report have been subject to rounding adjustments. Accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

### Water Crisis

Our results and operational performance for the fiscal year ended December 31, 2017 were partially affected by the lowest stream flow measurements in over 80 years due to the serious drought in 2014 and 2015. With the return of the rainfall to its historical average for the rainy season that began in October 2015 and ended in March 2016, the level of water in the reservoirs that provide water to the population of the São Paulo metropolitan region returned to normal and the measures taken during the water crisis to continue to service consumers were gradually discontinued. However, heightened public awareness of the need to conserve water during the crisis resulted in our customers adopting lower water consumption practices during the water crisis and these practices have been partially integrated into our consumers’ daily habits. Another probable factor for why consumptions levels have not yet returned to their pre-water crisis levels despite the return of the rainfall to its historical average is the contraction of the Brazilian economy, which may have resulted in lower consumption of water by industry and other businesses. As a result, despite our reservoirs having a higher volume of water available for treatment, the total volume of water billed to our clients did not return to the volume of water billed in 2013, before the water crisis. As of December 31, 2017, the reservoirs in the São Paulo metropolitan region, where our largest market is located, contained 916.8 million m<sup>3</sup> of water storage for treatment, compared to 951.1 million m<sup>3</sup> available for treatment as of December 31, 2016. The measurements for these years do not include the so called “technical reserve” of 287.5 million m<sup>3</sup>. See “Item 4.B. Business Overview—The Recent Water Crisis”. Average monthly water production in 2017 for the São Paulo metropolitan region was 60.6 m<sup>3</sup>/s, compared to 58.5 m<sup>3</sup>/s in 2016, 52.0 m<sup>3</sup>/s in 2015, 62.2 m<sup>3</sup>/s in 2014 and 69.1 m<sup>3</sup>/s in 2013, the year before the water crisis started. For more information, see “Item 3.D. Risk Factors—Risks Relating to Our Business—“The measures we took to mitigate the effects of the drought that occurred in 2014 and 2015 resulted in a significant decrease in the volume of water billed and revenues from services we provide and, despite the discontinuation in May 2016 of the measures that were used to face the drought, new consumption habits were incorporated and the volume of water billed continues to be impacted by those measures.” and “Item 4.B. Business Overview—The Recent Water Crisis”.

### Convenience Translations

We have translated some of the *real* amounts contained in this annual report into U.S. dollars. The rate used to translate such amounts in respect of the year ended December 31, 2017 was R\$3.3080 to US\$1.00, which was the commercial rate for the purchase of U.S. dollars in effect on December 31, 2017, as reported by the Central Bank. The U.S. dollar equivalent information presented in this annual report is provided solely for the convenience of the reader and should not be construed as implying that the *real* amounts represent, or could have been or could be converted into, U.S. dollars at the above rate. See “Item 3.A. Selected Financial Data—Exchange Rates” for more detailed information regarding the Brazilian foreign exchange system and historical data on the exchange rate of the *real* against the U.S. dollar.



**Rounding**

Some percentages and numbers included in this annual report have been subject to rounding adjustments. Accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures that precede them.

**Other Information**

In this annual report, unless the context otherwise requires, references to “we,” “us,” “our,” “Company,” or “SABESP” refer to Companhia de Saneamento Básico do Estado de São Paulo – SABESP.

In addition, references to:

- “ARSESP” are to the São Paulo State Sanitation and Energy Regulatory Agency (*Agência Reguladora de Saneamento e Energia do Estado de São Paulo*);
- “ADR” or “ADRs” are to American Depositary Receipt or American Depositary Receipts, respectively;
- “ADS” or “ADSs” are to American Depositary Share or American Depositary Shares, respectively;
- “Brazil” are to the Federative Republic of Brazil;
- “Central Bank” are to the Central Bank of Brazil;
- “Coverage” indicators are to (a) the number of homes that are actually connected to the water network or sewage collection network, plus the number of homes for which the water and sewage networks are available for connection but which are not connected to those networks (referred to as “feasible” or “connectable” homes), as a portion of (b) the total number of homes within the urbanized service area covered by our contract with the municipality (i.e., the “serviceable area”);
- “CVM” are to the *Comissão de Valores Mobiliários*, the Brazilian regulator of securities;
- “federal government” and “Brazilian government” are to the federal government of the Federative Republic of Brazil and “state government” are to the state government of the State of São Paulo;
- “real,” “reais” or “R\$” are to the Brazilian real, the official currency of Brazil;
- “Regional Systems” are to the area where the regional systems’ executive office operates, comprising 330 municipalities in the interior and coastline regions of the state of São Paulo;
- “São Paulo metropolitan region,” with respect to our operations, are to the area where the metropolitan executive office operates, comprising 38 municipalities, including the city of São Paulo;
- “Service” indicators are to (a) the number of homes that are actually connected to the water network or sewage collection network, as a portion of (b) the total number of homes within a given serviceable area;
- “Sewage Treatment Coverage” indicators are to the amount of consumer units connected to the sewage treatment system;
- “State” are to the State of São Paulo, which is also our controlling shareholder;
- “U.S. dollars” or “US\$” are to the United States dollar, the official currency of the United States;
- “water crisis” are to the drought we have experienced from late 2013 and throughout most of 2015. This drought, the most serious that our service region has experienced in more than 80 years, primarily affected the Cantareira System, our largest water production system.

Information in this annual report related to liters, water and sewage volumes, number of employees, kilometers, water and sewage connections, population served, operating productivity, water production, water and sewage lines (in kilometers), water loss index and investment in programs has not been audited.

### ***Market Information***

We make statements in this annual report about our market share and other information relating to Brazil and the industry in which we operate. We have made these statements on the basis of information from third-party sources and publicly available information that we believe is reliable, such as information and reports from the Brazilian Institute of Geography and Statistics (*Instituto Brasileiro de Geografia e Estatística*), or IBGE, and the State Data Analysis System Foundation (*Fundação Sistema Estadual de Análise de Dados*), or SEADE, among others. We have no reason to believe that any of this information is inaccurate in any material respect.

References to urban and total population in this annual report are estimated based on research prepared by SEADE entitled “Projections of Population and Residences for the Municipalities of the State of São Paulo: 2010-2050” (*Projeção da População e dos Domicílios para os Municípios do Estado de São Paulo: 2010-2050*).

***Our Contracts and the Municipalities We Serve***

Throughout this document, we refer to the 368 municipalities we serve and to our 370 contracts. This difference results from the fact that we have two partial water contracts with the municipality of Mogi das Cruzes. However, as the majority of the municipality is serviced on a wholesale basis, Mogi das Cruzes has not been included in the total number of municipalities we serve. Most of our contracts with the municipalities we serve are program contracts which have a term of 30 years

## CAUTIONARY STATEMENTS ABOUT FORWARD LOOKING STATEMENTS

This annual report includes forward looking statements, mainly in Items 3 through 5. We have based these forward looking statements largely on our current expectations and projections about future events and financial trends affecting our business. These forward looking statements are subject to risks, uncertainties and assumptions, including, among other factors:

- general economic, political, demographical and other conditions in Brazil and in other emerging market countries;
- changes in applicable laws and regulations, as well as the enactment of new laws and regulations, including those relating to environmental, tax and employment matters in Brazil;
- availability of the water supply;
- the impact on our business of lower water consumption practices adopted by our customers during the water crisis, which may remain in place despite the discontinuation of the measures adopted to serve the São Paulo metropolitan region during the water crisis;
- any measures that we may be required to take to ensure the provision of water to our customers;
- our exposure to probable increases in the frequency of extreme weather conditions, including droughts and intensive rain and other climatic events;
- fluctuations in inflation, interest rates and exchange rates in Brazil;
- the interests of our controlling shareholder;
- our potential corporate reorganization, as approved by State Law No. 16,525 on September 15, 2017;
- our ability to collect amounts owed to us by our controlling shareholder and by municipalities;
- our ability to continue to use certain reservoirs under current terms and conditions;
- our capital expenditure program and other liquidity and capital resources requirements;
- power shortages, rationing of energy supply or significant changes in energy tariffs;
- the effects of the agreement for provision of water and sewage services in the city of São Paulo, which we executed with the State and the city of São Paulo;
- the lack of formal agreements between our company and certain municipalities to which we provide water and sewage services, including cities comprising metropolitan regions, urban conurbations, and the fact that the State and municipal governments share competency regarding these services;

- the municipalities' ability to terminate our existing concession agreements prior to their expiration date and our ability to renew such agreements;
- our ability to provide water and sewage services in additional municipalities and to maintain the right to provide the services for which we currently have contracts;
- the size and growth of our customer base and its consumption habits;
- our ability to comply with the requirements regarding water and sewage service levels included in our agreements with municipalities;
- our level of debt and limitations on our ability to incur additional debt;
- our ability to access financing with favorable terms in the future;

- the costs we incur in complying with environmental laws and any penalties for failure to comply with these laws;
- the outcome of our pending or future legal proceedings;
- the delay or postponement in investment in our sewage system;
- our management's expectations and estimates relating to our future financial performance;
- the regulations issued by ARSESP regarding several aspects of our business, including limitations on our ability to set and adjust our tariffs;
- the possibility to be subject to a regulatory agency, other than ARSESP; and
- other risk factors as set forth under "Item 3.D. Risk Factors".

The words "believe," "may," "estimate," "continue," "anticipate," "plan," "intend," "expect" and similar words are intended to forward looking statements. In light of these risks and uncertainties, the forward looking events and circumstances discussed in this annual report might not occur. Our actual results could differ substantially from those anticipated in our forward looking statements. Forward looking statements speak only as of the date they were made and we do not undertake any obligation to update or revise any forward looking statements, whether as a result of new information, future events or otherwise, unless required by law. Any such forward looking statements are not an indication of future performance and involve risks.

## Part I

### ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

### ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

### ITEM 3. KEY INFORMATION

#### A. Selected Financial Data

The following selected financial data should be read in conjunction with our audited financial statements (including the notes thereto), “Presentation of Financial and Other Information” and “Item 5. Operating and Financial Review and Prospects”.

The selected financial data as of December 31, 2017 and 2016 and for the years ended December 31, 2017, 2016 and 2015 have been derived from our audited financial statements, presented in accordance with IFRS, and included in this annual report. The selected financial data as of December 31, 2015, 2014 and 2013 and for the years ended December 31, 2014 and 2013 have been derived from our audited financial statements, presented in accordance with IFRS, which is not included in this annual report.

We have included information with respect to the dividends and/or interest attributable to shareholders’ equity paid to holders of our common shares since January 1, 2013 in *reais* and in U.S. dollars translated from *reais* at the commercial market selling rate in effect as of the payment date under the caption “Item 8.A. Financial Statements and Other Financial Information—Dividends and Dividend Policy—Payment of Dividends”.

2017 <sup>(1)</sup>	<b>For the year ended December 31,</b>				
US\$	2017 R\$	2016 R\$	2015 R\$	2014 R\$	2013 R\$
<i>(in millions, except per share and per ADS <sup>(2)</sup> data)</i>					

#### Selected Income Statement

##### Data:

Net operating revenue	4,416.0	14,608.2	14,098.2	11,711.6	11,213.2	11,315.6
Cost of services	(2,653.9)	(8,779.0)	(9,013.1)	(8,260.8)	(7,635.6)	(6,816.3)
Gross profit	1,762.2	5,829.2	5,085.1	3,450.8	3,577.6	4,499.3
Selling expenses	(232.4)	(768.7)	(730.0)	(598.1)	(736.6)	(637.1)
Administrative income (expenses)	(332.2)	(1,099.0)	(934.9)	45.0	(924.4)	(729.1)
Operating profit	1,197.6	3,961.7	3,429.6	3,044.0	1,910.7	3,138.8
Financial income (expenses), net	(138.5)	(458.1)	699.4	(2,456.5)	(635.9)	(483.2)
Profit for the year	761.6	2,519.3	2,947.1	536.3	903.0	1,923.6



Earnings per share – basic and diluted <sup>(3)</sup>	1.11	3.69	4.31	0.78	1.32	2.81
Earnings per ADS – basic and diluted <sup>(3)</sup>	1.11	3.69	4.31	0.78	1.32	2.81
Dividends and interest on shareholders' equity per share <sup>(3)</sup>	0.06	0.19	1.02	0.19	0.32	0.67
Dividends and interest on shareholders' equity per ADS <sup>(3)</sup>	0.06	0.19	1.02	0.19	0.32	0.67
Weighted average number of common shares outstanding <sup>(3)</sup>	683,509,869	683,509,869	683,509,869	683,509,869	683,509,869	683,509,869

(1) Translated at the commercial selling rate at closing for the purchase of U.S. dollars, as reported by the Central Bank, as of December 31, 2017 of R\$3.3080 to US\$1.00.

(2) ADS-American Depositary Share.

(3) On April 22, 2013, our shareholders approved a stock split, following which each common share represented three new common shares. Therefore, per share information in the selected financial data has been retrospectively restated to give effect to the stock split to all periods presented.

**Selected Statement of Financial Position Data**

As of December 31,

	2017 <sup>(1)</sup> US\$	2017 R\$	2016 R\$	2015 R\$	2014 R\$	2013 R\$
	<i>(in millions, except per share and per ADS <sup>(2)</sup> data)</i>					
Property, plant and equipment	77.1	255.1	302.4	325.1	304.8	199.5
Intangible assets	10,116.7	33,466.1	31,246.8	28,513.6	25,979.5	23,846.2
Total assets	11,954.8	39,546.4	36,745.0	33,706.6	30,355.4	28,274.3
Current portion of long term loans and financing	528.0	1,746.8	1,246.6	1,526.3	1,207.1	640.9
Long term loans and financing	3,130.1	10,354.2	10,717.6	11,595.3	9,578.6	8,809.1
Interest on capital	181.0	598.6	700.0	127.4	214.5	457.0
Total liabilities	6,660.7	22,033.4	21,325.8	19,990.0	17,051.0	15,343.5
Equity	5,294.1	17,513.0	15,419.2	13,716.6	13,304.4	12,930.8
Capital stock	3,023.0	10,000.0	10,000.0	10,000.0	10,000.0	6,203.7

**Selected Statements of Cash Flows****Data:**

Net cash generated from operating activities	998.2	3,301.9	3,003.6	2,641.4	2,480.3	2,777.2
Net cash used in investing activities	(596.0)	(1,971.4)	(2,130.7)	(2,459.5)	(2,757.7)	(2,281.5)
Net cash provided by (used in) financing activities	(282.2)	(933.6)	(625.9)	(265.7)	218.5	(629.7)
Purchases of intangible assets and property, plant and equipment as presented in our statement of cash flow	(597.6)	(1,976.7)	(2,135.8)	(2,452.1)	(2,748.3)	(2,335.8)

(1) Translated at the commercial selling rate at closing for the purchase of U.S. dollars, as reported by the Central Bank, as of December 31, 2017 of R\$3.3080 to US\$1.00.

(2) ADS-American Depositary Share.

**Operating Data**

Indicator	As of and for the year ended December 31,		
	2017	2016	2015
Number of water connections (in thousands)	8,863	8,654	8,420
Number of sewage connections (in thousands)	7,302	7,091	6,861
Percentage of population with water connections (“service” indicator) (in percent) <sup>(1)</sup>	95	95	96
Percentage of population with sewer connections (“service” indicator) (in percent) <sup>(1)</sup>	83	82	83
Percentage of population covered by water network (“coverage” indicator) (in percent) <sup>(2)</sup>	98	98	99

Percentage of population covered by sewage network (“coverage” indicator) (in percent) <sup>(2)</sup>	90	89	90
Percentage of consumer units connected to the sewage treatment system (“sewage treatment coverage” indicator) (in percent)	75	74	72
Volume of water billed during period (in millions of cubic meters)	2,075.9	1,990	1,914
Water Billed Loss Index during period (average) (in percent) <sup>(3)</sup>	20.1	20.8	16.4
Water Metered Loss Index during period (average) (in percent) <sup>(4)</sup>	30.7	31.8	28.5
Water loss per connection per day (average) <sup>(5)</sup>	302	308	258
Number of employees <sup>(6)</sup>	13,672	14,137	14,223

(1) Is equal to (a) the number of homes that are actually connected to the water network or sewage collection network, as a portion of (b) the total number of homes within the serviceable area.

(2) It is equal to (a) the number of homes that are actually connected to the water network or sewage collection network, plus the number of homes for which the water and sewage networks are available for connection but which are not connected to those networks (referred to as “feasible” or “connectable” homes), as a portion of (b) the total number of homes within the urbanized service area covered by our contract with the municipality (i.e., the “serviceable area”).

(3) Includes both physical and non physical water loss. Water Billed Loss Index represents the quotient of (i) the difference between (a) the total volume of water produced plus (b) the total volume of water invoiced minus (c) the volume of water excluded from our calculation of water loss, divided by (ii) the total volume of water produced. For more information, see “Item 4.B. Business Overview—Description of Our Activities—Water Operations—Water Loss”. We exclude the following from our calculation of water loss: (i) water discharged for periodic maintenance of water transmission lines and water storage tanks; (ii) water supplied for municipal uses such as firefighting; (iii) water we consume in our facilities; and (iv) estimated water loss related to the supply of water to shantytowns (*favelas*).

(4) Includes both physical and non physical water loss. The Water Metered Loss Index represents the quotient of (i) the difference between (a) the total volume of water produced minus (b) the total volume of water measured minus (c) the volume of water that we exclude from our calculation of water loss, divided by (ii) the total volume of water produced. For more information, see “Item 4.B. Business Overview—Description of Our Activities—Water Operations—Water Loss”. We exclude the following from our calculation of water loss: (i) water discharged for periodic maintenance of water transmission lines and water storage tanks; (ii) water supplied for municipal uses such as firefighting; (iii) water we consume in our facilities; and (iv) estimated water loss related to the supply of water to shantytowns (*favelas*).

(5) Measured in liters/connection per day, this amount is calculated by dividing (i) the average annual water loss by (ii) the average number of active water connections multiplied by the number of days of the year. This calculation method is based on worldwide market practice within the sector. See “Item 4.B. Business Overview—Description of Our Activities—Water Operations—Water Loss”. We exclude the following from our calculation of water loss: (i) water discharged for periodic maintenance of water transmission lines and water storage tanks; (ii) water supplied for municipal uses such as firefighting; (iii) water we consume in our facilities; and (iv) estimated water loss related to the supply of water to shantytowns (*favelas*).

(6) In 2015, this figure included 370 employees who retired due to disability. This number was excluded from the 2016 and 2017 figures.

### Exchange Rates

In the past, the Brazilian National Monetary Council (*Conselho Monetário Nacional*), or the “CMN”, has introduced changes to the Brazilian foreign exchange regime, such as unifying the Commercial and Floating Markets and easing the rules governing the ability of Brazilian residents to acquire foreign currency, among others. On March 24, 2010, the CMN and the Central Bank approved Resolution No. 3,844/2010, as amended, which led to a series of measures to consolidate and simplify Brazilian foreign exchange market regulations.

The Brazilian foreign exchange system allows any person or legal entity to purchase or sell foreign currency and make international transfers of *reais*, regardless of the amount, subject to certain regulatory procedures.

The Brazilian currency has experienced frequent and substantial variations in relation to the U.S. dollar and other foreign currencies in recent decades. Between 2003 and mid 2008, the *real* appreciated significantly against the U.S. dollar with the exchange rate reaching R\$1.634 in August 2008, although it depreciated by 32.0% against the U.S. dollar during full year 2008, closing the year at R\$2.337 per US\$1.00. The *real* strengthened again by 25.5% in 2009 and 4.3% in 2010, but depreciated against the U.S. dollar by 12.6% in 2011, 8.94% in 2012, 14.63% in 2013, 13.39% in 2014 and 47.01% in 2015, falling to R\$3.9048 against the U.S. dollar at December 31, 2015. The *real* fell further during the first months of 2016, reaching a low of R\$4.1558 against the U.S. dollar on January 21, 2016, but then regained some value, reaching R\$3.2591 per US\$1.00 at December 31, 2016. During 2017, the *real* remained relatively stable, depreciating only 1.5% against the U.S. dollar by year-end.

Since 1999, following Brazil’s implementation of a floating rate regime, the Central Bank has not directly intervened in the exchange market. However, the Central Bank, using financial instruments at its disposal, may buy and sell foreign currency in the market in order to influence the exchange rate and decrease volatility with respect to the Brazilian *real*, and did so at various points during 2017. We cannot predict whether the Central Bank or the Brazilian government will continue to let the *real* float freely or will intervene in the exchange rate through a currency band system or other procedure. The *real* may fluctuate against the U.S. dollar substantially in the future. For further information on this risk, see “Item 3.D. Risk Factors—Risks Relating to Brazil— The devaluation of the *real* to foreign currencies may adversely affect us and the market price of our common shares or ADSs”.

Exchange rate fluctuations will affect the U.S. dollar equivalent of the *real* price of our common shares on the São Paulo Stock Exchange (*B3 S.A. – Brasil, Bolsa, Balcão*, or *B3*, formerly *BM&FBOVESPA S.A. Bolsa de Valores, Mercadorias e Futuros*, or *BM&FBOVESPA*), as well as the U.S. dollar equivalent of any distributions we make in *reais* with respect to our common shares.

The following tables set forth the selling rate, expressed in *reais* per U.S. dollar (R\$/US\$), for the periods indicated:

<b>Year ended December 31,</b>	<b>Year end</b>	<b>R\$ per US\$1.00</b>		
		<b>Average<sup>(1)</sup></b>	<b>Low</b>	<b>High</b>
2013	2.3426	2.1605	2.4457	1.9528
2014	2.6562	2.3547	2.7403	2.1974
2015	3.9048	3.3387	4.1949	2.5754
2016	3.2591	3.4833	4.1558	3.1193
2017	3.3080	3.2031	3.0510	3.3807

<b>Month ended</b>	<b>Period end</b>	<b>R\$ per US\$1.00</b>		
		<b>Average</b>	<b>Low</b>	<b>High</b>
October 31, 2017	3.2769	3.1912	3.1315	3.2801
November 30, 2017	3.2616	3.2594	3.2136	3.2920
December 31, 2017	3.3080	3.2919	3.2322	3.3332
January 31, 2018	3.1624	3.2106	3.1391	3.2697
February 28, 2018	3.2449	3.2415	3.1730	3.2821
March 31, 2018	3.3238	3.2792	3.2246	3.3380
April 30, 2018	3.4811	3.4075	3.3104	3.5040
May 31, 2018 (through May 24)	3.6436	3.6190	3.5308	3.7503

Source: Central Bank

(1) Average of the exchange rates on the last day of each month.

The following tables set forth the selling rate, expressed in *reais* per Japanese Yen (R\$/¥1.00):

Year ended December 31,	Year end	R\$ per ¥1.00		
		Average <sup>(1)</sup>	Low	High
2013	0.0223	0.0221	0.0248	0.0196
2014	0.0222	0.0222	0.0239	0.0212
2015	0.0324	0.0276	0.0351	0.0219
2016	0.0279	0.0289	0.0305	0.0278
2017	0.0294	0.0291	0.0287	0.0296

Month ended	Period end	R\$ per ¥1.00		
		Average	Low	High
October 31, 2017	0.0291	0.0289	0.0286	0.0292
November 30, 2017	0.0289	0.0289	0.0286	0.0289
December 31, 2017	0.0294	0.0291	0.0287	0.0296
January 31, 2018	0.0290	0.0290	0.0286	0.0293
February 28, 2018	0.0304	0.0300	0.0290	0.0305
March 31, 2018	0.0313	0.0309	0.0304	0.0315
April 30, 2018	0.0319	0.0317	0.0309	0.0321
May 31, 2018 (through May 24)	0.0333	0.0329	0.0322	0.0339

Source: Central Bank

(1) Average of the exchange rates on the last day of each period.

## B. Capitalization and Indebtedness

Not applicable.

## C. Reasons for the Offer and Use of Proceeds

Not applicable.

## D. Risk Factors

### Risks Relating to Brazil

*The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. This influence, as well as Brazilian political and economic conditions, could adversely affect us and the market price of our common shares and ADSs.*

The Brazilian government frequently intervenes in the Brazilian economy and occasionally makes significant changes in policy and regulations. The Brazilian government's actions to control inflation and other policies and regulations have often involved, among other measures, changes in interest rates, tax policies, price and tariff controls, currency devaluation or appreciation, capital controls and limits on imports. Our business, financial condition and results of operations, as well as the market price of our common shares or ADSs, may be adversely affected by changes in

public policy at federal, state and municipal levels with respect to public tariffs and exchange controls, as well as other factors, such as:

- the regulatory environment related to our business operations and concession agreements;
- interest rates;
- exchange rates and exchange controls and restrictions on remittances abroad;
- currency fluctuations;
- inflation;
- liquidity of the Brazilian capital and lending markets;
- tax and regulatory policies and laws;
- economic and social instability; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

For example, the Brazilian government may change its tax policy, such as by changing tax rates or imposing temporary taxes. If overall taxes are increased, we may be unable to immediately recover the difference from our consumers, which may have an adverse effect on our financial condition and results of operations.

Uncertainty over whether the Brazilian government will change policies or regulations affecting these or other factors may contribute to economic uncertainty in Brazil and to heightened volatility in Brazilian securities markets and securities issued abroad by Brazilian issuers. Brazil was downgraded below investment grade by Standard & Poor's Global Ratings, or S&P, on September 9, 2015, and received a further downgrade by the same rating agency on February 17, 2016. In addition, Brazil was downgraded below investment grade by Fitch Ratings Inc., or Fitch, on December 16, 2015 and received a further downgrade by the same agency on May 5, 2016. Moody's Investors Service, Inc., or Moody's, also downgraded Brazil below investment grade on February 24, 2016. During the first months of 2018, Brazil received additional downgrades by S&P on January 11, 2018 and Fitch on February 23, 2018. Following the impeachment of former President Dilma Rousseff, the Vice-President Michel Temer formally took office on August 31, 2016, announcing a series of economic reforms. We cannot assure you that the Brazilian government will continue with its current economic policies, or that these and other developments in Brazil's economy and government policies will not, directly or indirectly, adversely affect our business and results of operations.

***Political conditions may have an adverse impact on the Brazilian economy and on our business.***

Brazil's political environment has historically influenced, and continues to influence, the performance of the country's economy. Political crises have affected and continue to affect the confidence of investors and the general public, which have historically resulted in economic deceleration and heightened volatility in the securities issued by Brazilian companies.

The recent economic instability in Brazil has contributed to a decline in market confidence in the Brazilian economy as well as to a deteriorating political environment. Various ongoing investigations into allegations of money laundering and corruption being conducted by the Office of the Brazilian Federal Prosecutor, including the largest such investigation, known as "*Operação Lava Jato*", have negatively impacted the Brazilian economy and political environment. Members of the Brazilian federal government and of the legislative branch as well as senior officers of large state-owned and private companies have faced or are currently facing allegations of corruption and money laundering as a result of these investigations. These individuals are alleged to have accepted bribes by means of kickbacks on contracts granted by the government to several infrastructure, oil and gas and construction companies. Certain of these companies have faced or are currently facing investigations by the Brazilian Securities Commission (*Comissão de Valores Mobiliários*), or CVM, and the U.S. Securities and Exchange Commission, or the SEC. The profits of these kickbacks allegedly financed the political campaigns of political parties forming the government's coalition, which funds were unaccounted for or not publicly disclosed. These funds were also allegedly destined toward the personal enrichment of certain individuals. A number of senior politicians, including members of Congress, former President Luiz Inácio Lula da Silva, and high-ranking executives officers of major state-owned and private companies in Brazil have been arrested, convicted of various charges relating to corruption, entered into plea agreements with federal prosecutors and/or have resigned or been removed from their positions. The potential outcome of *Operação Lava Jato* as well as other ongoing corruption-related investigations is uncertain, but they have already hurt the image and reputation of those companies that have been implicated as well as the general market perception of the Brazilian economy, political environment and the Brazilian capital markets. We have no control over, and cannot predict, whether such investigations or allegations will lead to further political and economic instability or whether new allegations against government officials will arise in the future.

President Dilma Rousseff was suspended from office on May 12, 2016, when the Brazilian Senate voted to hold a trial on impeachment charges against her. President Rousseff was replaced by Vice-President Michel Temer, who served as acting President until Ms. Rousseff was permanently removed from office by the Senate on August 31, 2016 for



infringing budgetary laws. Michel Temer then became President for the remainder of the presidential term, which is due to end in December 2018. In June 2017, the Brazilian Higher Electoral Court (*Tribunal Superior Eleitoral*, or TSE) cleared the electoral alliance formed by Ms. Rousseff and Mr. Temer of charges that it had violated campaign finance laws in the 2014 election. President Temer remains the subject of investigations by the Brazilian Federal Police and the Office of the Brazilian Federal Prosecutor relating to allegations of corruption, however, and may ultimately be subject to impeachment proceedings before his presidential term ends. We cannot predict how the ongoing investigations and proceedings will affect us or the market price of our common shares or ADSs. Furthermore, uncertainty over whether the acting Brazilian government will implement changes in policy or regulation in the future may contribute to economic uncertainty in Brazil and to heightened volatility in the securities issued abroad by Brazilian companies.

Presidential elections are to be held in Brazil in October 2018. We cannot predict the outcome of those elections, including whether any successor to the current President of Brazil will adopt policies or changes to current policies, which may have a material adverse effect on us. Furthermore, the political uncertainty resulting from the presidential elections may have an adverse effect on our business, results of operations and financial condition.

In addition, political demonstrations in Brazil over the last few years have affected the development of the Brazilian economy and investors' perceptions of Brazil. For example, street protests, which started in mid-2013 and continued through 2016, demonstrated the public's dissatisfaction with the worsening Brazilian economic condition (including an increase in inflation and fuel prices as well as rising unemployment), the perception of widespread corruption.

Any of the above factors may create additional political uncertainty, which could harm the Brazilian economy and, consequently, our business, financial condition, results of operations and the price of our ADSs.

***Inflation and the Brazilian government's measures to combat inflation may contribute to economic uncertainty in Brazil, adversely affecting us and the market price of our common shares or ADSs.***

Inflation and the Brazilian government's measures to combat it have had and may in the future have significant effects on the Brazilian economy and our business. Tight monetary policies with high interest rates may restrict Brazil's growth, the availability of credit and our cost of funding. Conversely, other Brazilian governmental actions, including lowering interest rates, intervention in the foreign exchange market and actions to adjust or fix the value of the *real*, may trigger increases in inflation. The Special Clearing and Settlement System (*Sistema Especial de Liquidação e Custódia*), or SELIC, the official overnight interest rate in Brazil, equaled 6.90%, 13.65%, and 14.15% at the end of 2017, 2016 and 2015, respectively, in line with the target rate set by the Brazilian Committee on Monetary Policy (*Comitê de Política Monetária*).

The Brazilian annual inflation rates, as measured by the Amplified Consumer Price Index (*Índice Nacional de Preços ao Consumidor Amplo*), or IPCA, were 2.95%, 6.29%, and 10.67% during 2017, 2016 and 2015, respectively. If Brazil experiences increases in inflation, our costs and expenses may rise, we may be unable to increase our tariffs at the same rate to counter the effects of inflation, and our overall financial performance may be adversely affected. In addition, a substantial increase in inflation may weaken investors' confidence in Brazil, causing a decrease in the market price of our common shares or ADSs.

***The devaluation of the real to foreign currencies may adversely affect us and the market price of our common shares or ADSs.***

The Brazilian currency experienced frequent and substantial devaluations in relation to the U.S. dollar and other foreign currencies during the decades leading up to the mid-1990s. Throughout this period, the Brazilian government implemented various economic plans and exchange rate policies, including sudden devaluations, periodic mini devaluations (during which the frequency of adjustments ranged from daily to monthly), floating exchange rate systems, exchange controls and dual exchange rate markets. From time to time since that period, there have continued to be significant fluctuations in the exchange rate between the Brazilian *real* and the U.S. dollar and other currencies. For example, the *real* appreciated 13.8%, 9.5% and 20.7% against the U.S. dollar in 2005, 2006 and 2007, respectively, reaching R\$1.634 in August 2008, although it depreciated by 32.0% against the U.S. dollar during full year 2008, closing the year at R\$2.337 per US\$1.00. The *real* strengthened again by 25.5% in 2009 and 4.3% in 2010, but depreciated against the U.S. dollar by 12.6% in 2011, 8.94% in 2012, 14.63% in 2013, 13.39% in 2014 and 47.01% in 2015, falling to R\$3.9048 against the U.S. dollar at December 31, 2015. The *real* fell further during the first months of 2016, reaching a low of R\$4.1558 against the U.S. dollar on January 21 2016, but then regained some value, reaching R\$3.2591 per US\$1.00 at December 31, 2016. During 2017, the *real* remained relatively stable, depreciating only 1.5% against the U.S. dollar by year-end. There can be no assurance that the *real* will not depreciate

further against the U.S. dollar. As of May 24, 2018, the commercial selling rate as reported by the Central Bank was R\$3.6436 per US\$1.00.

Depreciation of the *real* against the U.S. dollar could create inflationary pressures in Brazil and cause increases in interest rates, which could negatively affect the growth of the Brazilian economy as a whole and harm our financial condition and results of operations, curtail our access to financial markets and prompt government intervention, including recessionary governmental policies. Depreciation of the *real* against the U.S. dollar could also lead to decreased consumer spending, deflationary pressures and reduced economic growth.

In the event of a significant devaluation of the *real* in relation to the U.S. dollar or other currencies, our ability to meet our foreign currency denominated obligations could be adversely affected because our tariff revenue and other sources of income are denominated solely in *reais*. In addition, because we have debt denominated in foreign currencies, any significant devaluation of the *real* will increase our financial expenses as a result of foreign exchange losses that we must record. We had total foreign currency denominated debt of R\$5,672.8 million as of December 31, 2017 and we anticipate that we may incur additional amounts of foreign currency denominated debt in the future. In 2017, our results of operations were negatively affected by the 1.50% depreciation of the *real* against the U.S. dollar, and the depreciation of the *real* against the yen by 5.38%, which together led to a R\$96.3 million negative impact on our foreign exchange result, net. We do not currently have any derivative instruments in place to protect us against a devaluation of the *real* in relation to any foreign currency. A devaluation of the *real* may adversely affect us and the market price of our common shares or ADSs. For more information, see Note 5(a) to our 2017 financial statements.

For further information on exchange rate instability impacts, see “Item 5.B. Liquidity and Capital Resources—Indebtedness Financing—Financial Covenants”.

***Developments and the perception of risk in other countries, especially in the United States and in emerging market countries, may adversely affect the market price of Brazilian securities, including our common shares and ADSs.***

The market price of securities of Brazilian companies is affected to varying degrees by economic and market conditions in other countries, including the United States and other Latin American and emerging market countries. Although economic conditions in these countries may differ significantly from economic conditions in Brazil, investors’ reactions to developments in these other countries may have an adverse effect on the market price of securities of Brazilian issuers. Crises in other emerging market countries or economic policies of other countries may diminish investor interest in securities of Brazilian issuers, including ours. This could adversely affect the market price of our common shares or ADSs, and could also make it more difficult for us to access the capital markets and finance our operations in the future, on acceptable terms or at all.

Global financial crises have caused, and in the future may again cause, significant consequences, including in Brazil, such as stock and credit market volatility, unavailability of credit, higher interest rates, a general slowdown of the world economy, volatile exchange rates, and inflationary pressure, among others, which may, directly or indirectly, materially and adversely affect us and the price of securities issued by Brazilian companies, including our common shares and ADSs.

### **Risks Relating to Our Control by the State of São Paulo**

***We are controlled by the State of São Paulo, whose interests may differ from the interests of non-controlling shareholders, including holders of ADSs.***

As it owns the majority of our common shares, the State is able to determine our operating policies and strategy, control the election of a majority of the members of our board of directors and appoint our senior management. As of May 24, 2018, the State owned 50.3% of our outstanding common shares. Both through its control of our board of directors as well as by enacting State decrees, the State has in the past directed our company to engage in business activities and make expenditures that promoted political, economic or social goals, but that did not necessarily enhance our business and results of operations. The State may direct our company to act in this manner again in the future. These decisions by the State may not be in the interests of our non-controlling shareholders, including holders of ADSs. See “Item 5.A. Operating and Financial Review and Prospects—Certain Transactions with Controlling Shareholder”.

In January 2015, following the elections for State governor in 2014, the re-elected governor, Mr. Geraldo Alckmin, appointed Mr. Jerson Kelman as our Chief Executive Officer, and Mr. Benedito Pinto Ferreira Braga Junior, the Secretary of State for the State Secretariat for Sanitation and Water Resources (Secretaria de Saneamento e Recursos Hídricos do Estado de São Paulo), as Chairman of our board of directors. In April 2018, Mr. Geraldo Alckmin stepped down from his position as governor in order to run in the presidential elections, and Mr. Marcio França, who was previously the vice-governor of the State, became governor. With our directors' terms expiring in April 2018, and considering that Federal Law No. 13,303/16 prohibits the appointment of secretaries of state to administrative positions of state-controlled companies, Mr. Mario Engler was appointed by the State as Chairman of our board of directors with a term of two years. In May 2018, Mr. Marcio França appointed Mrs. Karla Bertocco Trindade as our Chief Executive Officer with a term expiring in June 2019. Additionally, pursuant to our bylaws, Mrs. Karla Bertocco Trindade will also be a member of our board of directors while holding the position of Chief Executive Officer. Following future elections for State governor, we cannot be sure whether any future State governor will make changes to our executive board. Changes in policy by State government may cause changes in all or some of the members of our management, which may have a material adverse effect on our business and results of operations.

In September 2017, the State of São Paulo obtained approval for State Law No. 16,525/2017, which authorizes the State of São Paulo to set up a controlling company to hold all of the shares that the State of São Paulo holds in our company. Once formed, this controlling company will control our company, pursuant to the provisions of Art. 116 of Law No. 6,404 of December 15, 1976, as amended, or the Brazilian Corporate Law. State Law No. 16,525/2017 allows other minority shareholders, including private companies and state companies, to hold shares of the controlling company, provided that the State of São Paulo holds the majority of the common shares of the controlling company. If and once formed, this controlling company may affect future shareholding in and the control of our company. On March 9, 2018, the State of São Paulo received a letter from a group of investors expressing interest in acquiring shares of the controlling company. This letter is being assessed by the State Privatization Program's Board (*Conselho Diretor do Programa Estadual de Desestatização - CDPED*), which has authority over our corporate reorganization plan, including the formation of the controlling company. The transaction proposed in the letter relates only to shares of the controlling company level and therefore would not affect the corporate control of our company, which will remain held by the State of São Paulo. The identity of the investors and the content of the letter remain confidential in accordance with the rules applicable to the administrative procedure established by CDPED for the purposes of operation.

***The State and some State entities owe us substantial unpaid debts. We cannot assure you as to when or whether the State will pay us.***

Historically, the State and some State entities have delayed payment of substantial amounts owed to us related to water and sewage services. As of December 31, 2017, the State owed us R\$106.0 million for water and sewage services. Additionally, the State also owes us substantial amounts related to reimbursements of State mandated special retirement and pension payments that we make to some of our former employees for which the State is required to reimburse us.

With respect to payment of pensions on behalf of the State, we had a contested credit amount of R\$1,021.7 million as of December 31, 2017. We do not record this contested amount as a reimbursement credit for actuarial liability due to the uncertainty of payment by the State. In addition, as of December 31, 2017, we had a provision for an actuarial liability in the amount of R\$2,543.9 million with respect to future supplemental pension payments for which the State does not accept responsibility. On March 18, 2015, we, the State and the São Paulo State Department of Water and Energy (*Departamento de Águas e Energia Elétrica do Estado de São Paulo*), or “DAEE”, with the intervention of the Department of Sanitation and Water Resources, executed an agreement providing for payment of R\$1,012.3 million, of which R\$696.3 million refers to principal and R\$316.0 million refers to monetary adjustment of the principal through February 2015. For a detailed discussion of this agreement, see “Item 7.B. Related Party Transactions—Agreements with the State” and Note 10 of our 2017 financial statements.

We have entered into agreements with the State to settle the overdue amounts that relate to water and sewage services. For a detailed discussion of these agreements, see “Item 7.B. Related Party Transactions—Agreements with the State” and Note 10 of our 2017 financial statements.

Although the State has complied with agreements negotiated with us in past years, we cannot assure you when or if the State will pay the contested credit amount, which is still under discussion, and the remaining overdue amounts it owes us. The amounts owed to us by the State for water and sewage services and reimbursements for pensions paid may increase in the future.

In addition, certain municipalities and other government entities also owe us payments. See “—Risks Relating to Our Business—We may face difficulties in collecting overdue amounts owed to us by municipalities to which we provide water on a wholesale basis and municipal government entities”.

***Our right to draw water from the Guarapiranga and Billings reservoirs may be challenged if another company that uses the reservoirs does not approve a settlement agreement with us.***

We draw water for use in the São Paulo metropolitan area from the Guarapiranga and Billings reservoirs. Empresa Metropolitana de Águas e Energia S.A., or EMAE, a company that is also controlled by the State of São Paulo, has a concession to produce hydroelectric energy using water from the same reservoirs. EMAE commenced various lawsuits against us in the past seeking compensation for the water we draw from these reservoirs. Those lawsuits have now been settled by way of an agreement between EMAE and our company (which is summarized under “Item 7. Major Shareholders and Related Party Transactions”).

On April 11, 2016, we were also named in a separate lawsuit commenced by minority shareholders of EMAE against the State of São Paulo, as controlling shareholder of EMAE. The minority shareholders are seeking an order to require the State to stop us from drawing water from the reservoirs without paying compensation to EMAE, and to allow EMAE to pump water from the reservoirs for its hydroelectric facility. The plaintiffs allege that the State, in its capacity as controlling shareholder of EMAE, has acted unduly to EMAE’s detriment and in favor of our company. The settlement agreement between EMAE and us will not necessarily put an end to this separate lawsuit.



In addition, on August 7, 2017 we were named in a new lawsuit against us, EMAE and the National Electric Energy Agency (*Agência Nacional de Energia Elétrica*, or ANEEL), brought by Alvaro Luiz de Lima de Alvares Otero, another minority shareholder of EMAE, requesting the annulment of ANEEL's order approving the settlement agreement mentioned above, as well as the condemnation of SABESP for indemnifying EMAE for damages suffered by EMAE. The plaintiff alleges that the order is illegal and harmful, jeopardizing the operational viability of the Henry Borden hydroelectric power plant, as well as the energy security of the State of São Paulo, the Southeast region of Brazil and Brazil as a whole. The judge dismissed this lawsuit without judgment on the merits, but this decision remains subject to appeal.

If one of the ongoing lawsuits by minority shareholders of EMAE requires the State to make a different decision regarding water use, our ability to draw water from the Guarapiranga and Billings reservoirs may be compromised. If we were no longer able to draw water from these reservoirs, we would have to transport water from locations farther away, which would increase our water transportation costs and may affect our ability to provide adequate service in the region, which may have an adverse effect on our financial condition and results of operations.

### **Risks Relating to Our Business**

*The measures we took to mitigate the effects of the drought that occurred in 2014 and 2015 resulted in a significant decrease in the volume of water billed and revenues from services we provide and, despite the discontinuation in May 2016 of the measures that were used to face the drought, new consumption habits were incorporated and the volume of water billed continues to be impacted by those measures.*

We experience decreases in our water availability from time to time due to droughts. The southeastern region of Brazil, particularly the southern region of Minas Gerais State and the Piracicaba, Capivari and Jundiá river basin, or "PCJ River Basin" (from which we extract most of the water used in the Cantareira System), and the northern area of the São Paulo metropolitan region experienced below average rainfall from 2012 to October 2015. In the October 2013 – March 2014 rainy season, rain levels and water inflow into the reservoirs reached the lowest stream flow measurements in over 80 years, a scenario that continued in the October 2014 – March 2015 rainy season. During the October 2015 – March 2016 and during the October 2016 – March 2017 rainy seasons, the level of rainfall in the region returned to the normal levels expected for the period. Improved rainfall during the rainy season of October 2015 – March 2016 and of October 2016 – March 2017, the collaborative efforts between us and the population we serve and emergency construction conducted by us since 2014 in order to reduce the impact of the water crisis, resulted in a restoration of the water levels of the Cantareira system.

The worst depletion of water storage occurred in the Cantareira System, the largest system of the São Paulo metropolitan region. As a result of the drought and low water volume in the Cantareira System, DAEE and the National Water Agency (*Agência Nacional de Águas*, or ANA), continuously regulated the volume of water we were permitted to extract from this system between March 2014 and May 2017. The DAEE and ANA determined this amount based on levels of rainfall, water inflow, level of water in our reservoirs and the solicitations we made to extract water based on this information, and informed us of the amount we were permitted to extract through periodical notices. In February 2016, as a result of the return of average rainfall levels to the region, we received authorization to extract 23 cubic meters per second, or m<sup>3</sup>/s, from the Cantareira System, an increase compared to the 13.5 m<sup>3</sup>/s we were authorized to extract for the majority of 2015, still significantly below the water volume we were allowed to extract in the period prior to February 2014, when we were allowed to extract up to a total of 33 m<sup>3</sup>/s. From September to November 2016 we received authorization to extract 25 m<sup>3</sup>/s, and from December 2016 to May 2017, we received authorization to extract 31 m<sup>3</sup>/s. In May 2017, the water grant that regulates the volume of water that may be extracted from the Cantareira System was renewed, based on the volume of water available in the reservoirs. In order to balance supply and demand despite the restricted water availability, we adopted a series of measures from 2014 to April 2016, including: (i) using treated water from other production systems to serve



consumers originally supplied by the Cantareira system; (ii) offering discounts (bonus) to consumers that would use below average amounts of water, compared to average consumption; (iii) reducing pressure in the water distribution lines in order to decrease leakage; (iv) adjusting the volume of treated water sold to municipalities that operate their own distribution network; and (v) using pumps in order to extract water located below the intakes of the Cantareira system, from the so-called “technical reserve”, which had never before been used to serve the population. See “Item 4.B. Business Overview—The Recent Water Crisis”.

With the return of the rainfall to its historical average for the rainy season that began in October 2015 and ended in March 2016, the volume of water available to the population of the São Paulo metropolitan region returned to a normal level and the measures taken during the water crisis to continue to service consumers were gradually discontinued. However, heightened public awareness of the need to conserve water during the crisis resulted in our customers adopting lower water consumption practices during the water crisis and these practices were partially integrated in our consumers' daily habits. As a result of this new behavior, despite us having a higher volume of water available for treatment, the volume of water billed to our clients did not return to the volume of water billed before the water crisis, in 2013. The average monthly water production in 2017 for the São Paulo metropolitan region was 60.6 cubic meters per second, or m<sup>3</sup>/s, compared to 58.5 m<sup>3</sup>/s in 2016, 52.0 m<sup>3</sup>/s in 2015, 62.2 m<sup>3</sup>/s in 2014 and 69.1 m<sup>3</sup>/s in 2013, the year before the water crisis started. The largest recovery of consumption occurred in the residential category. The industrial category showed slower growth due to the Brazilian economy and the investments made by this sector during the water crisis, such as the reuse of water, the use of rainwater and alternative sources of supply.

At the end of March 2018, the total volume of water stored in the reservoirs that supply the metropolitan region of São Paulo was 1,162.8 billion m<sup>3</sup> compared to 1,223.9 billion m<sup>3</sup> at the end of March 2017 and 1,178.8 billion m<sup>3</sup> at the end of March 2016. In addition, the Cantareira system's maximum storage capacity, including the technical reserve of 287.5 million m<sup>3</sup>, is 1,269.5 billion m<sup>3</sup>. Excluding the technical reserve, which is 287.5 million m<sup>3</sup>, the Cantareira's maximum storage capacity is 982.0 million m<sup>3</sup>. The volume of water in the Cantareira system recovered throughout the October 2015 – March 2016 rainy season and was 641.9 million m<sup>3</sup> as of March 2016, which represents 50.6% of its maximum storage capacity, including the technical reserve of 287.5 million m<sup>3</sup>. The volume of water in the Cantareira system was 932 million m<sup>3</sup> as of March 31, 2017, which represents 73.4% of its maximum storage capacity, including the technical reserve of 287.5 million m<sup>3</sup>. The volume of water in the Cantareira system was 532.3 million m<sup>3</sup> (not including the technical reserve of 287.5 million m<sup>3</sup>) as of March 31, 2018, as the rain levels and water inflows into the reservoirs that supply the metropolitan region of São Paulo during the October 2017-March 2018 rainy season were below the historical average. In December 2017, 7.8 million inhabitants were serviced by this system, compared to 7.6 million and 5.4 million in December 2016 and December 2015, respectively. For more information about the water crisis, see "Item 4.B. Business Overview—The Recent Water Crisis".

The drought prompted a reduction in the volume of water billed, impacting our revenue especially in 2014 and 2015. In 2014, the water volume billed decreased 3.1% and the gross operational revenue fell by 6.7% compared to 2013. In 2015, the water volume billed decreased 8.0% and our gross operational revenue increased slightly by 0.5% compared to 2014. In 2016, the volume of water billed increased 4%, and the gross operational revenue increased by 24.3% compared to 2015. In 2017, the volume of water billed increased 4.3% and the gross operational revenue increased by 9.9% compared to 2016.

We cannot assure you that our consumers will revert to their pre-crisis consumption habits or, if at all, when this will occur nor that this will not adversely affect our financial condition in the future. See "Item 5.B. Liquidity and Indebtedness Financing—Financial Covenants".

***We are exposed to risks associated with the provision of water and sewage services.***

Our industry is affected by the following risks relating to the provision of water and sewage services:

- We depend on a water right issued by ANA and the São Paulo State Department of Water and Energy (*Departamento de Águas e Energia Elétrica do Estado de São Paulo*, or DAEE), in order to extract water from the Cantareira System. In May 2017, the concession that regulates the volume of water that may be extracted from the Cantareira System, the main water system we use to serve the São Paulo metropolitan region, based on the volume of water available in the reservoirs was renewed. Under the new terms, the water we are permitted to draw from the

system is divided into five tranches: (i) if the volume of water available is higher than 60% of the reservoirs' capacity, we can draw up to 33m<sup>3</sup>/s; (ii) if the volume of water is between 40% and 60% of the reservoirs' capacity, we can draw up to 31m<sup>3</sup>/s; (iii) if the volume of water is between 30% and 40% of the reservoirs' capacity, we can draw up to 27m<sup>3</sup>/s; (iv) if the volume of water is between 20% and 30% of the reservoirs' capacity, we can draw up to 23m<sup>3</sup>/s; and (v) if the volume of water available is lower than 20% of the reservoirs' capacity, we can draw up to 15.5m<sup>3</sup>/s.

- We are dependent upon energy supplies to conduct our business. Any shortages or rationing of energy may prevent us from providing water and sewage services and may also cause material damage to our water and sewage systems when we resume operations. The Electric Sector Monitoring Committee (*Comitê de Monitoramento do Setor Elétrico – CMSE*), has guaranteed the supply of electrical energy to the National Interconnection System (*Sistema Interligado Nacional – SIN*) in 2018. Thus, there is no forecast of any shortages or rationing of energy in 2018. See “Item 4.B. Business Overview—Energy Consumption”.

- We are exposed to various weather-related risks, since our financial performance is closely linked to climate patterns. The possible increase in the frequency of extreme weather conditions in the future may adversely affect the water available for abstraction, treatment, and supply. Droughts could adversely affect the water supply systems, resulting in a decrease in the volume of water distributed and billed as well as in the revenue derived from water supply services. An increase in heavy rainfall could impact the regular operation of water sources, including abstraction of water from our reservoirs due to increased soil erosion, silting, and runoff of pollutants that affect the aquatic ecosystems. See “Item 4.B. Business Overview—Environmental Matters—Climate Change Regulations: Reduction of Greenhouse Gases (GHG) Emissions”.
- The increasing degradation of watershed areas (*Mananciais*) may affect the quantity and quality of water available to meet demand from our customers. See “Item 4.A. History and Development of the Company—Capital Expenditure Program” and “Item 4.A. History and Development of the Company—Main Projects of Our Capital Expenditure Program”.
- In addition to the risks discussed under “—The terms of our agreement to provide water and sewage services in the city of São Paulo could have a material adverse effect on us,” we may not be able to increase our tariffs on a timely basis, or at all, in order to pass on increases in inflation or operating expenses, including taxes, to our customers. These constraints may have an adverse effect on our ability to fund our capital expenditure program and financing activities and to meet our debt service requirements. See “Item 4.B. Business Overview—Tariffs—Second Ordinary Tariff Revision (2017-2020)” and “Item 5.A. Operating and Financial Review and Prospects—Factors Affecting Our Results of Operations—Effects of Tariff Increases”.
- The state and federal government agencies that manage water resources could impose substantial charges for the abstraction of water from bodies of water and the discharge of sewage. We may not be able to pass these charges on to our customers. See “Item 4.B. Business Overview—Environmental Matters—Water Usage”.
- Our water and sewage pipes are susceptible to degradation caused by factors such as age, intense traffic, population density and commercial and industrial development, which may provoke accidents in the networks and affect the regular provision of our services, impacting society and the environment. See “Item 4.B. Business Overview—Description of Our Activities—Water Operations—Water Distribution” and “Item 4.B. Business Overview—Description of Our Activities—Sewage Operations—Sewage System”.

Any of the above may have a material adverse effect on us.

***Current regulatory uncertainty, especially with regard to implementation and interpretation of the Brazilian Basic Sanitation Law, may have an adverse effect on our business.***

Our operations in the state of São Paulo occur both in locations where the planning, monitoring and tariff regulation of basic sanitation services are responsibilities of the municipalities and in locations where such responsibilities are shared between the State and municipalities. The Basic Sanitation Law No. 11,445/2007 went into effect in early 2007, and although Federal Decree No. 7,217/2010 (as modified by Federal Decree No. 8,211/2014, No. 8,629/2015 and No. 9,254/2017) implemented a series of new principles under the Basic Sanitation Law in 2010, the full implementation of a number of its provisions remains subject to regulations that the federal government has not yet published.

Law 13,329/16 instituted a “Special Incentive Regime for the Development of Basic Sanitation” (*Regime Especial de Incentivos para o Desenvolvimento do Saneamento Básico – REISB*), seeking to incentivize companies that provide public basic sanitation services to invest more through tax credits, starting in 2018 and running until 2026. In 2016, Law 13,312/2016 amended Law No. 11,445/2007 and now includes the obligation to adopt environmental criteria that include, among other measures, individual metering of water consumption per habitation unit. However, since this change is still being implemented and shall only come into effect in 2021, we are not currently able to predict its impact on our business.

The Basic Sanitation Law still requires that the federal government, states and municipalities establish independent regulators who monitor basic sanitation services and regulate tariffs. In compliance with this law, the state of São Paulo established ARSESP in 2007. Currently, our regional and local operations, including tariff regulation, are monitored and regulated by ARSESP, and the remainder of our operations is in the process of negotiating new contractual bases. Regulatory agencies determine tariff increases for our water and sewage services, on which our results of operations and financial condition are highly dependent. As a result, we cannot anticipate all the effects that the Basic Sanitation Law and the decree will have on our business and operations, if any.

In 2009, ARSESP enacted rules regarding the following: (i) general terms and conditions for water and sewage services; (ii) procedures for communication regarding any failure in our services; (iii) penalties for deficiencies in the provision of basic sanitation services; and (iv) procedures for confidential treatment of our customers' private information. The implementation of these and other more recent rules will particularly impact our commercial and operations processes, and may adversely affect us in ways we cannot currently predict. Implementation of these rules started in 2011 and is expected to continue for the next few years. For more information, see "Item 4.B. Business Overview—Government Regulations Applicable to Our Contracts—Rules Enacted by ARSESP".

In 2011, ARSESP altered the standard contract that we are required to use in our relationships with retail customers. This alteration requires that invoices be sent to the user of the service rather than the owner of the property. Since 2011, we have implemented several measures and instituted new rules for the update of our clients registry. Currently, more than 90% of our water and sewage connections are billed to the user of our services, as foreseen under current regulations. Related to the collection of debt, we are also faced with the challenge of collecting customers' taxpayer identification numbers, which are required to register for our services and are needed for the judicial collection of outstanding fees in the event of nonpayment. We continuously update our customers' registration information, but we face difficulties in updating this information in areas with high concentrations of social vulnerability and noncompliance.

In August 2012, ARSESP issued Resolution No. 346/2012, which established that users should be compensated for any interruptions in water supply. Implementation of this regulation has been suspended pending further technical discussions. In 2013, ARSESP held public consultations that resumed technical discussions on the subject, but the new resolution that will replace Resolution No. 346/2012 has not yet been published.

The Basic Sanitation Law No. 11,445/2007 also allows municipalities to create their own regulatory agencies rather than being regulated by ARSESP. As a result, a number of municipalities have created their own regulatory agencies. If other municipalities create new agencies or retain regulatory powers, we may be subject to their regulation and to any limitations on our services that such agencies may set. We are involved in legal proceedings that dispute the authority of these new agencies to regulate and monitor our local contracts and our operations in metropolitan regions and urban clusters instituted by the State. We cannot foresee any changes that any such new agencies may implement regarding our business. If any such changes are unfavorable, they could materially and adversely affect us.

The State of São Paulo, pursuant to Article 25, Section 3 of the Brazilian Constitution, enacted the State Complementary Law, or "LCE", creating the metropolitan regions of São Paulo (LCE No. 94/1974), Baixada Santista (LCE No. 815/1996), Campinas (LCE No. 870/2000), Vale do Paraíba and Litoral Norte (LCE No. 1,166/2012), Sorocaba (LCE No. 1,241/2014), and the urban clusters of Jundiaí (LCE No. 1,146/2011) and Piracicaba (LCE No. 1,178/2012). These areas incorporate independent municipalities that modify the exercise of their constitutional competencies, including those related to basic sanitation services, and increase the number of judicial disputes concerning the regulation and oversight of services in areas currently served by us and regulated by ARSESP. We cannot anticipate the result of these judicial disputes and the adverse material effects that may result from them, especially if the rules of regulation and monitoring of services issued by municipal agencies come to coexist with those already published by ARSESP and implemented into our operational and corporate processes since 2011.

There are reports that during 2018 there may be a change in legislation that impacts the regulatory framework of the sanitation industry. If enacted, this legislation could have a material adverse effect on our business, results of operations and financial condition. Currently, it is not possible to predict such effects since the terms of this legislation are not yet known.

For more information on ARSESP regulations, see "Item 4.B. Business Overview—Government Regulations Applicable to Our Contracts—Rules Enacted by ARSESP—Consumer Relations in the State of São Paulo".



***It is not possible to predict the impact of the decision by the Brazilian Supreme Court regarding the shared management of basic sanitation services in metropolitan areas or the effect that this decision may have on our business, activities, financial condition or results of operations***

On March 6, 2013, the Brazilian Supreme Court decided a matter related to the shared management of basic sanitation services in the state of Rio de Janeiro. In its decision, the court ruled that the state of Rio de Janeiro must establish a new entity, owned by both the state of Rio de Janeiro and the relevant municipalities, to oversee the planning, regulation and auditing of basic sanitation services in its metropolitan region with the non-partisan participation of all the municipalities located in the metropolitan region, creating a requirement that the state and the municipalities must participate jointly in the shared management of public services.

However, this decision is not yet fully effective, as a ruling on a motion for clarification is currently pending, and therefore does not yet alter the legislative framework regarding basic sanitation that is currently in effect for the State of São Paulo. The São Paulo metropolitan region (including the municipalities to which we provide water on a wholesale basis, but excluding the concession infrastructure construction revenue) accounted for 70.7% of our gross operating revenue from services in 2017.

In January 2015, the Federal Government issued the Metropolitan Bylaws (Law No. 13,089/2015), amended by Provisional Measure No. 818 of January 11, 2018, establishing within the term of five years, counted from the date of the institution of the metropolitan region or urban cluster: (i) the general guidelines for the planning, management and performance of public interest initiatives in metropolitan regions and in urban clusters instituted by the states; (ii) the general planning standards for integrated urban development and other interfederal governance instruments; and (iii) the criteria to receive federal loans related to urban development. In addition, the Metropolitan Bylaws foresees mechanisms for integrated management and interfederal governance as well as the sharing of decisions by regional entities.

Despite the Brazilian Supreme Court's March 6, 2013 decision and the Metropolitan Bylaws, some municipalities in metropolitan regions and urban clusters, including in metropolitan regions where we operate, have been conducting bidding processes for the concession of sanitation services without including shared management. We cannot predict the effect of this non-compliance of the shared management requirement on our business, financial condition or results of operations. Furthermore, we cannot predict how the shared management requirement will be carried out in the São Paulo metropolitan region and other municipalities in which we operate or what effect the shared management may have on our business, financial condition or results of operation.

For more information on services in metropolitan regions, see "Item 4.B. Business Overview—Government Regulations Applicable to Our Contracts—Agreements with Municipalities and Metropolitan Regions".

***The terms of our agreement to provide water and sewage services in the city of São Paulo could have a material adverse effect on us.***

The provision of water and sewage services in the city of São Paulo accounted for 50.1% of our gross operating revenues (excluding revenues relating to the construction of concession infrastructure) in the year ended December 31, 2017.

On June 23, 2010, the State and the city of São Paulo executed an agreement in the form of a *convênio* with our and ARSESP's consent, under which they agreed to manage the planning and investment for the basic sanitation system of the city of São Paulo on a joint basis. In application of the *convênio*, we executed a separate contract dated June 23,



2010 with the State and the city of São Paulo, to regulate the provision of these services for the following 30 years. Among other principal terms of this separate agreement, we must transfer 7.5% of the gross revenues we derive under the *convênio* and subtract (i) COFINS and PASEP taxes and (ii) unpaid bills of publicly owned properties in the city of São Paulo, to the Municipal Fund for Environmental Sanitation and Infrastructure (*Fundo Municipal de Saneamento Ambiental e Infraestrutura*), established by Municipal Law No. 14,934/2009. See “Item 7.B. Related Party Transactions—Agreement with the State and the city of São Paulo” for further discussion of the principal terms of the *convênio* and principal terms of the separate contract we executed in application of the *convênio*.

ARSESP is required to ensure that the tariffs will adequately compensate us for the services we provide, which includes the pass-through to tariffs. However, our existing tariff and adjustment formulas have never included the charge to consumers related to the transfer of 7.5% of the gross revenues obtained from providing sanitation services in the municipality of São Paulo to the São Paulo Municipal Fund for Environmental Sanitation and Infrastructure as established under the *convênio*.

In March 2013, ARSESP issued Resolution No. 407/2013 authorizing us to pass through to the service bill the 7.5% transfer to the São Paulo Municipal Sanitation and Infrastructure Fund as a legal charge, as defined by municipal legislation. However, pursuant to the Sewage and Water Supply Service Contracts, this charge must be included in the calculation of the tariff.

In April 2013, ARSESP issued Resolution No. 413/2013, which suspended Resolution No. 407/2013 until the conclusion of the first tariff revision process, thereby postponing our authorization to pass the charge through to consumers on the service bill. The postponement of Resolution No. 407/2013 was due to a request from the São Paulo State Government to analyze, among other things, methods of reducing the impact on consumers.

In April 2014, ARSESP issued Resolution No. 484/2014, (further ratified by Resolution No. 520, issued November 2014), which established the conclusion of the first tariff revision. However, the State and the city of São Paulo requested to maintain the suspension of ARSESP Resolution No. 407/2013, postponing our authorization to pass the charge through to consumers on the service bill, until the revision of our contract with the State and city of São Paulo is concluded.

In May 2014, ARSESP issued Resolution No. 488/2014, which maintained the suspension of Resolution ARSESP No. 407/2013 until the results are obtained in the revision of the contract signed between us, the city and the State of São Paulo, thereby delaying the authorization to pass the charge through to consumers on the service bill.

In December 2016, we concluded the first four-year revision of our contract with the city of São Paulo, which altered our service quality, investment and investment tracking targets. However, the issue of the 7.5% charge was not discussed.

As of December 31, 2017, we have transferred approximately R\$2.6 billion to the São Paulo Municipal Fund for Environmental Sanitation and Infrastructure since 2010. We cannot assure you when and how we will recover this amount.

In January 2018, the second step of our Second Ordinary Tariff Revision was initiated. In this review, the possibility of including the average tariff in the portion related to transfers to municipal funds, as is the case with the 7.5% that we transfer to the São Paulo Municipal Fund for Environmental Sanitation and Infrastructure was discussed.

On May 9, 2018 ARSESP announced the final results of the Second Ordinary Tariff Revision, recognizing the regulatory limit of 4% of each municipality's direct operating revenue in the tariff calculation. As a result, 1.84% was declared the tariff for the Municipality of São Paulo, corresponding to the 4% regulatory limit.

On May 24, 2018, as a result of the final result of the Second Ordinary Tariff Revision, we filed a reconsideration request as well as a clarification and revision request with ARSESP. As part of the clarification and revision request, we requested that ARSESP provide a revision of the calculation of the financial component related to municipal funds. For more information, see "Item 4.B. Business Overview—Tariffs—Second Ordinary Tariff Revision (2017-2020)."

We cannot assure you that this 7.5% charge will eventually be passed in full through to customers or that the continued delay in passing this charge in full through to customers will not further affect our financial condition. For additional information on ARSESP regulations, see "Item 4.B. Business Overview—Tariffs" and "Item 4.B. Business Overview—Government Regulations Applicable to Our Contracts—Rules Enacted by ARSESP".

***We currently lack formal agreements or concessions with 51 of the municipalities to which we provide service, and 32 of our existing concession agreements will expire between 2018 and 2030. We may face difficulties in continuing to provide water and sewage services in return for payment in these and other municipalities, and we cannot assure you that they will continue to purchase services from us on the same terms or at all.***

As of December 31, 2017, we held formal 30-year agreements with 287 municipalities (including the city of São Paulo) of the 368 municipalities we serve. We entered into six of these agreements during 2017. The 287 municipalities with which we had formal agreements at year-end accounted for 81.7% of our total revenues for the year ended December 31, 2017, and 72.3% of our intangible assets as of December 31, 2017. Of the 51 served municipalities for which we lacked formal agreements at year-end, we were in the process of actively renegotiating with all municipalities. Together, these 51 municipalities accounted for 10.3% of our total revenues for the year ended December 31, 2017 and 19.6% of our intangible assets as of that same date. Between 2018 and 2030, 32 of our existing concession agreements will expire. These 32 concession agreements accounted for 6.2% of our total revenues

for the year ended December 31, 2017 and 5.7% of our intangible assets as of that same date.

We may not be able to continue providing service on current terms, or at all, in the municipalities for which we do not have formal agreements, including the 51 for which we are renegotiating expired agreements. In particular, the lack of formal concessions or contractual rights in these municipalities means that we may not be able to enforce our right to continue to provide services and we may face difficulties in being paid on a timely basis, or at all, for the unamortized assets. If we are successful in renegotiating the expired agreements, or executing formal agreements with the municipalities for which we have never had agreements, those agreements may not contain terms that are as favorable as those under which we currently operate. We cannot make any such assumption because the Basic Sanitation Law prevents us from planning, regulating and monitoring our services and it requires more stringent control by the municipalities or by ARSESP. The municipalities for which we do not have formal agreements may choose to start providing water and sewage services directly themselves, or may run public tenders to select another provider. They may set eligibility requirements for which we do not qualify and, if we do qualify and participate in these tenders, we may not win.

Any of these events could have a material adverse effect on our business, results of operations and financial condition. See “Item 4.B. Business Overview—Our Operations” and “Item 4.B. Business Overview—Government Regulations Applicable to our Contracts—Contracts for the Provision of Essential Basic Sanitation Services in Brazil.”

In the municipalities with which we did not have formal agreements by December 31, 2017, we continued operating with municipal approval or with judicial support.

***Municipalities may terminate our concessions before they expire in certain circumstances. The indemnification payments we receive in such cases may be less than the value of the investments we made.***

Municipalities have the right to terminate our concessions if we fail to comply with our contractual or legal obligations or if the municipality determines in an expropriation proceeding that early termination of the concession is in the public interest. If a municipality terminates our concession, we are entitled to be indemnified for the unamortized portion of our investments.

The Basic Sanitation Law provides that on early termination of a concession, the entity that provides sanitation services should carry out a valuation of the assets that relate to the services provided, in order to calculate the unamortized portion of its investments. This valuation uses the criteria defined in the service contract or, in the absence of a contract, is based on customary practice with respect to the services for the preceding 20 years. The resulting indemnification payment may be less than the remaining value of the investments the sanitation service provider made. Nonetheless, the indemnification payments may not occur voluntarily by the municipality, creating an opportunity for judicial dispute. If faced with such a situation, there is the risk that the judicial decision will consider the indemnification as undue or set it at a lower value than that of our investments.

With regard to our operations that lack contracts or have indefinite or overdue timeframes, the Basic Sanitation Law reduced the maximum time period for payment of indemnification in such cases to four years. This provision applies to concession agreements entered into prior to the enactment of the Basic Sanitation Law only to the extent that the concession agreement does not contain a contractual indemnification provision, or we have not otherwise entered into an agreement with the municipality with regard to such early termination. These provisions have not yet been tested by the courts and we are therefore unable to predict the effect of the Basic Sanitation Law on our rights to indemnification for the early termination of any particular concession.

We have been, and are currently party to concession-related proceedings related to indemnification issues regarding the resumption of water supply and sewage collection services by some municipalities. For more information, see Note 19 to our 2017 financial statements included in this annual report. Other municipalities may seek to terminate their concession agreements before the contractual expiration date. If this occurs and we do not receive adequate indemnification for our investments, or the indemnification is paid over an extended period, we may suffer material harm to our financial position.

***We may face difficulties in collecting overdue amounts owed to us by municipalities to which we provide water on a wholesale basis and municipal government entities.***

As of December 31, 2017, our total accounts receivable was R\$5,538.7 million. Of this amount, certain municipalities to which we provide water on a wholesale basis owed us R\$2,568.2 million, and certain municipal government entities owed us R\$817.9 million. Of the total amount owed by municipalities, R\$189.0 million was overdue by between 30 and 360 days and R\$2,355.7 million was overdue by over 360 days.

The Brazilian courts are entitled to obligate us to continue to supply water to these municipalities, even when we have not received payments due to us. We have no way of ensuring that negotiations with these municipalities or legal action taken against the municipalities will result in payments being made. For example, the municipalities of Santo André, Guarulhos and Mauá owe us significant sums in respect of water that we have been providing to them on a wholesale basis. We have intensified the process of collecting these sums and other amounts, and we executed Protocols of Intentions with Santo André, Guarulhos and Mauá in late 2015 and early 2016 seeking to resolve the

outstanding amounts and restore normal commercial relations with them. In those three cases, the Protocol of Intentions was terminated.

In April 2017, we signed a Protocol of Intentions with the Autonomous Service of Water and Sewage of Guarulhos ("SAAE" - *Serviço Autônomo de Água e Esgoto de Guarulhos*) to evaluate (i) possible solutions to commercial relations between the municipality and our company and (ii) existing debts owed to us by SAAE. In August 2017, we announced that Guarulhos and us decided to move forward with the development of: (i) a judicial agreement for SAAE to pay the debt owed to us in installments, and (ii) an interdependence agreement for us to provide the municipality of Guarulhos' water supply on a wholesale basis.

We are currently negotiating the terms of these agreements and we cannot guarantee when and if definitive agreements will be signed. In 2017, the municipality of Guarulhos paid around 80% of its monthly bills on time. For more information, see "Item 4.B. Business Overview-Description of Our Activities-Wholesale Operations-Wholesale Water Services".

With respect to the municipality of Santo André, we signed a protocol of intention on May 11, 2017 and since then we have been working with the municipality of Santo André on the preparation of studies and evaluations aimed at balancing commercial relations and debts existing between the municipality and our company.

With respect to the municipality of Mauá, on April 19, 2018 we published a press release stating that we have been in contact with the municipality of Mauá regarding directly supplying water to four neighborhoods that have been affected by a water shortage, and that we will initiate formal discussions to engage in negotiations with the municipality.

For more information on wholesale operations, see “Item 4.B. Business Overview—Description of Our Activities—Wholesale Operations”. In addition, some entities associated with municipal governments for which we provide services also do not make regular payments. We cannot guarantee if or when these entities will make payments on a regular basis or pay the amounts they owe us. If these municipalities and related entities do not pay the amounts they owe us, we may suffer further material harm to our financial position.

***Any failure to obtain new financing may adversely affect our ability to continue our capital expenditure program.***

Our capital expenditure program will require resources of approximately R\$17.3 billion in the period from 2018 through 2022. In 2017 we recorded R\$3.4 billion in capital expenditures.

In addition to cash generated by our operations, we have funded and intend to continue funding these capital expenditures with issuances of debt securities in the domestic and international capital markets as well as borrowings in Brazilian *reais* and foreign currencies. A significant portion of our financing needs is obtained through long term financing at attractive interest rates from Brazilian federal public banks, multilateral agencies and international governmental development banks. If the Brazilian government changes its policies regarding the financing of water and sewage services, or if we fail to obtain long term financing at attractive interest rates from domestic and international multilateral agencies and development banks in the future, we may not be able to meet our obligations or finance our capital expenditure program, which could have a material adverse effect on our business and financial condition.

Furthermore, Brazilian public and private financial institutions are legally limited up to a certain percentage of their shareholder’s equity to provide loans to public sector entities, including, for example, us. These limitations could adversely affect our ability to continue our capital expenditure program.

Our debt includes financial covenants that impose indebtedness limits on us. Our failure to comply with these covenants could seriously impair our ability to finance our capital expenditure program, which could have a material adverse effect on us. For further information on these covenants, see “Item 5.B. Liquidity and Capital Resources—Indebtedness Financing—Financial Covenants”.

***Compliance with environmental laws and environmental liability payments could have a material adverse effect on us.***

We are subject to extensive Brazilian federal, state and municipal laws and regulations relating to the protection of human health and the environment. These laws and regulations set potable water standards and limit or prohibit the discharge or spillage of effluent produced in our operations, particularly raw sewage. We occasionally suffer accidents such as leakages or breaks in pipes that could lead to liability for damages under environmental law. We could be subject to various types of criminal, administrative and civil proceedings for non-compliance with environmental laws and regulations that could expose us to penalties and criminal sanctions, such as fines, closure orders and significant indemnification obligations. The scope and enforcement of environmental laws in Brazil are

becoming more stringent, and our capital expenditures and environmental compliance costs may increase substantially as a result. These expenses may lead us to reduce expenditure on strategic investments, which could harm our business. In addition, Brazilian courts are enforcing environmental laws more stringently than in the past, which may result in fines or liability for damages that are significantly higher than those we currently anticipate. We are party to various environmental proceedings that could have a material adverse impact on us, including civil processes and investigations relating, among others, to the release of untreated sewage into waterways or the disposal of sludge generated by treatment plants. More recently, we are involved in proceedings challenging the extraction of water resources in the face of the recent water crisis. Any unfavorable judgment in relation to these proceedings, or any material environmental liabilities, may have a material adverse effect on us. For further information on these proceedings, see “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”. For further information on investments in environmental programs, see “Item 4.A. History and Development of the Company—Main Projects of our Capital Expenditure Program”, “Item 4.B. Business Overview—Description of our Activities—Sewage Operations—Sewage Treatment and Disposal”, “Item 4.B Business Overview—Environmental Matters” and “Item 4.B. Business Overview— Environmental Matters—Environmental Regulation”. For further information on the Water Crisis, see “Item 4.B. Business Overview—The Recent Water Crisis”.

*New laws and regulations relating to climate change and changes in existing regulation, as well as the escalation of the physical effects of extreme weather events, may result in increased liabilities and increased capital expenditures, which could have a material adverse effect on us.*

Current federal, state and municipal laws and regulations on climate change establish global goals, which we will have to meet, concerning greenhouse gas emissions and this may require us to increase our investments in order to comply with these laws. Currently, such goals have not yet been established for the sanitation sector, however, if we increase our capital expenditures for this purpose, we may be required to reduce expenditures on other strategic investments.

In addition, climate change may lead to increased frequency of extreme weather events such as droughts or torrential rain, which may affect our ability to deliver our services and require us to strengthen our actions such as:

- investing in seeking new water sources located further from major consumer centers;
- investing in new technologies;
- improvement of water conservation practices and demand management alternatives such as economic mechanisms or educational programs; and
- increasing the capacity of our water reserves.

Extreme weather events such as torrential rain may also cause impacts to our installations that can lead to negative impacts to the environment and society.

A rise in sea level could result in increased salinity in the river estuaries where we abstract water, which could affect water treatment in these areas. Rising sea levels could also cause damage in our sewage collection network.

Additionally, increases in air temperature could affect demand for water. Extreme weather events may also reduce water levels in the reservoirs that power hydroelectric power plants in Brazil, which may cause energy shortages and increase electricity prices, which may adversely affect our costs and operations.

We cannot predict all of the effects of extreme weather events, therefore making it difficult to predict necessary investments. We have not provisioned any funds for climate change events as current technology and scientific understandings of climate change make it difficult to predict potential expenses and liabilities.

We may be required to adopt new norms to improve our energy use efficiency and minimize the release of greenhouse gases when we renew the environmental licenses for the systems already in operation or when we obtain environmental licenses for new enterprises.

We may need to make substantial new expenditures, either to comply with new environmental regulations linked to climate change or to prevent or correct the physical effects of extreme weather events, any of which could have a material adverse effect on our results of operations.

For more information, see “Item 4.B. Business Overview—Environmental Matters—Climate Change Regulations: Reduction of Greenhouse Gases (GHG) Emissions” and “Item 4.B. Business Overview—Energy Consumption”.

*Any substantial monetary judgment against us in legal proceedings may have a material adverse effect on us.*



We are party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among others, civil, tax, labor, corporate and environmental issues. As of December 31, 2017, the estimated total claims asserted was R\$55,705.2 million (net of R\$461.4 million in escrow deposits), including contingent liabilities. A substantial monetary judgment against us in one or more of these legal proceedings may have a material adverse effect on our financial condition. We have recognized provisions totaling R\$1,078.2 million (net of escrow deposits) as of December 31, 2017. For more information, see Note 19 to our 2017 financial statements included in this annual report. These provisions do not cover all legal proceedings involving monetary claims filed against us and it may be insufficient to cover the ultimate resolution of these claims. Any unfavorable judgment in relation to these proceedings may have a material adverse effect on us. For more information, see “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”.

***Our business is subject to cyberattacks and security and privacy breaches.***

Our business involves the collection, storage, processing and transmission of customers', suppliers and employees' personal or sensitive data. We also use key information technology systems for controlling water, sewage and commercial, administrative and financial operations. An increasing number of organizations, including large businesses, financial institutions and government institutions, have disclosed breaches of their information technology and information security systems, some of which have involved sophisticated and highly targeted attacks, including on portions of their websites or infrastructure.

The techniques used to obtain unauthorized, improper or illegal access to our systems, our data or our customers' data, to disable or degrade service, or to sabotage systems are constantly evolving, may be difficult to detect quickly, and often are not recognized until launched against a target. Unauthorized parties may attempt to gain access to our systems or facilities through various means, including, among others, hacking into our systems or those of our customers, partners or vendors, or attempting to fraudulently induce our employees, customers, partners, vendors or other users of our systems into disclosing user names, passwords or other sensitive information, which may in turn be used to access our information technology systems. Certain efforts may be supported by significant financial and technological resources, making them even more sophisticated and difficult to detect.

We have established an Information Security Committee with members appointed by our executive officers. The mission of this committee is to undertake projects and actions related to the protection or mitigation of the vulnerabilities and risks of our information technology assets. Although we have developed systems and processes, such as this committee, that are designed to protect our data, the data of our customers, employees and suppliers, and to prevent data loss and other security breaches, these security measures cannot provide absolute security. Our information technology and infrastructure may be vulnerable to cyberattacks or security breaches, and third parties may be able to access our customers', suppliers' and employees' personal or proprietary information that are stored on or accessible through those systems. Our security measures may also be breached due to human error, malfeasance, system errors or vulnerabilities, or other irregularities. Any actual or perceived breach of our security could interrupt our operations, result in our systems or services being unavailable, result in improper disclosure of data, materially harm our reputation and brand, result in significant legal and financial exposure, lead to loss of customer confidence in, or decreased use of, our products and services, and adversely affect our business and results of operations. In addition, any breaches of network or data security at our suppliers (including data center and cloud computing providers) could have similar negative effects. Actual or perceived vulnerabilities or data breaches may lead to claims against us. We cannot guarantee that the protections we have in place to protect our operating technology and information technology systems are sufficient to protect against cyberattacks and security and privacy breaches.

**Risks Relating to Our Common Shares and ADSs**

***We may not always be in a position to pay dividends or interest on shareholders' equity and ADSs.***

Depending on our future results, our shareholders may not receive dividends or interest on own capital if we do not generate a profit. Despite the requirement to distribute a minimum of 25% of our annual net income to shareholders, our future financial position may not permit us to distribute dividends or pay interest on own capital.

***The relative volatility and illiquidity of the Brazilian securities markets may substantially limit your ability to sell our common shares underlying the ADSs at the price and time you desire.***

Investing in securities from emerging markets such as Brazil involves greater risk than investing in securities of issuers in major securities markets, and these investments are often considered to be more speculative in nature. The Brazilian securities market is substantially smaller, less liquid, more concentrated and can be more volatile than major

securities markets. Accordingly, although you are entitled to withdraw the common shares underlying the ADSs from the depositary at any time, your ability to sell the common shares underlying the ADSs at a price and time at which you wish to do so may be substantially limited. There is also significantly greater concentration in the Brazilian securities market than in major securities markets. The ten largest companies in terms of market capitalization represented approximately 52.5% of the aggregate market capitalization of the B3 as of December 31, 2017.

***Investors who exchange ADSs for common shares may lose their ability to remit foreign currency abroad and obtain Brazilian tax advantages.***

The Brazilian custodian for the common shares underlying our ADSs must obtain a certificate of registration from the Central Bank in order to be entitled to remit U.S. dollars abroad for payments of dividends and other distributions relating to our common shares or upon sales of our common shares. If an ADR holder decides to exchange ADSs for the underlying common shares, the holder will be entitled to continue to rely on the custodian's certificate of registration for five business days from the date of exchange. After that period, the holder may not be able to obtain and remit U.S. dollars abroad upon sale of our common shares, or distributions relating to our common shares, unless he or she obtains his or her own certificate of registration or registers the investment under CMN Resolution No. 4,373/2014, dated September 29, 2014, which entitles registered foreign investors (the "4,373 Holder") to buy and sell on a Brazilian stock exchange. If the holder does not obtain a certificate of registration or register under Resolution No. 4,373/2014, the holder will generally be subject to less favorable tax treatment on gains with respect to our common shares.

If a holder attempts to obtain his or her own certificate of registration, the holder may incur expenses or suffer delays in the application process, which could delay his or her ability to receive dividends or distributions relating to our common shares or the return of his or her capital in a timely manner. The custodian's certificate of registration or any foreign capital registration obtained by a holder may be affected by future legislative changes, and additional restrictions applicable to the holder, the disposition of the underlying common shares or the repatriation of the proceeds of disposition may be imposed in the future.

***A holder of common shares or ADSs may face difficulties in protecting his or her interests as a shareholder because we are a Brazilian mixed capital company.***

We are a mixed capital company (*sociedade de economia mista*) organized under the laws of Brazil, and all of our directors and officers and our controlling shareholder reside in Brazil. All of our assets are located in Brazil. As a result, it may not be possible for a holder to effect service of process upon us or these other persons within the United States or other jurisdictions outside Brazil or to enforce against us or these other persons judgments obtained in the United States or other jurisdictions outside Brazil. Because judgments of U.S. courts for civil liabilities based upon the U.S. federal securities laws may only be enforced in Brazil if certain requirements are met, a holder may face more difficulty in protecting his or her interests in the case of actions by our directors, officers or our controlling shareholder than would shareholders of a corporation incorporated in a state or other jurisdiction of the United States. In addition, under Brazilian law, none of our assets which are essential to our ability to render public services are subject to seizure or attachment. Furthermore, the execution of a judgment against our controlling shareholder may be delayed, since the State may only be able to pay a judgment if it is provided for in its budget in a subsequent fiscal year. None of the public property of our controlling shareholder is available for seizure or attachment, either prior to or after judgment.

***Mandatory arbitration provisions in our bylaws may limit the ability of a holder of our ADSs to enforce liability under U.S. securities laws.***

Under our bylaws, any disputes among us, our shareholders and our management with respect to the *Novo Mercado* rules, the Brazilian Corporate Law and Brazilian capital markets regulations will be resolved by arbitration conducted pursuant to the B3 Arbitration Rules in the Market Arbitration Chamber. Any disputes among shareholders and ADR holders, and any disputes between us and our shareholders and ADR holders, will also be submitted to arbitration. As a result, a court in the United States might require that a claim brought by an ADR holder predicated upon the U.S. securities laws be submitted to arbitration in accordance with our bylaws. In that event, a purchaser of ADSs would be effectively precluded from pursuing remedies under the U.S. securities laws in the U.S. courts. However, a

court in the United States could allow claims predicated upon the U.S. securities laws brought by holders who purchased ADSs on the NYSE to be submitted to U.S. courts.

*A holder of our common shares and ADSs might be unable to exercise preemptive rights and tag along rights with respect to the common shares.*

U.S. holders of common shares and ADSs may not be able to exercise the preemptive rights and tag along rights relating to common shares unless a registration statement under the U.S. Securities Act of 1933, as amended, or the Securities Act, is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file a registration statement with respect to our common shares relating to these rights, and we cannot assure you that we will file any such registration statement. Unless we file a registration statement or an exemption from registration is available, an ADR holder may receive only the net proceeds from the sale of his or her preemptive rights and tag along rights or, if these rights cannot be sold, they will lapse and the ADR holder will receive no value for them.

*Holders of our ADSs do not have the same voting rights as our shareholders.*

Holders of our ADSs do not have the same voting rights as holders of our shares. Holders of our ADSs are entitled to the contractual rights set forth for their benefit under the deposit agreements. ADS holders exercise voting rights by providing instructions to the depository, as opposed to attending shareholders meetings or voting by other means available to shareholders. In practice, the ability of a holder of ADSs to instruct the depository as to voting will depend on the timing and procedures for providing instructions to the depository, either directly or through the holder's custodian and clearing system. The deposit agreement also provides that if the depository does not receive any instructions from a holder of ADRs, the ADR holder may be deemed to have given a discretionary proxy to a person designated by our company and the underlying shares may be voted by such person. However, we have chosen not to designate any person to exercise these deemed proxy rights with respect to any annual or special general meetings, and ADSs for which no specific voting instructions were received by the Depository were therefore not voted at that meeting.

## **ITEM 4. INFORMATION ON THE COMPANY**

### **A. History and Development of the Company**

#### **Overview**

Companhia de Saneamento Básico do Estado de São Paulo – SABESP is a mixed capital company (*sociedade de economia mista*) with limited liability. We were incorporated on September 6, 1973 under the laws of the Federative Republic of Brazil. We are registered with the Commercial Registry of the State of São Paulo (*Junta Comercial do Estado de São Paulo*) under registration number NIRE 35300016831. Our principal executive offices are located at Rua Costa Carvalho, 300, 05429-900 São Paulo, SP, Brazil. Our telephone number is +55 11 3388 8000. Our agent for service of process in the United States is CT Corporation System, with offices at 818 West Seventh Street – Team 1, Los Angeles, CA 90017. We are allowed to operate, in a subsidiary form, in other Brazilian locations and abroad. See “Item 4.B. Business Overview— Government Regulations Applicable to Our Contracts—Contracts for the Provision of Essential Basic Sanitation Services in Brazil”.

We believe we are one of the largest water and sewage service providers in the world (based on the number of customers in 2014, according to the inDepth Water Yearbook 2014-2015). We operate water and sewage systems in the state of São Paulo, which includes the city of São Paulo, Brazil's largest city. According to the IBGE, the state of São Paulo is Brazil's most populous state and the state with the highest gross domestic product, or GDP, in Brazil. For the year ended December 31, 2017, we generated net revenue of R\$14,608.2 million and net income of R\$2,519.3

million. Our total assets amounted to R\$39,546.4 million and our total shareholders' equity amounted to R\$17,513.0 million as of December 31, 2017.

As of December 31, 2017, we provided water and sewage services to a broad range of residential, commercial, industrial and governmental customers in 368 of the 645 municipalities in the state of São Paulo, including the city of São Paulo. Substantially all of our concessions or program agreements have 30 year terms. As of December 31, 2017, we lacked formal agreements for 51 of the municipalities we serve, each of which we are currently in the process of renegotiation. From January 1, 2018 through 2030, 32 further concessions will expire, and we will seek to replace them with program agreements. In addition to the 368 municipalities we served, we also provided water service to the municipality of Mogi das Cruzes, pursuant to two partial water contracts under which we service only certain neighborhoods of that municipality. See "Presentation of Financial and Other Information—Other Information—Our Contracts and the Municipalities We Serve".

We also supply water on a wholesale basis to five municipalities in the São Paulo metropolitan region in which we do not operate water distribution systems (together covering a total estimated urban population of approximately 3.0 million residents). Four of these municipalities also utilize our sewage treatment services. For the year ended December 31, 2017, the São Paulo metropolitan region (including the municipalities to which we provide water on a wholesale basis) accounted for 70.7% of our gross operating revenue (excluding revenues relating to the construction of concession infrastructure), while the Regional Systems accounted for 29.3%.

As of December 31, 2017, we provided water services through 8.9 million water connections to approximately 24.9 million people, representing approximately 57% of the total population of the state of São Paulo, and had a water coverage ratio of 98% with respect to all regions. As of that date, we provided sewage services through 7.3 million sewage connections to approximately 21.6 million people and had an effective sewage service ratio of 83%. As of December 31, 2017, we operated using 74,396 kilometers of water pipes and water transmission lines and 50,991 kilometers of sewer lines.

We also provide water and/or sewage services to four other municipalities through special purpose companies. In addition, we have three partnerships with private companies: Aquapolo Ambiental S.A., Attend Ambiental S.A. and Paulista Geradora de Energia S.A. Aquapolo Ambiental S.A. commenced operations in the second half of 2012 and operates the largest water recycling facility in the southern hemisphere. Aquapolo Ambiental S.A. has the capacity to supply up to 1,000 liters per second to industries in the Capuava petrochemical cluster of the São Paulo metropolitan region, but is currently providing approximately 650 liters per second as a result of demand. Attend Ambiental S.A. commenced operations in the second half of 2014 to operate a pre-treatment plant for non-domestic effluent in the São Paulo metropolitan region. Paulista Geradora de Energia S.A., which was formed in 2015, focuses on the implementation and commercial exploration of water potential in small hydroelectric power plants, located at Vertedouro Cascata and the Guaraú Water Treatment Plant, with a total capacity of 7 MW. We were planning to commence construction in the course of the second semester of 2017, but the current economic situation in Brazil has reduced the availability of credit, and therefore the commencement of construction has been rescheduled for the second half of 2018. See “Note 12 to the Financial Statements - Investments”. In addition, we provide consulting services regarding the rational use of water, the updating of institutional models, and commercial and operational management in Panama, through a consortium. We previously provided consulting services to Honduras and Nicaragua, but these consulting services have been completed.

The State of São Paulo, our controlling shareholder, is required by State Law No. 11,454/2003 to own at least 50% plus one of our common shares. As of May 24, 2018, the State owned 50.3% of our outstanding common shares. As a mixed capital company, we are an integral part of the State governmental structure. Our strategy and major policy decisions are formulated in conjunction with the State Secretariat for Sanitation and Water Resources as part of the State’s overall strategic planning. The majority of the members of our board of directors and our board of executive officers are nominated by the State government.

In addition, our capital expenditure budget is subject to approval by the State legislature and is approved in conjunction with the budget of the State Secretariat for Sanitation and Water Resources as a whole. Our financial statements and accounting records are subject to review by the State Accounts Tribunal (*Tribunal de Contas*), as are all accounts of the State.

Our results of operations and financial condition are generally affected (i) by our ability to raise tariffs, control costs and improve productivity; (ii) the general economic conditions in Brazil and abroad; and (iii) climate conditions. In order to supply water to the São Paulo metropolitan region, we use water from eight systems, most of which were affected by the most severe drought in our service region in over 80 years, which occurred during 2014 and 2015. Of



those, the Cantareira System, our largest water system, was the most affected. In order to balance supply and demand despite the restricted water availability, we adopted throughout 2014 and 2015 a series of initiatives. In March 2016, as a result of the increased level of rainfall and increased predictability of the level of water in our reservoirs, we cancelled the Water Consumption Reduction Incentive Program and the Contingency Tariff to water meter readings recorded as of May 1, 2016. For further information on the water crisis, see “Item 3.D. Risk Factors—The measures we took to mitigate the effects of the drought that occurred in 2014 and 2015 resulted in a significant decrease in the volume of water billed and revenues from services we provide and, despite the discontinuation in May 2016 of the measures that were used to face the drought, new consumption habits were incorporated and the volume of water billed continues to be impacted by those measures.” and “Item 4.B Business Overview—The Recent Water Crisis”.

### **Our Strengths**

We believe that our strong business position and future prospects derive from the following strengths:

***Well established business with significant size, scale and know how to operate in complex urban settings.*** We believe we are one of the largest water and sewage service providers in the world. We provide water services directly to approximately 24.9 million people and supply water on a wholesale basis to an additional urban population of approximately 3.0 million people. As of December 31, 2017, we had an effective water coverage ratio of 98% in respect of all regions in which we operate. We also provide sewage services directly to approximately 21.6 million people, achieving an effective sewage service ratio of 83% in respect of all regions in which we operate as of December 31, 2017. Our significant size and scale have required us to operate in complex urban settings such as shantytowns (*favelas*) and environments without urban planning, thereby enabling us to develop well trained personnel, skills for operating in adverse conditions that we believe our competitors lack.

***Operations in Brazil's most populous and wealthy state.*** The state of São Paulo, which is located in the most developed and economically active region of Brazil, is the most populous state in Brazil, with an estimated total population of 43.8 million as of December 31, 2017. The city of São Paulo had an estimated total population of 11.7 million as of the same date, while the São Paulo metropolitan region had a total population of 20.8 million. Based on its GDP, the state of São Paulo is the wealthiest state and largest economy in Brazil. The GDP of the state of São Paulo was approximately R\$1.7 trillion in 2015, representing approximately 26.3% of Brazil's total GDP, according to the most recent data collected by the IBGE. The state of São Paulo generates more revenue from water and sewage services than any other Brazilian state.

***Strong Base of Contracted Business.*** Between January 1, 2007 and December 31, 2017, we executed 30-year agreements with 287 of the 368 municipalities we serve, including an agreement with the city of São Paulo, in June 2010, and Santos in September 2015. For the year ended December 31, 2017, income from these 30-year agreements accounted for 81.7% of our gross operating revenues (including revenues relating to the construction of concession infrastructure).

***Access to low cost and diverse sources of financing.*** Our strong cash flow generation from operations and our role as an essential public service provider places us in a privileged position in our industry to obtain low cost, long term financing from Brazilian public banks, and domestic and international multilateral agencies and development banks. We do not depend on a limited number of sources of financing, but instead have access to various funding alternatives in the Brazilian and international markets to fund our working capital needs and our capital expenditure programs.

***Strong corporate governance practices.*** In 2002, we joined the *Novo Mercado* segment of the B3, which is the listing segment in Brazil with the highest corporate governance requirements. As a result, we are committed to certain corporate governance standards that are not otherwise required by Brazilian law, which provides heightened protection to our shareholders and enhances the quality of information we disclose to the market. From December 2007 until December 2015, we were part of the B3 Corporate Sustainability Index, or ISE. In 2016, due to the need to focus the attention of all our departments on overcoming the water crisis, we decided not to participate in the selection process to be a part of the ISE. As of the date of this annual report, we have not yet recommenced participation in this selection process.

***High quality operations.*** We believe that we adhere to high standards of service and employ the best available technology in the sanitation business to control the quality of the water we abstract, process and distribute. Of our 16 laboratories in total, our central laboratory and 13 of our regional laboratories are accredited by the National Institute of Metrology, Quality and Technology, Standardization and Industrial Quality, or INMETRO, and comply with the ABNT NBR ISO IEC 17025 standard, thereby assuring the quality and accuracy of our test results. Moreover, our laboratories and field teams use the latest equipment to detect substances controlled by regulations and have highly trained teams to handle contingencies and customer complaints. We believe our technology enhances the efficiency and quality of our operations.

## **Our Strategy**

Our mission is to provide water and sewage services, contributing to improvements in quality of life and the environment. Our goal is to become a global reference in the provision of basic sanitation services in a sustainable, competitive and innovative manner, focused on the needs of our clients. To this end, our strategic objectives are based upon the guiding principles of water availability, excellence in the provision of services, sustainable growth, fostering and expanding our operating base, innovation and technology, motivation of personnel and expansion of our sewage treatment coverage.

***Secure water availability in the areas where we operate.*** Our goal is to secure the availability of water in the areas where we operate, as well as to promote a rational and integrated use of water resources, respecting demand and critical levels of water for each region, and allocating resources in the short, medium and long run in order to guarantee access to water. Our goal is to consistently meet the needs of our consumers with our services. Furthermore, we have planned a series of short-term and medium-term measures that we believe will increase the ability of our immediate water supply to cope with the water crisis and significantly improve future water security by the end of the decade. For more information, see “Item 4.B. Business Overview—The Recent Water Crisis” and “—Capital Expenditure Program”.

***Ensure the quality and availability of our services in our existing service area through excellence in service provision and improving our operating efficiency.*** Our goal is to maintain the water coverage ratio, coupled with a high standard of quality and availability of our services, and meet the expected growth in our operating basis. We also intend to increase our sewage coverage by adding 1.1 million sewage connections by 2022. In addition, we seek to reduce both physical and non physical water loss. See “—Capital Expenditure Program”.

We also seek to improve our processes by implementing: (i) a new management model based on the Management Excellence Model of the National Quality Foundation (*Modelo de Excelência na Gestão da Fundação Nacional da Qualidade*) that seeks to improve management processes alignment and best practices sharing within the company; (ii) an enterprise resourcing planning system, or “ERP system” (SAP), and a customer relationship management system, or “CRM system” (Net@suite), to replace our commercial and management information systems. The ERP system was implemented in April 2017 and Net@suite is expected to be implemented in 2018.

These projects intend to increase our speed and productivity in responding to regulatory changes; to strengthen and streamline our financial, commercial and administrative structure; to provide a solid and integral base of information to support the decision-making process; and to increase the efficiency of our operations while also reducing costs.

***Continue to seek sustainable growth.*** Our goal is to grow while balancing our economic and financial results with environmental and social considerations, to secure positive financial results so as to guarantee investments for the provision of services, as well as to provide an adequate and just remuneration for our shareholders. We seek to act as citizens and to promote the well-being of the communities we operate in and the protection of the environment. We aim to apply our principles of financial growth and sustainability to each business unit, assigning goals and setting clear responsibilities to each unit so as to strengthen our financial results. To achieve this goal, we intend to use our best efforts to reduce operating costs and increase productivity and profitability. We plan to improve the management of our assets, as well as to continue to reduce our total operating expenses by automating some of our facilities, streamlining operational processes, implementing integrated planning and further investing in internal technological research and development.

We also plan to continue our efforts to improve our collection of overdue accounts receivable from municipalities to which we provide services, from the State and from other governmental entities, including by exploring opportunities to offset these outstanding debts against certain possessory or property rights over utilities relating to water and sewage systems. We intend to continue to fund our working capital needs and estimated capital expenditure programs with diversified sources of financing, such as domestic and international development banks and multilateral agencies. We will continue to seek market opportunities for low cost financing and restructuring of our indebtedness if and when advantageous and appropriate.

Since 2008, we have expanded into activities that complement water and sewage services in which we may leverage our know how, size, scale and profitability. These activities include consulting and management of sanitation systems.

Currently, we provide water and/or sewage services to four other municipalities through special purpose companies and have three partnerships with private companies. See “Item 4. Information on the Company—History and

Development of the Company—Overview”.

***Maintain and expand our operating base.*** We intend to maintain and expand our operating base by executing new agreements. To this end, we are actively seeking to develop closer relationships with the municipal governments that we currently serve in order to increase customer loyalty and thereby renew all or substantially all our concession agreements as they expire. We also regularly explore the possibility of executing agreements for the provision of water and sewage services in municipalities in the state of São Paulo in which we currently have no operations or to which we currently supply water and provide sewage treatment solely on a wholesale basis, which together represent a total population of approximately 16.5 million. We evaluate possible expansion opportunities in terms of proximity to our existing service areas to maximize return on investment and improve our financial performance. In June 2010, we entered into a 30 year agreement with the State and city of São Paulo for the provision of water and sewage services in the city of São Paulo, which in the year ended December 31, 2017 accounted for 50.1% of our gross operating revenues (excluding revenues relating to the construction of concession infrastructure). Between January 1, 2007 and December 31, 2017, we entered into agreements with 287 municipalities (including our services agreement with the city of São Paulo), of which six were entered into in 2017. These 287 municipalities accounted for 81.7% of our total revenues for the year ended December 31, 2017 and 72.3% of our intangible assets as of the same date. As of December 31, 2017, 51 of our concessions had expired and are currently being renegotiated. These 51 municipalities accounted for 10.3% of our total revenues for the year ended December 31, 2017 and 19.6% of our intangible assets as of the same date. From January 1, 2018 through 2030, 32 concession agreements, accounting for 6.2% of our revenues for the year ended December 31, 2017 and 5.7% of our intangible assets as of the same date, will expire.

***Seek opportunities to adopt and develop innovative technology.*** We plan to stimulate the creation, adoption and diffusion of innovative solutions aiming to generate value and to improve our provision of basic sanitation services while promoting environmental protection and maintaining our competitiveness and profitability. In accordance with our bylaws, our activities comprise water supply, sanitary sewage services, urban rainwater management and drainage services, urban cleaning services, solid waste management services, and also related activities, including the planning, operation, maintenance and commercialization of energy, and the commercialization of services, products, benefits and rights that directly or indirectly arise from our assets, operations and activities. We are also authorized to carry out activities through subsidiaries in other Brazilian locations and in other countries. See Item “5.C. Research and Development, Patents and Licenses, Etc.”

***Establish efficient and competitive ways of motivating, retaining and attracting personnel.*** We intend to provide our personnel with programs for professional and personal development, growth opportunities and recognition. These programs include competitive benefit packages and a healthy and collaborative work environment. We seek to raise workplace satisfaction, well-being, engagement and productivity.

***Expand our sewage treatment coverage.*** Our goal is to progress in the implementation of sewage collection and treatment structures in an economically and technologically viable way. We had an effective sewage coverage ratio of 90% as of December 31, 2017 and plan to increase this ratio to 93% by 2022 by adding over 1.1 million sewage connections and the indicator of consumer units connected to the sewage treatment system from 75% to 83% by 2022. These investments are necessary to restore the quality of the rivers and lakes, providing new sources for water supply. In addition, there are municipalities in the state of São Paulo representing a total population of approximately 16.5 million to which we currently do not provide water or sewage services, or to which we currently supply water solely on a wholesale basis. Our strong presence in the State and experience in providing water and sewage services places us in a privileged position to expand our sewage services to these additional municipalities in the state of São Paulo as well as to other Brazilian states and abroad. For more information, see “Item 4.B. Business Overview—Description of our Activities—Sewage Operations” and “Item 4.B. Business Overview—Competition” and “Item 4.B. Business Overview—Tariffs”.

Our strategic objectives also focus on our political and institutional relationships as well as on our commitment to the market to increase shareholder value.

In 2017 we invested R\$3.4 billion and between 2018 and 2022 we plan to invest an additional R\$17.3 billion to improve and expand our water and sewage systems, increase water security, and meet the growing demand for water and sewage services in the state of São Paulo, thereby encouraging these customers to continue using our services.

We believe that our overall strategy will enable us to meet the demand for high quality water and sewage services in the state of São Paulo as well as in other Brazilian states and abroad, while creating shareholder value and strengthening our results of operations and our financial condition.

## **State of São Paulo**

The state of São Paulo is one of 26 states that, together with the Federal District of Brasília, constitute the Federative Republic of Brazil. The state of São Paulo is located in the southeastern region of the country, which also includes the States of Minas Gerais, Espírito Santo and Rio de Janeiro, and which is, according to IBGE, the most developed and economically active region of Brazil. The state of São Paulo is located on the Atlantic coast of Brazil and is bordered by the states of Rio de Janeiro and Minas Gerais to the north, the state of Paraná to the south and the state of Mato Grosso do Sul to the west.



The state of São Paulo occupies approximately 3.0% of Brazil's land mass and encompasses an area amounting to approximately 96,000 square miles. According to the SEADE, the state of São Paulo had an estimated total population of 43.8 million as of December 31, 2017. The city of São Paulo, capital of the state of São Paulo, had an estimated total population of 11.7 million, with a total population of 20.8 million inhabitants in the São Paulo metropolitan region, as of December 31, 2017. The São Paulo metropolitan region encompasses 39 municipalities and is the largest metropolitan region in the Americas and the fifth largest metropolitan region in the world, according to the United Nations' Data Booklet "The World's Cities in 2016", with approximately 47% of the total population of the state of São Paulo as of December 31, 2017. According to the most recent data collected by the IBGE, the GDP of the state of São Paulo was approximately R\$1.7 trillion in 2015, representing approximately 26.3% of Brazil's total GDP, and making it the largest economy of any state in Brazil based on GDP. According to the IBGE, the state of São Paulo is also the leading Brazilian state in terms of manufacturing and industrial activity, with a strong position in car manufacturing, pharmaceuticals, computer manufacturing, steel making and plastics, among other activities, as well as a leading position in the banking and financial services industries. The state of São Paulo is the leading export state in Brazil, according to the Brazilian Ministry of Development, Industry and Foreign Trade (*Ministério do Desenvolvimento, Indústria e Comércio Exterior*).

## History

Until the end of the nineteenth century, water and sewage services in the state of São Paulo were generally provided by private companies. In 1875, the Province of São Paulo granted a concession for the provision of water and sewage services to Cantareira Water and Sewage Company (*Companhia Cantareira de Água e Esgotos*). In 1893, the government of the Province of São Paulo assumed responsibility for the provision of water and sewage services from Cantareira Water and Sewage Company and formed the Office of Water and Sewers (*Repartição de Água e Esgotos*), a government agency. Since that time, water and sewage services in the São Paulo metropolitan region have been administered by the State government. Historically, water and sewage services in substantially all other municipalities of the State were administered directly by the municipalities, either by municipal water and sewage departments or through *autarquias* of the municipal government. *Autarquias* are relatively autonomous public bodies with separate legal standing, assets and revenues, created by law to carry out the administration of public services where the government deems that a decentralized administrative and financial structure would be advantageous.

In 1954, in response to dramatic population growth in the São Paulo metropolitan region, the State government created the Department of Water and Sewers (*Departamento de Águas e Esgotos*) as an *autarquia* of the State. The Department of Water and Sewers provided water and sewage services to various municipalities in the São Paulo metropolitan region.

A major restructuring of the entities providing water and sewage services in the state of São Paulo occurred in 1968, with the creation of the Water Company of the São Paulo metropolitan Region (*Companhia Metropolitana de Água de São Paulo*), or the "COMASP", the purpose of which was to provide potable water on a wholesale basis for public consumption in the various municipalities of the São Paulo metropolitan region. All assets relating to the production of potable water for the São Paulo metropolitan region previously owned by the Department of Water and Sewers were transferred to COMASP. In 1970, the State government created the Superintendence of Water and Sewers of the City of São Paulo (*Superintendência de Água e Esgoto da Capital*), or the "SAEC", to distribute water and collect sewage in the city of São Paulo. All assets relating to water services previously owned by the Department of Water and Sewers were transferred to the SAEC. Also in 1970, the State created the Basic Sanitation Company of the São Paulo metropolitan Region (*Companhia Metropolitana de Saneamento de São Paulo*), or the SANESP, to provide sewage treatment services for the São Paulo metropolitan region. All assets relating to sewage services previously owned by the Department of Water and Sewers were transferred to the SANESP. The Department of Water and Sewers was subsequently closed.



On June 29, 1973, pursuant to State Law No. 119/1973, COMASP, SAEC and SANESP merged to form our Company with the purpose of implementing the directives of the Brazilian government set forth in the National Water Supply and Sanitation Plan (*Plano Nacional de Saneamento*). We were incorporated under the laws of Brazil as a *sociedade anônima* for indefinite duration. The National Water Supply and Sanitation Plan was a program sponsored by the Brazilian government, which financed capital investments in, and assisted in the development of, state controlled water and sewage companies. Since our formation, other State governmental and State controlled companies involved in water supply and sewage collection and treatment in the state of São Paulo have been merged into our company. The State has always been our controlling shareholder, as required by State Law No. 11,454/2003. We have therefore been integrated into the State governmental structure and our strategies have been formulated in conjunction with the strategies of the State Department of Water Resources and Sanitation. Additionally, a majority of the members of our board of directors and our management are appointed by the State Government.

Our capital expenditure budget is subject to approval by the State legislative chamber. This approval is obtained simultaneously with the approval of the budget of the São Paulo Secretariat for Sanitation and Water Resources (*Secretaria de Saneamento e Recursos Hídricos do Estado de São Paulo*). We are also subject to supervision from the Court of Audit of the State of São Paulo (*Tribunal de Contas do Estado de São Paulo*), with regard to our accounting, financial and budgetary activities and our operating assets.

We provide water and sewage services directly to a large number of residential, commercial and industrial private consumers, as well as to a variety of public entities, in 368 of the 645 municipalities in the State, including in the city of São Paulo. We also supply water on a wholesale basis to five municipalities in the São Paulo metropolitan region in which we do not operate water distribution systems, and four of these municipalities also utilize our sewage treatment services. According to the inDepth Water Yearbook 2014-2015, we are the fourth largest water and sewage service company in the world in terms of number of clients.

In 1994, we were registered with the CVM as a publicly-held company and are therefore subject to the CVM's rules, including those relating to the periodic disclosure of extraordinary facts or relevant events. Our common shares have been listed on the B3 under the ticker "SBSP3" since June 4, 1997.

In 2002, we joined the *Novo Mercado* segment of the B3, which is the listing segment in Brazil with the highest corporate governance requirements. In the same year, we registered our common shares with the Securities and Exchange Commission, or SEC, and started trading our shares in the form of ADR – level III on the New York Stock Exchange, or NYSE, under the ticker "SBS".

In 2004, the State of São Paulo carried out a secondary offer of common shares of our company in the Brazilian and international markets.

State Law No. 12,292/2006 amended State Law No. 119/1973, which created our Company, and now authorizes us to provide water and sewage services outside of the state of São Paulo, both to other states of Brazil and to other countries. This law also authorizes us to own interests in other public or private public companies and Brazilian or international consortia. In addition, this law permits us to incorporate subsidiaries and enter into a partnership with or acquire interests in a private company with a corporate purpose related to the sanitation business.

In December 2007, Law No. 1,025/2007, which provided for the creation of regulatory agencies for the supervision of water and sewage services, created ARSESP, the regulatory agency that regulates and supervises the services we provide.

In September 2017, the State of São Paulo obtained approval for State Law No. 16,525/2017, which authorizes the State of São Paulo to set up a controlling company to hold all of the shares that the State of São Paulo holds in our company. Once formed, this controlling company will control our company, pursuant to the provisions of Art. 116 of the Brazilian Corporate Law. State Law No. 16,525/2017 allows other minority shareholders, including private companies and state companies, to hold shares of the controlling company, provided that the State of São Paulo holds the majority of the common shares of the controlling company. On March 9, 2018, the State of São Paulo received a letter from a group of investors expressing interest in acquiring shares of the controlling company. This letter is being assessed by the State Privatization Program's Board (*Conselho Diretor do Programa Estadual de Desestatização - CDPED*), which has authority over our corporate reorganization, including the formation of the controlling company. The transaction proposed in the letter relates only to shares of the controlling company level and therefore would not affect the corporate control of our company, which will remain held by the State of São Paulo. The identity of the investors and the content of the letter remain confidential in accordance with the rules applicable to the administrative procedure established by CDPED for the purposes of operation.

### **Corporate Organization**

We currently have six management divisions, each of which is supervised by one of our executive officers.

Our board of directors allocates responsibilities to our executive officers following an initial proposal made by our Chief Executive Officer, in accordance with our bylaws. The Chief Executive Officer is responsible for coordinating all management divisions in accordance with the policies and directives established by our shareholders' meeting, our board of directors and board of executive officers, including the coordination, evaluation and control of all functions related to the Chief Executive Officer's office and staff, integrated planning, business management and corporate organization, communication, audit, ombudsman and quality. The Chief Executive Officer represents our company before third parties and certain powers can be granted to attorneys in fact. The executive officers described below report to the Chief Executive Officer:

- the Corporate Management Officer, who is responsible for marketing (commercial processes), human resources and social responsibility, legal affairs, information technology, asset management, supplies and contracts;
- the Chief Financial Officer and Investor Relations Officer, who is responsible for financial planning, costs and tariffs, raising capital and allocating financial resources to divisions of our company, conducting capital markets and other debt incurrence transactions and managing debt levels, controller, accounting, corporate governance and investor relations;
- the Technology, Enterprises and Environment Officer is responsible for environmental management, technological and operational development, quality control of water and sewage, the development, coordination and execution of special investment programs, projects, research innovation and new business ventures; and
- the Chief Operating Officer for the São Paulo metropolitan region Division and the Chief Operating Officer for the Regional Systems Division, who are responsible for managing the operation, maintenance, execution of planning and works for water and sewage supply systems (including for the services that we provide on a wholesale basis), sales and call center services, and have overall responsibility for the financial and operational performance of their divisions. The Chief Operating Officers are also responsible for sanitation advisory services to independent municipalities and for mediation and negotiation with communities and local governments, aimed at aligning our interests with the interests of our clients.

### Capital Expenditure Program

Our capital expenditure program is designed to improve and expand our water and sewage system and to increase and protect our water sources in order to sustain water security, meet the growing demand for water and sewage services in the state of São Paulo and improve the overall environmental impact of our activities. Our capital expenditure program has four specific goals with respect to the municipalities we serve:

- (I). to continue to increase water security and meet demand growth for treated water;
- (II). to expand the percentage of households connected to our sewage system;
- (III). to increase the treatment of sewage collected; and
- (IV). to increase operating efficiency and reduce water loss.

We have budgeted investments in the total amount of R\$17.3 billion from 2018 through 2022. We invested R\$3.4 billion, R\$3.9 billion and R\$3.5 billion in 2017, 2016 and 2015, respectively.

The following table sets forth our planned capital expenditures for water and sewage infrastructure for the years indicated:

	Planned Capital Expenditures					Total
	2018	2019	2020	2021	2022	
	<i>(in millions of reais)</i>					
Water	1,445.7	1,519.8	1,445.3	1,368.3	1,341.1	7,120.2
Sewage Collection	1,200.2	1,459.6	1,397.8	1,799.0	1,875.2	7,731.8
Sewage Treatment	254.4	394.2	656.8	595.9	540.2	2,441.5
<b>Total</b>	<b>2,900.3</b>	<b>3,373.6</b>	<b>3,499.9</b>	<b>3,763.2</b>	<b>3,756.5</b>	<b>17,293.5</b>

Our capital expenditure program from 2018 through 2022 will continue to focus on achieving our targets by making regular investments to maintain and expand our infrastructure and to reduce water loss in the 368 municipalities we served as of December 31, 2017. The recent drought has prompted a reduction in the volume of water billed, particularly in 2014 and 2015, and thus a reduction in revenue. Due to the drought and the need to prioritize construction to mitigate the effects of the water crisis and increase water security in the Metropolitan Region of São Paulo, we were required to adjust our investment programs commencing in 2014. These adjustments are expected to continue in 2018 due to the priority given since 2014 to emergency investments in water.

## **Main Projects of Our Capital Expenditure Program**

The following is a description of the main projects in our capital expenditure program.

**Investments in Water** – We have a series of ongoing and scheduled projects involving water production and distribution. For the period from 2018 through 2022, we plan to spend R\$7.1 billion in water-related investments.

The main programs are:

### *Metropolitan Water Program*

Demand for our water services has grown steadily over the years in the São Paulo metropolitan region and has at times exceeded the capacity of our water systems. On account of the high demand, prior to September 1998, a portion of our customers in this region received water only on alternate days of the week. We refer to this as “water rotation”. In order to address this situation, we implemented the Metropolitan Water Program (*Programa Metropolitano de Água*) to improve regular water supply to the entire São Paulo metropolitan region. This program terminated in 2000 and the water rotation measure was eliminated, but still we have maintained our investment plans for the region.

Since 2000, the Metropolitan Water Program has increased the production capacity in 8.1 m<sup>3</sup>/s, 5 m<sup>3</sup>/s of which can be attributed to the Public Private Partnership, or “PPP”, conducted in the Alto do Tietê concluded in 2011, and 2.1 m<sup>3</sup>/s of which can be attributed to increased production in Guarapiranga System, concluded in 2015.

Aiming to improve the provision of water to the São Paulo Metropolitan Region, in April 2018, we increased treated water production capacity by approximately 6.4 m<sup>3</sup>/s by concluding construction and initiating pre-operation of the São Lourenço System. In addition, in March 2018, we began transferring water from the Jaguari reservoir (part of the Paraíba do Sul Basin) to the Atibainha reservoir (part of the PCJ River Basin). This interconnection adds 5.13 m<sup>3</sup>/s of water availability.

In 2017, we invested approximately R\$460 million in the Metropolitan Water Program.

### Interconnection of Jaguari and Atibainha Reservoirs

In March 2018, we completed the interconnection of the Jaguari and Atibainha reservoirs, which is a strategic and priority works project to guarantee secure access to water for the metropolitan region of São Paulo. With contracted investments of R\$555 million, this construction allows for the transfer of an average 5.13 m<sup>3</sup>/s of water from the Jaguari reservoir of the Paraíba do Sul Basin to the Atibainha reservoir of the Cantareira System, the largest system that provides water to the metropolitan region of São Paulo. In the future, the transfer of water shall also work in the opposite direction, from the Atibainha reservoir to the Jaguari reservoir, optimizing the reservation capacity of both reservoirs, and benefitting the population of the Paraíba Valley. The construction work on the interconnection began in February 2016 and was completed during March 2018. In March 2018, we also began transferring water from the Jaguari reservoir (part of the Paraíba do Sul Basin) to the Atibainha reservoir (part of the PCJ River Basin).

### São Lourenço Project

The metropolitan region lacks water sources, which requires us to obtain water from increasingly distant sources. In order to address this situation, we developed, under a PPP contract, a new supply system called São Lourenço, which expands our production capacity by 6.4 m<sup>3</sup>/s and should be able to benefit a population of almost 2.0 million people.

The PPP contract was executed in August 2013 and construction began in April 2014. The project was undertaken by Sistema Produtor São Lourenço S.A., which is a special purpose company controlled by the construction companies Camargo Corrêa Construtora S.A. and Andrade Gutierrez S.A. The construction of the new system began in April 2014 and was completed in April 2018. Upon completion, pre-operation began. Camargo Corrêa Construtora S.A. and Andrade Gutierrez S.A. sold their shares of Sistema Produtor São Lourenço S.A. to CGGC Construtora do Brasil Ltda., a Chinese-owned company. This transaction was completed in May 2018.

As of December 31, 2017, the estimated amount of the PPP contract was R\$6.0 billion (including R\$2.2 billion in construction and maintenance and operation of the system). After monetary adjustment, the contract amounts to approximately R\$7.9 billion and has a 25-year term, four years of which was dedicated to the construction, while the other 21 years will be dedicated to service delivery. These services include the operation and maintenance of the sludge treatment system of the water treatment plant and disposal of the waste thus generated; electromechanic and civil maintenance of the untreated water pumping stations, of the water treatment plant and the untreated water pipeline; preservation and cleaning, surveillance and property security.

#### Reversal of the Itapanhaú River

We plan to begin construction of a pumping system for the Itapanhaú River during the first half of 2018. This system is expected to have the capacity to pump an average of 2 m<sup>3</sup>/s (maximum of 2.5 m<sup>3</sup>/s) of water to Biritiba-Mirim, part of the Alto Tietê system. The project aims to improve water security in the São Paulo metropolitan region and is expected to directly benefit approximately 4.5 million residents that receive water from the Alto Tietê system as well as indirectly benefit 21 million people in the greater São Paulo region via the integrated system. We expect to invest a total of R\$91.7 million in this project.

#### Corporate Program for Reduction of Water Loss

The objective of the Corporate Program for Reduction of Water Loss (*Programa Corporativo de Redução de Perdas de Água*) is to reduce water loss by efficiently integrating and expanding existing initiatives in our business units.

This program has a 12 year term that began in 2009. We anticipate total investments of approximately R\$6.3 billion (current value) throughout the term of the program. Funding for the program will come from our own resources as well as from credit facilities provided by the Japan International Cooperation Agency, or JICA, and BNDES.

The program aims to reduce the rate of water loss from 436 liters per connection per day in December 2008 to 273 liters per connection per day by 2020, which is equivalent to reducing the Water Billed Loss Index from 27.6% in December 2008 to 17.9% in 2020 and to reducing the Water Metered Loss Index (based on measured consumption) from 34.1% in December 2008 to 29.0% in 2020. In 2017, our water loss measured 302 liters per connection per day, our Water Billed Loss Index was 20.1% and our Water Metered Loss Index averaged 30.7%.

#### Water Source Program

The Water Source Program (*Programa Mananciais*), created in 2009 and ended in 2017, consisted of various projects that focused on the preservation and improvement of water sources in the São Paulo metropolitan region, especially in the Guarapiranga and Billings reservoirs. The program's investments were directed mostly towards the creation of infrastructure to collect sewage and transport it to treatment plants in order to reduce the discharge of effluent into water sources. The program also included the protection of green spaces and the urbanization of shantytowns (*favelas*) and was supported by the federal government, the state of São Paulo, the municipality of São Paulo, the World Bank, and us. In 2017, R\$20.6 million was invested in the Water Source Program.

#### Coastal Water Program

The Coastal Water Program (*Programa Água no Litoral*) combines various long term activities to expand water production capacity in the Baixada Santista metropolitan region and the southern coast of the state of São Paulo. The program aims to benefit approximately three million people, including both the local population and tourists. It aims to increase the level of reliability of the local systems, eliminating existing and potential deficiencies and irregularities in the water supply. Through this program we aim to increase the availability of treated water and improve the quality of water available to the population. The fund will come from our own funds and financing from *Caixa Econômica*



*Federal.*

During the first phase of this program, we have focused mainly on increasing water production in order to satisfy demand and improve water quality in the Baixada Santista metropolitan region. In order to reach this goal, we built two water treatment plants, which started operations in 2013: Mambu/Branco, with water treatment capacity of 1.6 m<sup>3</sup>/s, and Jurubatuba, with water treatment capacity of 2 m<sup>3</sup>/s. We have also begun constructing two additional water treatment plants in the municipality of Peruíbe.

In 2016, the integrated system of the Baixada Santista metropolitan region was reinforced with the commencement of operations at the Melvi Treated Water Reserve Center, located in Praia Grande. The Center's reserves went from 20 million to 45 million liters. The infrastructure is part of the Mambu-Branco production center (inaugurated in 2013 in Itanhaém) and will serve residents and tourists in two municipalities of the Baixada Santista region (Praia Grande and São Vicente). In 2017, we invested R\$22.6 million in the Coastal Water Program.

**Investments in Sewage**—We have a series of ongoing and scheduled projects involving the collection, removal and treatment of sewage. For the period from 2018 through 2022, we plan to invest R\$10.2 billion in sewage. The main programs are:

### Tietê Project

The Tietê river crosses the São Paulo metropolitan region and receives most of the region's runoff and wastewater. The environmental status of the river reached a critical level in 1992. In an effort to reverse the situation, the State of São Paulo created a recovery program designed to contribute to the progressive revitalization of the Tietê river by installing sewage collection lines along the banks of the Tietê river and its tributaries. These lines collect raw sewage and deliver it to our sewage treatment facilities.

We carried out the first phase of the program between 1992 and 1998, when we completed the construction of three additional sewage treatment facilities. This involved total investment of US\$1.1 billion financed by the Inter American Development Bank, or "IADB", *Caixa Econômica Federal* and us.

The second phase of the project, which was carried out from 2000 through 2008, continued to expand and optimize the sewage system in the São Paulo metropolitan region, focusing primarily on improvements to expand the delivery of raw sewage to the sewage treatment facilities that were built in the first phase. Upon the conclusion of the second phase of the project in 2008, we were able to collect approximately 5,000 liters of raw sewage per second and send it to the five sewage treatment plants in our integrated system for treatment. Total investments in this phase amounted to approximately US\$500 million, financed by the IADB, and the *Banco Nacional de Desenvolvimento Econômico e Social*, or BNDES, and us.

The first and second phases of the Tietê Project contributed to an increase from 70.0% to 84.0% in the sewage collection rate and an increase from 24.0% to 70.0% in the treatment of sewage collected in the São Paulo metropolitan region. As a result, the sewage collection system covered a total of 15.8 million people (5.1 million more than the number of people served when the Tietê Project was initiated), and the sewage treatment system covered 11.1 million people (8.5 million more than the number of people served when the Tietê Project was initiated).

The third phase of the Tietê Project, initiated in 2010, aims to expand collection levels to 87.0% and sewage treatment levels to 84.0% in the São Paulo metropolitan region. The total estimated cost of the third phase is approximately US\$2 billion, financed by the IADB, BNDES, *Caixa Econômica Federal*, and us.

The five principal sewage treatment facilities in the São Paulo metropolitan region have an aggregate installed capacity of 20.5 cubic meters of sewage per second and currently treat an aggregate of 18 cubic meters of sewage per second (13.5 m<sup>3</sup>/s greater than the volume treated at the start of the Tietê Project).

Following completion of the third phase of the Tietê Project, the sewage treatment system will serve an additional 5 million people.

Continuing our efforts to amplify and optimize the sewage system of the São Paulo metropolitan region near the areas we serve, thus contributing to the progressive revitalization of the Tietê river, we have structured the fourth phase of the Tietê Project. The total estimated cost of this phase is approximately US\$2 billion.

We continued to work on items from the third phase and began in 2014 to implement measures related to the fourth phase. In 2017, we invested approximately R\$411.1 million in this project.

Due to the drought and the need to prioritize construction to mitigate the effects of the water crisis and increase water security in the São Paulo Metropolitan Region, we have reduced the volume of investment in this program.

Clean Stream Program

The Clean Stream Program (*Programa Córrego Limpo*), an agreement between the State, acting through our company, and the city of São Paulo, aims to decontaminate urban streams in the city of São Paulo by eliminating the discharge of sewage into streams and rainwater runoff routes, cleaning streams and banks, and removing and relocating low income households located on the banks of streams.

Since 2007, 151 urban streams have been decontaminated, benefiting approximately 2.5 million people. In 2017, we invested R\$7.8 million in the Clean Stream Program. The program is supported by funds from the *Caixa Econômica Federal* as well as our own funds. Part of the investment related to the Tietê Project benefits the Clean Stream Program.

In 2017, the actions of the Clean Stream Program allowed for the cleaning of two important streams in the city of São Paulo, Uberaba and M'Boi Mirim, benefiting approximately 270 thousand people. During the year, we also continued to inspect and monitor the water quality of streams that were previously decontaminated.

However, despite our constant monitoring of pollution levels, the municipality of São Paulo's difficulties in moving low-income families who live in risky areas has led to a slowdown in progress under the program. We have renewed the partnership with the municipality and are currently defining objectives for 2018.

### Clean Wave Program

The main goals of the Clean Wave Program (*Programa Onda Limpa*) are to improve and expand the sewage systems in the municipalities comprising the Baixada Santista metropolitan region on the southern coast of the state, increasing the sewage collection rate to 90% and treating 100% of this collected sewage, thereby improving the bathing water quality at 82 beaches in the region by the end of the decade. This project is being carried out in three phases, the first of which has already begun and the second and third of which are in the planning phase. The first phase, which increased the sewage collection rate to 77%, was completed in 2017. The funds came from our own resources as well as from loan agreements entered into with JICA and from BNDES.

In 2017, we invested R\$71 million in the Clean Wave Program. As a result of our investments, sewage collection in the Baixada Santista metropolitan region increased since the beginning of the program has increased from 53% in 2007 to 77% in 2017. All of the sewage that was collected was also treated. Towards the goal of increasing sewage collection, and given that we have already installed sewage networks, we are now prioritizing strengthening the connection of our customers to the sewage network. As of December 31, 2017, we had completed approximately 110 thousand sewage connections.

Under the program's second phase, we plan to execute the expansion and renovation of two Oceanic Sewage Disposal System in the city of Praia Grande, located in the Baixada Santista metropolitan region. This phase aims to enlarge and implement sewage collection and treatment systems and complete 47 thousand new connections. It is expected to be concluded by 2021.

Finally, the third phase of the Clean Wave Program will aim to universalize sewage collection and treatment services. This phase is planned to occur between 2026 and 2030, and will benefit areas where the population is expanding. Together, the second and third phases will invest approximately R\$1.8 billion in Baixada Santista metropolitan region.

### ***Other Policies and Programs***

#### *Nossa Guarapiranga*

In December 2011, we launched the Nossa Guarapiranga project, the main objective of which is to improve the water quality in the Guarapiranga basin, an urban water source for the São Paulo metropolitan region. The basin serves one million people directly in the areas near Guarapiranga and indirectly serves a further three million people who consume the water from the basin. We carried out actions on three fronts as part of this project: (i) we installed ecobarriers at the bottom of the reservoir's main affluents in order to retain solid residue and installed drains to collect residue from rivers in the Guarapiranga basin; (ii) we developed diagnosis and control services for the removal of

plants that obstruct water extraction; and (iii) we removed and disposed of solid residue that had accumulated at the bottom of the dam in the river basin. Two vessels were built specifically for this purpose. We work as a collaborative team with the municipal government of São Paulo in the Nossa Guarapiranga project, with the municipal government of São Paulo transporting all of the residue collected through these fronts to a sanitary landfill. In 2017, we removed 17,700 m<sup>3</sup> of solid residue from this basin.

*Pró Conexão*

In 2012, the State of São Paulo approved a project to subsidize connections to the sewage system for low income families. Initially intended to last eight years, the project involves capital expenditures of up to R\$349.5 million of which 80% will be provided by the State government and 20% by us. In this period we expect that this program will create 192 thousand new sewage connections benefiting approximately 800 thousand people. As of December 2017, we completed approximately 23.5 thousand sewage connections under the *Pró-Conexão* program.

We believe that this program will increase the efficiency of our other sewage collection programs and help improve water quality in the region's rivers and basins as well as improve quality of life for low income families. For more information see "Item 7.B. Major Shareholders and Related Party transactions—Related Party transactions—Agreements with the State."

A large part of this work was executed by our own personnel, which considerably reduced the need for investment.

## **B. Business Overview**

### **Our Operations**

As of December 31, 2017, we provided water and sewage services to 368 municipalities in the state of São Paulo under concession agreements, program agreements, other forms of legal arrangements or without formal agreements. We also supply treated water on a wholesale basis to five municipalities located in the São Paulo metropolitan region and urban conurbations. The majority of these concessions have 30 year terms. Due to court orders, we temporarily suspended our services in two other municipalities (Cajobi e Macatuba). For more information, see "Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings". Between January 1, 2007 and December 31, 2017, we entered into agreements with 287 municipalities (including our services agreement with the city of São Paulo) in accordance with the Basic Sanitation Law, of which six were entered into in 2017. As of December 31, 2017, these 287 municipalities accounted for 81.7% of our gross operating revenues (including revenues relating to the construction of concession infrastructure). In addition to the contracts that have 30 year terms, the municipalities entered into cooperation contracts with the State of São Paulo, delegating the regulation and monitoring of the provision of services to ARSESP. As of December 31, 2017, 51 of our agreements or concessions had expired but we continued to provide water and sewage services to these municipalities and were in negotiations with these municipalities to execute program agreements to substitute the expired concessions. From January 1, 2018 through 2030, 32 concessions will expire.

For more information on laws and regulations related to our concession operations, see "—Government Regulations Applicable to our Contracts".

### **Description of Our Activities**

As set forth in Article 2 of our bylaws, we are permitted to render basic sanitation services with the goal of providing basic sanitation services to the entire population in the municipalities where we conduct our activities without harming our long term financial sustainability. Our activities comprise water supply, sanitary sewage services, urban rainwater management and drainage services, urban cleaning services, solid waste management services and related activities, including the planning, operation, maintenance and commercialization of energy, and the commercialization of services, products, benefits and rights that directly or indirectly arise from our assets, operations and activities. We are allowed to act in a subsidiary form in other Brazilian locations and abroad. See "—Government Regulations Applicable to Our Contracts—Establishment of ARSESP". For a description of our operating segments please see Note 24 to our financial statements as of and for the year ended December 31, 2017.

Operating segments are presented in our annual report in a manner consistent with the internal reporting provided to our chief operating decision maker, which is the board of directors and the board of executive officers, pursuant to how that is determined under IFRS 8. Under Brazilian GAAP, prior to our conversion to IFRS, the financial information for construction services was not separately presented and construction costs related to concessions were capitalized within property, plant and equipment. As a result, our chief operating decision maker did not review the results of this business. Following our conversion to IFRS, our chief operating decision maker decided to continue to

exclude the construction results from the internal reporting of our revenues and expenses, thus not basing their decisions on discrete financial information for that business. Consequently, the business did not qualify as an operating segment under IFRS 8. Nonetheless, after our conversion to IFRS and for IFRS financial statement purposes only, we started to record such results separately as construction revenue and costs under IFRIC 12. Although such information is available discretely, however, it is not analyzed by our chief operating decision maker as such and is not the basis for operational decisions.

We set forth below a description of our activities.

## ***Wholesale Operations***

### *Wholesale Water Services*

We provide water services on a wholesale basis to five municipalities located in the São Paulo metropolitan region (Guarulhos, Mauá, Mogi das Cruzes, Santo André and São Caetano do Sul). Agreements to provide water services on a wholesale basis must comply with the Basic Sanitation Law, which designates these services as “interdependent activities” and regulates each stage of the service. The law requires that the service be supervised by an independent agency, stipulates registration of the cost of the service, and requires assurance of payment among the several service providers in order to continue the provision of the services, in accordance with the rules to be published by ARSESP. Our agreements currently comply with the provisions of the Basic Sanitation Law. In 2017, the revenues from wholesales water services were R\$ 277.7 million.

The Brazilian courts are entitled to obligate us to continue to supply water to these municipalities, even when we have not received payments due to us. If they do not pay, we have no way of ensuring that negotiations with these municipalities or legal action taken against them will result in payments being made. For example, the municipalities of Santo André, Guarulhos and Mauá owe us significant sums in respect of water that we have been providing to them on a wholesale basis. For more information, see “Item 3.D. Risk Factors—Risks Relating to Our Business—We may face difficulties in collecting overdue amounts owed to us by municipalities to which we provide water on a wholesale basis and municipal government entities”. We have intensified the process of collecting these sums and other amounts using the Single Registry of Debtors of São Paulo (*Cadastro Único de Devedores de São Paulo*), or State CADIN, and we executed Protocols of Intentions with Santo André, Guarulhos and Mauá in late 2015 and early 2016 seeking to resolve the outstanding amounts and restore normal commercial relations with them. The negotiations with Mauá and Santo André broke down in June 2016, and the Protocol of Intentions was terminated. The negotiations with Guarulhos also ended in August 2016, but we executed a new Protocol of Intentions with Guarulhos on April 10, 2017, or SAAE, and with Santo André on May 11, 2017, both with the same aim as the Protocols of Intentions previously terminated.

In August 2017, we announced that Guarulhos and us decided to move forward with the development of: (i) a judicial agreement for SAAE to pay the debt in installments, and (ii) an interdependence agreement, under which we provide the municipality of Guarulhos’ water supply on a wholesale basis. The main terms of these developments are:

I. Judicial agreement for SAAE to pay the debt owed to us in installments:

- a) Payment of the existing debt of R\$2.9 billion in 480 monthly installments, bearing interest of 0.5% per month and correction by the IPCA index; and
- b) 30% discount on the R\$2.9 billion of debt owed by the municipality of Guarulhos to our company in connection to payment during the installment period.

II. Interdependence agreement for the supply of water by us on a wholesale basis:

- a) Establishment of a guarantee in favor of our company, through the fiduciary assignment of SAAE’s receivables, with automatic segregation of amounts owed to us by the bank that centralizes SAAE’s collection; and
- b) A 20% discount on the monthly amount billed for the services of water supply on a wholesale basis, as a result of the establishment of the guarantee and the automatic payment.



We are currently negotiating the terms of these agreements and we cannot guarantee when and if definitive agreements will be signed. In 2017, the municipality of Guarulhos paid around 80% of its monthly bills on time.

With respect to the municipality of Santo André, we signed a protocol of intention on May 11, 2017 and since then we have been working with the municipality of Santo André on the preparation of studies and evaluations aimed at balancing commercial relations and debts existing between the municipality and our company.

With respect to the municipality of Mauá, on April 19, 2018 we published a press release stating that we have been in contact with the municipality of Mauá regarding directly supplying water to four neighborhoods that have been affected by a water shortage, and that will initiate formal discussions to engage in negotiations with the municipality.

#### *Wholesale Sewage Services*

Currently, we provide sewage services on a wholesale basis to the municipalities of Mauá, Mogi das Cruzes, Santo André and São Caetano do Sul. Our agreement with Santo André for these services was executed with the intervention of the Public Prosecution Office. Our agreements with the other municipalities resulted from our environmental efforts and municipal authorities' awareness of environmental issues. Through these agreements, in 2017 we treated approximately 42.8 million cubic meters of sewage from these municipalities. We believe this illustrates our commitment to social and environmental responsibility. In 2017, our revenues from wholesale sewage services were R\$35.1 million.

In December 2008, we entered into a five year agreement for the collection and treatment of 20% of the sewage generated by the city of Guarulhos. We have not yet started to provide these services, and they will only be able to commence when the construction projects on linking the Guarulhos sewage to our sewage system are finalized. These construction projects are the responsibility of the Guarulhos sanitation company, which as of December 31, 2017 had not yet carried out the necessary construction projects.

#### *Water Operations*

Our supply of water to our customers generally involves abstraction of water from various sources, subsequent treatment and distribution to our customers' premises. In 2017, we produced approximately 2,783.2 million of cubic meters of water. The São Paulo metropolitan region (including the municipalities to which we supply water on a wholesale basis) currently is, and has historically been, our core market, accounting for approximately 69.0% of water invoiced by volume in 2017.

The following table sets forth the volume of water that we produced and invoiced for the periods indicated:

	<b>Year ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
	<i>(in millions of cubic meters)</i>		
Produced:			
São Paulo metropolitan region	1,952.3	1,888.8	1,679.4
Regional Systems	830.9	807.4	787.2
<b>Total</b>	<b>2,783.2</b>	<b>2,696.2</b>	<b>2,466.6</b>
Invoiced:			
São Paulo metropolitan region	1,175.8	1,136.7	1,084.3
Wholesale	256.7	227.4	215.5
Regional Systems	643.4	626.2	613.9
<b>Total</b>	<b>2,075.9</b>	<b>1,990.3</b>	<b>1,913.7</b>

The difference between the volume of water produced and the volume of water invoiced generally represents both physical and non physical water loss. See “—Water Loss”. In addition, we do not invoice:

- water discharged for periodic maintenance of water transmission lines and water storage tanks;

- water supplied for municipal uses such as firefighting;
- water consumed in our own facilities; and
- estimated water loss associated with water we supply to shantytowns (*favelas*).

*Seasonality*

Although seasonality does not affect our results in a significant way, in general, higher water demand is observed during the summer and lower water demand during the winter. The summer coincides with the rainy season, while the winter corresponds to the dry season. The demand in the coastal region is increased by tourism, with the greatest demand occurring during the Brazilian summer holiday months.

*Water Resources*

We can abstract water only to the extent permitted by DAEE pursuant to water right granted by it. Depending on the geographic location of the river basin or if the river crosses more than one state (federal domain), the approval of ANA a federal agency under the Ministry of the Environment is required. We currently abstract substantially all of our water supply from rivers and reservoirs, with a small portion being abstracted from groundwater. Our reservoirs are filled by impounding water from rivers and streams, by diverting the flow from nearby rivers, or by a combination of both methods. For more information on water usage regulation, see “—Environmental Matters—Water Usage”.

In order to supply water to the São Paulo metropolitan region, we rely on 20 reservoirs of non treated water and 226 reservoirs of treated water, which are located in the areas under the influence of the eight water producing systems comprising the interconnected water system of the São Paulo metropolitan region. The total capacity of the water sources available for treatment in this area is 75.9 m<sup>3</sup>/s, not including an additional 5.5 m<sup>3</sup>/s resulting from the emergency construction work conducted by us in 2014 and 2015. Total current installed capacity is 75.8 m<sup>3</sup>/s and can be distributed to the São Paulo metropolitan region. Average verified production for the interconnected water system of the São Paulo metropolitan region was 60.6 m<sup>3</sup>/s during 2017. The Cantareira, Guarapiranga and Alto Tietê systems produce 82.7% of the water we distributed in the São Paulo metropolitan region in 2017.

In March 2018, we began operations on one important project for the interconnected water system of the São Paulo metropolitan region with the beginning of the transfer of water from the Jaguari reservoir to the Atibainha reservoir. The interconnection between the Jaguari and Atibainha reservoirs will have an average flow of 5.13m<sup>3</sup>/s and represents an important increase in water security for the Cantareira System and for the water supply in the São Paulo metropolitan area. For more information see “—Capital Expenditure Program—Main Projects of Our Capital Expenditure Program—Interconnection of Jaguarí and Atibainha Reservoirs”.

The construction of the São Lourenço Production System, another important project for the interconnected water system of the São Paulo metropolitan region, began in April 2014 and was completed in April 2018. Upon completion in April 2018, pre-operation began. The São Lourenço Production System represents an increase of 6.4m<sup>3</sup>/s in water availability and production capacity of the region’s integrated system and is the ninth interconnected production system for the Metropolitan Region. For more information see “—Capital Expenditure Program—Main Projects of Our Capital Expenditure Program—São Lourenço Project”.

In 2017, the Cantareira system accounted for 41.3% of the water that we supplied to the São Paulo metropolitan region (including the municipalities to which we supplied water on a wholesale basis), which represented 70.7% of our gross operating revenues (excluding revenues relating to the construction of concession infrastructure) for the year. For more information, see “Item 3.D. Risk Factors—Risks Relating to Our Business—We are exposed to risks associated with the provision of water and sewage services”.

Current river basin committees are authorized to charge both for water usage and the dumping of sewage into water bodies. We participate in the decentralized and integrated management of water resources established by the National Policy on Water Resources. We are represented by 159 employees on the State River Basin Committees and the Federal Committees that act in the state of São Paulo and in the National and State Councils on Water Resources.

The following table sets forth the water production systems from which we produce water for the São Paulo metropolitan region:

<b>Production Rate<sup>(1)</sup></b>		
<b>2017</b>	<b>2016</b>	<b>2015</b>
<i>(in cubic meters per second)</i>		

**Water production system:**

Cantareira	25.0	22.0	14.1
Guarapiranga	13.3	13.9	14.9
Alto Tietê	11.8	11.7	12.1
Rio Claro	3.9	3.8	3.9
Rio Grande (Billings reservoir)	4.5	4.9	5.0
Alto Cotia	1.2	1.2	0.9
Baixo Cotia	0.8	0.9	1.0
Ribeirão da Estiva	0.1	0.1	0.1
<b>Total</b>	<b>60.6</b>	<b>58.5</b>	<b>52.0</b>

(1) Average of the twelve months ended December 31, 2017, 2016 and 2015.

The Guarapiranga and Billings reservoirs and a portion of some of the reservoirs of the Alto Tietê system are owned by other companies controlled by the State. In the cities of the interior region of São Paulo, our principal source of water consists of surface water from nearby rivers and from wells. For additional information on the Alto Tietê system, see “Item 7.B. Related Party Transactions—Transactions with the State of São Paulo—Agreements with the State”.

Statewide, we estimate that we are able to supply nearly all of the demand for water in all of the areas where we operate, subject to droughts and extraordinary climate events. We installed 207.3, 200.2 and 226.0 thousand new water connections in 2017, 2016 and 2015, respectively. The interconnected water system of the São Paulo metropolitan region serves 30 municipalities, of which 25 are operated directly by us under this system. Through this system, we serve the other five municipalities on a wholesale basis, whereas distribution is the responsibility of other companies or departments related to each municipality.

In order to reach the final customer, the water is stored and transported through a complex and interconnected system. This water system requires permanent operational supervision, engineering inspection, maintenance, and quality monitoring and measurement control.

To ensure the continuous provision of regular water supply in the São Paulo metropolitan region, we intend to invest R\$7.1 billion from 2018 to 2022 to increase our water production and distribution capacities as well as to improve the water supply systems. In 2017, our total investment in water supply systems amounted to R\$2.2 billion, of which R\$1.8 billion were invested in the São Paulo metropolitan region.

#### *Water Treatment*

We treat all water at our water treatment facilities prior to dispatching it to our water distribution network. We operate 240 treatment facilities, of which eight are a part of the Metropolitan Production System—located in the São Paulo metropolitan region and account for approximately 70.2% of all water we produced in 2017. The type of treatment used depends on the nature of the source and quality of the untreated water. For example, water abstracted from rivers requires more treatment than water drawn from groundwater sources requires. All of the water we treat receives fluoridation treatment.

#### *Water Distribution*

We distribute water through our own networks of water pipes and water transmission lines, ranging in size from 2.5 meters to 75 millimeters in diameter. Storage tanks and pumping stations regulate the volume of water flowing through the networks in order to maintain adequate pressure and continuous water supply.

The following table sets forth the total number of kilometers of water pipes and water transmission lines and the number of connections in our network as of the dates indicated:

	<b>As of December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Water distribution pipes and water transmission lines (in kilometers)	74,396	73,015	71,705
Number of connections (in thousands)	8,863	8,654	8,420

More than 90% of the water pipes in our water distribution network are made of cast iron or polyvinylchloride, or PVC. Distribution pipes at customers’ residences typically are made from high density polyethylene tubing. Our water

transmission lines are mostly made of steel, cast iron or concrete.

As of December 31, 2017, our water distribution pipes and water transmission lines included: (i) 38,221 kilometers in the São Paulo metropolitan region; and (ii) 36,174 kilometers in the Regional Systems.

As of that date, we had 408 storage tanks in the São Paulo metropolitan region with a total capacity of 2.2 million cubic meters, and 2,031 storage tanks in the Regional Systems. Furthermore, we had 462 treated water pumping stations in the São Paulo metropolitan region aqueduct system, including stations at treatment facilities, intermediate trunk transfer pumping stations and small booster stations serving local areas.

Water transmission lines that require maintenance are cleaned and their lining is replaced. We are typically notified of water main fractures or breaks by the public through a toll free number maintained by us. We consider the condition of the water pipes and water transmission lines in the São Paulo metropolitan region to be adequate as of the date of this annual report. Due to age, external factors such as traffic, the dense population, and commercial and industrial development, water pipes and water transmission lines in the São Paulo metropolitan region are somewhat more susceptible to degradation than those in the Regional Systems. To counter these effects, we have a maintenance program in place for water pipes and water transmission lines that is intended to address anticipated fractures and clogs due to brittleness and encrustation, and to help ensure water quality in the region.

The new customers whose water pipes are more than 20 meters away from the water transmission lines are responsible for covering part of the costs of connecting to our water distribution network. They must cover the costs of connecting to the network from the customer's premises, including costs of purchasing and installing the water meter and related labor costs. We perform the installation of the water meter and conduct periodical inspections and measurements. After completion of installation, the customer is responsible for the water meter.

The following table sets forth projected new water connections for the periods indicated in thousands:

	in thousands					
	2018	2019	2020	2021	2022	2018 – 2022
São Paulo metropolitan region	105	98	97	95	95	490
Regional Systems	63	62	58	55	55	293
<b>Total</b>	<b>168</b>	<b>160</b>	<b>155</b>	<b>150</b>	<b>150</b>	<b>783</b>

### Water Loss

The difference between the volume of water produced and the volume of water invoiced generally represents both physical and non physical water loss.

The Water Billed Loss Index represents the quotient of (i) the difference between (a) the total volume of water produced minus (b) the total volume of water invoiced plus (c) the volume of water excluded from our calculation of water loss, divided by (ii) the total volume of water produced.

The Water Metered Loss Index represents the quotient of (i) the difference between (a) the total volume of water produced minus (b) the total volume of water measured minus (c) the volume of water that we exclude from our calculation of water loss, divided by (ii) the total volume of water produced.

The Water Loss per Connection per day measured in liters per connection per day represents the quotient of (i) the average annual water loss, divided by (ii) the average number of active water connections multiplied by the number of days of the year. This calculation method is based on worldwide market practice for the sector.

We exclude the following from our calculation of water loss: (i) water discharged for periodic maintenance of water transmission lines and water storage tanks; (ii) water supplied for municipal uses such as firefighting; (iii) water we consume in our facilities; and (iv) estimated water loss related to the supply of water to shantytowns (*favelas*).

Among the principal indicators utilized to measure rates of water loss are the following:

- Water Billed Loss Index (WBLI), in %;
- Water Metered Loss Index (based on metered consumption) (WMLI); and
- Water Loss per Connection, (TLDC) in liters per connection per day.

These indicators are calculated by applying the following formulas:

$$\text{WBLI} = \frac{V_{\text{produced}} - (V_{\text{invoiced}} + V_{\text{used}})}{V_{\text{produced}}}$$

$$\text{WMLI} = \frac{V_{\text{produced}} - (V_{\text{measured}} + V_{\text{used}})}{V_{\text{produced}}}$$



$$\text{TLDC} = \frac{V_{\text{produced}} - (V_{\text{measured}} + V_{\text{used}})}{N_{\text{connection}} \times \text{No. of days of a given period}}$$

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Where:

$V_{\text{produced}}$ : corresponds to the volume of water produced at a given period;

$V_{\text{billed}}$ : corresponds to the volume of water billed at a given period;

$V_{\text{measured}}$ : corresponds to the volume of water measured at a given period;

$V_{\text{used}}$ : corresponds to the volume of water used for operational, public, private and social needs (supply shantytown areas) at a given period; and

$N_{\text{connections}}$ : corresponds to the average number of active water connections.

Using this calculation method, as of December 31, 2017, we experienced 348 liter/connection per day of water loss in the São Paulo metropolitan region and 232 liter/connection per day in the Regional Systems, averaging 302 liter/connection per day. We have a Corporate Program for Reduction of Water Loss in place that aims to reduce total water loss to around 273 liters/connection per day, Water Billed Loss Index to 17.9% and the Water Metered Loss Index to 29.0% by 2020. Nonetheless, on account of the drought, the negative impacts on our revenue during 2015 and the necessity to prioritize investing in the expansion of water availability, the scope and the goals of our Corporate Program for Reduction of Water Loss are under revision.

In order to continue to supply water to the population despite its low availability, one of the measures that we adopted was to further reduce water pressure across our network of operation. Inasmuch as the utilization of water sources, real water loss (water physically lost, which corresponds to about 65% of the Water Metered Loss Index) fell from 22.2% in December 2008 to 20.0% in December 2017. This reduction is not only the result of initiatives to combat water loss including, for example, strengthening our supply systems' "pressure management", but it can also be attributed to atypical and temporary operations.

For more information on the measure we have adopted to confront the water crisis, see "—The Recent Water Crisis".

Our strategy to reduce water loss has two approaches:

- reduction in the level of physical loss, which results mainly from leakage. To this end we are primarily replacing and repairing water transmission lines and pipes and installing probing and other equipment, including strategically located pressure regulating valves; and
- reduction of non physical loss, which results primarily from the inaccuracy of our water meters installed at our customers' premises and from clandestine and illegal use. To this end we are upgrading and replacing inaccurate water meters and expanding our anti fraud personnel.

We are taking measures to decrease physical loss by reducing response time to fix leakages and by better monitoring of non visible water main fractures. Among other initiatives, we have adopted the following measures to reduce physical water loss:

- the introduction of technically advanced valves to regulate water pressure throughout our water transmission lines in order to maintain appropriate water pressure downstream. These valves are programmed to respond automatically to variations in demand. During peak usage, the flow of water in the pipes is at its highest point;

however, when demand decreases, pressure builds up in the water transmission lines and the resulting stress on the network can cause significant water loss through cracks and an increase in ruptures of the pipes. The technically advanced valves are equipped with probes programmed to feed data to the valve in order to reduce or increase pressure to the water transmission lines as water usage fluctuates; the reconfiguration of interconnected water distribution to permit the distribution of water at lower pressure;

- the implementation of routine operational leak detection surveys to reduce overall water loss;

- the monitoring of and improved accounting with respect to water connections, especially for large volume customers;
- regular checking on inactive customers and monitoring non residential customers that are accounted for as residential customers and, therefore, billed at a lower rate;
- preventing fraud with the use of new, more sophisticated water meters that are more accurate and less prone to tampering;
- installing water meters where none are present; and
- conducting preventive maintenance of existing and newly installed water meters.

### *Water Quality*

We believe that we supply high quality treated water that is consistent with the standards set by Brazilian law, which are similar to the standards set in the United States of America and Europe. Pursuant to the Brazilian Ministry of Health (*Ministério da Saúde*) regulations, we have significant statutory obligations regarding the quality of treated water.

In general, the state of São Paulo has excellent water quality from underground or surface water sources. However, high rates of population growth, increased urbanization and disorganized occupation of some areas of the São Paulo metropolitan region have reduced the quantity and quality of water available to serve the population in the southern area of the São Paulo metropolitan region and in the coastal region. Currently, we successfully treat this water to make it potable. We are also investing in improvements of our water transmission lines and our treatment systems to ensure the quality and availability of water for the upcoming years.

Water quality is monitored at all stages of the distribution process, including at the water sources, water treatment facilities and in the distribution network. We have 15 regional laboratories, one central laboratory, and laboratories located in all water treatment facilities that monitor water quality, as required by our standards and those set by law. Our laboratories analyze an average of 90 thousand samples per month on distributed water, with samples collected from residences. Our central laboratory located in the city of São Paulo is responsible for organic compound analysis using the chromatographic and spectrometric methods as well as heavy metals analysis by atomic absorption technique. Our central laboratory and 13 of our regional laboratories have obtained the ABNT NBR ISO IEC 17025 accreditation (accreditation for general requirements for the competence of testing and calibration laboratories) awarded by the National Institute of Metrology, Quality and Technology, or INMETRO.

All chemical products used for water treatment are analyzed and follow strict specifications set out in recommendations made by the National Health Foundation (*Fundação Nacional de Saúde*), or NHF, ABNT, and the National Standard Foundation, or NSF, and the American Water Works Association, or AWWA, to eliminate toxic substances that are harmful to human health. From time to time, we face problems with the proliferation of algae, which may cause an unpleasant taste and odor in the water. In order to mitigate this problem, we work on: (i) fighting algae growth at the water source and (ii) using advanced treatment processes at the water treatment facilities that involve the use of powdered activated carbon and oxidation by potassium permanganate. The algae growth creates significant additional costs for water treatment because of the higher volumes of chemicals used to treat the water. Until the conclusion of the program in 2017, we participated in the Water Source Program (*Programa Mananciais*) together with other organizations engaged in the promotion of urban development and social inclusion to mitigate pollution in the São Paulo metropolitan region. In addition, we also participate in the Clean Stream Program to clean important streams in the city of São Paulo. Other initiatives also aimed at improving the water quality in the

water sources located in the of São Paulo metropolitan region are *Nossa Guarapiranga* and *Pró Conexão*. See “—Main Projects of Our Capital Expenditure Program—Metropolitan Water Program—Water Source Program,” “—Clean Stream Program,” and “—Other Policies and Programs—Nossa Guarapiranga”.

We believe that there are no material instances where our standards are not being met. However, we cannot be certain that future breaches of these standards will not occur.

#### *Fluoridation*

As required by Brazilian law, we add fluoride to the water at our treatment facilities prior to its distribution into the water supply network. Fluoridation primarily consists of adding fluorosilicic acid to water at between 0.6 mg/L and 0.8 mg/L to assist in the prevention of tooth decay among the population.

### *Sewage Operations*

We are responsible for the collection, removal, treatment and final disposal of sewage. As of December 31, 2017, we collected approximately 81% and 85% of all the sewage produced in the municipalities in which we operate in the São Paulo metropolitan region and in the Regional Systems, respectively. During 2017, we collected approximately 83% of all the sewage produced in the municipalities in which we operated in the state of São Paulo. We installed 221.8 thousand, 236.6 thousand and 226.1 thousand new sewage connections in 2017, 2016 and 2015, respectively.

### *Sewage System*

The purpose of our sewage system is to collect and treat sewage and to adequately dispose of the treated sewage. As of December 31, 2017, we were responsible for the operation and maintenance of 50,991 kilometers of sewage lines, of which approximately 26,544 kilometers are located in the São Paulo metropolitan region and 24,447 kilometers are located in the Regional Systems, respectively.

The following table sets forth the total number of kilometers of sewage lines and the total number of sewage connections in our network for the periods indicated:

	<b>As of December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Sewage lines (in kilometers)	50,991	50,097	48,774
Sewage connections (in thousands)	7,302	7,091	6,861

Our sewage system comprises a number of systems built at different times and constructed primarily from clay pipes and, more recently, PVC tubing. Sewage lines larger than 0.5 meters in diameter are primarily made of concrete. Our sewage system is generally designed to operate by gravitational flow, although pumping stations are required in certain parts of the system to ensure the continuous flow of sewage. Where pumping stations are required, we use sewage lines made of cast iron.

The public sewage system operated by us was structured in order to receive, in addition to household effluents, a portion of non-domestic effluents (such as industrial sewage and sewage from other non domestic sources) for treatment together with household effluents. Non-domestic effluents have characteristics that are qualitatively and quantitatively different from household effluents. As a result, the discharge of non-domestic effluents into the public sewage system is subject to compliance with specific legal demands with the purpose of protecting the sewage collection and treatment systems, the health and safety of operators and the environment. The current environmental legislation establishes standards for the discharge of these effluents into the public sewage system and stipulates that such effluents be subject to pretreatment. These standards are defined in State Decree No. 8,468/1976.

Before the discharge is permitted, we carry out acceptance studies that assess the capacity of the public sewage system to receive the discharge as well as the compliance with regulations. Upon the conclusion of these studies, the technical and commercial conditions for receiving the discharge are established, which are then formalized in a document signed by us and the effluent producer. Failure to comply with these conditions can lead to the application of penalties by us. In extreme cases, the State of Sao Paulo Environmental Agency (*Companhia Ambiental do Estado de São Paulo*), or CETESB, is notified in order for the applicable measures to be taken. Effluents from our treatment facilities must comply with limitation guidelines for release of effluents into receiving water bodies. Additionally, the quality of the water in the receiving water body must not be impaired by the release of such effluents, as established

by State Decree No. 8,468/1976 and Conama Resolution No. 357/2005, as amended by Conama Resolution No. 430/2011.

We considered the condition of the sewage lines in the São Paulo metropolitan region to be adequate as of the date of this annual report. Due to a greater volume of sewage collected, a higher population and more extensive commercial and industrial development, the sewage lines in the São Paulo metropolitan region are more deteriorated than those of the Regional Systems. To counter the effects of deterioration, we maintain an ongoing program for the maintenance of sewage lines intended to address anticipated fractures arising from obstructions caused by system overloads.

Unlike the São Paulo metropolitan region, the interior region of São Paulo State does not generally suffer obstructions caused by sewage system overload. The coastal region, however, experiences obstructions in its sewage lines primarily due to infiltration of sand, especially during the rainy season in the summer months. In addition, the sewage coverage ratio in the coastal region is lower than in the other regions served by us, at approximately 79% as of December 31, 2017.

New sewage connections are made on substantially the same basis as connections to water lines: we assume the cost of installation for the first 20 meters of sewage lines from the sewage network to all customers' sewage connections and the customer is responsible for the remaining costs.

The following table sets forth projected new sewage connections for the periods indicated:

	2018	2019	2020	2021	2022	2018	2022	
	<i>in thousands</i>							
São Paulo metropolitan region	115	138	146	155	123		677	
Regional Systems	85	87	90	90	87		439	
<b>Total</b>	<b>200</b>	<b>225</b>	<b>236</b>	<b>245</b>	<b>210</b>		<b>1,116</b>	

#### *Sewage Treatment and Disposal*

In 2017, approximately 63% and 98% of the consumer units of the sewage services used our sewage treatment system in the São Paulo metropolitan region and the Regional Systems, respectively, or 75% of the consumer units of our sewage services in the state of São Paulo, was connected at our treatment facilities and afterwards discharged into receiving water bodies such as rivers and the Atlantic Ocean, in accordance with applicable legislation. Though we have not yet reached full coverage of sewage collection and treatment services in the regions where we operate, we are making efforts to reach this goal.

We currently operate nine ocean outfalls and 548 sewage treatment facilities, of which the five largest, located in the São Paulo metropolitan region, have treatment capacity of approximately 21 cubic meters of sewage per second.

In the São Paulo metropolitan region, the treatment process used by most treatment facilities is the activated sludge process.

Sewage treatment in the Regional Systems will vary according to the particularities of each area. In the interior region of São Paulo State, treatment consists largely of stabilization ponds. There are 440 secondary treatment facilities in the interior region of São Paulo State that have treatment capacity of approximately 16 cubic meters of sewage per second. Similar to our disposal process for treated sewage collected in the São Paulo metropolitan region, the majority of sewage collected in the coastal region receives treatment and disinfection and is then discharged into rivers and also into the Atlantic Ocean through our ocean outfalls, in accordance with applicable legislation. We have 84 sewage treatment facilities in the coastal region.

We are a party to a number of legal proceedings related to environmental matters. See “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”. In addition, our capital expenditure program includes projects to increase the amount of sewage that we treat. See “Item 4.A. History and Development of the Company—Capital Expenditure Program” and “Item 4.B. Business Overview—Environmental Matters—Environmental Regulation—Sewage Requirements”.



*Sludge Disposal*

The generation of sludge is inherent to the sanitation cycle. The treatment of water and sewage produces residue which needs to be disposed of appropriately to prevent harm to the environment. Sludge removed from the treatment process typically contains water and a very small proportion of solids. We use filter presses, belt presses, drying beds and centrifugation machines, among other processes, to abstract the water from the sludge.

Sludge disposal must comply with State and Federal law requirements, such as Resolution No. 375/2006 of the CONAMA, Federal Law No. 12,305/2010, Federal Decree No. 7,404/2010, State Law No. 12,300/2006 and State Decree No. 54,645/2009.

Currently, the sludge generated through our activity goes mainly to landfills. In turn, we treat the leachate generated in these landfills.

Current legislation and the population at large demand advances in the search for alternative technologies that minimize the generation of and find beneficial uses for sludge. In light of these demands, we work on several fronts, seeking innovative approaches to the destination and final disposal of sludge.

Additionally, using financing from the Financier of Studies and Projects (*Financiadora de Estudos e Projetos*, or FINEP), we are also developing two other innovating projects aiming to reduce the disposal of sludge in landfills.

The first project uses a gasification system that uses specialist technology to transform sludge from sewage treatment plants into a solid product, weighing 5% of its initial weight, which can be re-used in construction work. The second project consists of a sludge dryer that uses highly mechanized and automated processes, drawing on solar energy, to reduce up to 70% of initial volume.

### Principal Markets in Which We Operate

As of December 31, 2017, we operated water and sewage systems in 368 of the 645 municipalities in the state of São Paulo. In addition, we currently supply water on a wholesale basis to five municipalities located in the São Paulo metropolitan region with a total population of approximately 3.0 million people.

The following table provides a breakdown of gross revenues from water supply and sewage services by geographic market for the years indicated:

	Year ended December 31,		
	2017	2016	2015
	<i>(in millions of R\$)</i>		
São Paulo metropolitan region	8,636.9	7,749.7	6,021.9
Regional Systems	3,586.8	3,372.5	2,924.9
<b>Total</b>	<b>12,223.7</b>	<b>11,122.2</b>	<b>8,946.8</b>

### Competition

In the state of São Paulo, there are 277 municipalities that operate their own water and sewage systems and that collectively have a total population of approximately 16.5 million, or approximately 38% of the population of the state of São Paulo.

The competition for municipal concessions arises mainly from the municipalities, as they may resume the water and sewage services that were granted to us and start providing these services directly to the local population. In this case, the municipal governments would be required to indemnify us for the unamortized portion of our investment. See “—Risk Factors—Risks Relating to Our Business—Municipalities may terminate our concessions before they expire in certain circumstances. The indemnification payments we receive in such cases may be less than the value of the investments we made”. In the past, municipal governments have terminated our concessions agreements before the expiration date. Furthermore, municipal governments have tried to expropriate our assets in an attempt to resume the provision of water and sewage services to local populations. See “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”. We negotiate expired concession agreements and concession agreements close to expiration with the municipalities in an attempt to maintain our existing areas of operations. In the state of São Paulo we face competition from private and municipal water and sewage service providers.

In recent years, we have also experienced an increasing level of competition in the market of water supply to industrial customers. Several large industrial customers located in municipalities we serve use their own wells to meet their water needs. In addition, competition for the disposal of non residential, commercial and industrial sludge in the São

Paulo metropolitan region has increased in recent years as private companies offer stand alone water treatment solutions inside the facilities of their customers. We have also established new tariff schedules for commercial and industrial customers in order to assist us in retaining these customers. Since these fixed demand agreements (take-or-pay contracts) with certain of our industrial customers were not covered by our bonus program, until April 2016, we suspended the fixed demand requirement in order to encourage lower water consumption. In May 2016, we reinitiated the fixed demand requirement, and the volumes of those contracts were revised according to clients' new consumption profiles. We started 2017 with 466 formal contracts and, after revision of the charge and volume, ended the year with 482 contracts. 18 contracts were terminated because they did not meet the minimum amount required.

Of the remaining 482 contracts, 40 were entered into in 2017. For more information about the water crisis, see “—The Recent Water Crisis”. For more information on Take-or-pay Contracts see “—Tariff Structure—Fixed Demand Agreements (Take-or Pay)”. For more information about the water crisis, see “—The Recent Water Crisis”.

## **Billing Procedures**

The procedure for billing and payment of our water and sewage services is largely the same for all customer categories. Water and sewage bills are based upon water usage determined by monthly water meter readings. Larger customers, however, have their meters read every 15 days to monitor consumption and thus avoid water loss resulting from leakages. Sewage billing is included as part of the water bill and is based on the water meter reading.

The majority of the bills for water and sewage services are delivered to our customers in person, mainly through independent contractors who are also responsible for reading water meters, although a proportion of clients elected, for convenience purposes, to receive their bill through regular mail. Water and sewage bills can be paid at some banks and other locations in the state of São Paulo. These funds are paid over to us after deducting average banking fees ranging from R\$0.29 to R\$1.32 per transaction for collection and remittance of these payments. Customers must pay their water and sewage bills by the due date if they wish to avoid paying a fine. We generally charge a penalty fee and interest on late bill payments. In 2017, 2016 and 2015, we received payment of 94.1%, 93.0% and 90.4%, respectively, of the amount billed to our retail customers, and 94.1%, 93.0% and 90.2%, respectively, of the amount billed to those customers other than State entities, within 30 days after the due date. In 2017, 2016 and 2015, we received 99.2%, 97.2% and 96.2%, respectively, of the amount billed to the State entities. Amounts in excess of 100.0% reflect our recovery of amounts billed in prior years. With respect to wholesale supply, in 2017, 2016 and 2015, we received payment of 60.1%, 74.1% and 43.8%, respectively, of the amount billed within 30 days.

We monitor water meter readings by use of hand held computers and transmitters. The system allows the meter reader to input the gauge levels on the meters into the computer and automatically print the bill for the customer. The hand held computer tracks water consumption usage at each metered location and prepares bills based on actual meter readings. Part of the water meter monitoring for billing purposes is carried out by our own personnel, trained and supervised by us, and part of it is carried out by third party contractors that employ and train their own personnel whose training we supervise.

## **Tariffs**

Tariff adjustments follow the guidelines established by the Basic Sanitation Law and ARSESP. The guidelines also establish procedural steps and the terms for the annual adjustments. The adjustments have to be announced 30 days prior to the effective date of the new tariffs, which previously would take effect in September. Pursuant to the most recent tariff revision, both the base date and future adjustments took place in April. In addition, on January 19, 2017 ARSESP released Resolution n° 706, which divided the Second Ordinary Tariff Revision process into two parts. The first part ended in October 2017, and the second part ended in May 2018.

Tariffs have historically been adjusted once a year and for periods of at least 12 months. See “—Government Regulations Applicable to our Contracts—Tariff Regulation in the State of São Paulo” for additional information regarding our tariffs.

With the publication of the Basic Sanitation Law, Federal Law No. 11,445/2007, states have been required to establish independent regulators responsible for the regulation of basic sanitation services, including tariff regulation. To exercise this assignment, the State of São Paulo enacted State Law No. 1,025/2007, which established ARSESP, which regulates and supervises the services we provide to the State and also to the municipalities that have agreed to its jurisdiction. The guidelines by which we readjust our tariffs are defined pursuant to State Decree No. 41,446/1996, which was ratified by Federal Law No. 11,445/2007 and regulated by by resolutions issued by ARSESP.

In regards to municipalities that have not explicitly selected ARSESP as their regulator, the Basic Sanitation Law allows the municipality to create other regulatory agencies of their own. In 2007, the municipality of Lins decided to create its own regulatory authority, although it revised this decision in 2010, transferring to ARSESP the regulation of

the water activities performed in Lins, including for the setting of tariffs. The municipality of Lins has reserved, however, the power to ultimately approve the tariff set by ARSESP.

In addition, in 2011, the municipalities located in the hydrographic basins of the Piracicaba, Capivari and Jundiaí rivers created a consortium known as ARES/PCJ to regulate and supervise our activities in those areas, and for similar purposes, in November 2013 the Regulatory Agency of São Bernardo do Campo (AR/SBC) was created. As a result of the creation of the ARES/PCJ, we are currently involved in legal proceedings in which ARES/PCJ is claiming that it has jurisdiction over the regulation and supervision of our activities in three municipalities (Mombuca, Santa Maria da Serra and Aguas de São Pedro). In 2016 we obtained a definitive favorable decision in the Piracaia proceeding. However, as the debate continues in other processes, we cannot predict the outcome of this case or how it may impact our business. Furthermore, regional and municipal agencies may continue to be created and may dispute with ARSESP regarding the regulation and oversight of our services. See “Item 3.D. Risk Factor—Risks Relating to Our Business—Current regulatory uncertainty, especially with regard to implementation and interpretation of the Brazilian Basic Sanitation Law, may have an adverse effect on our business”.

In 2009, ARSESP invited public discussion and hearings to take place regarding the methodology for tariff revisions. In 2010, ARSESP issued Resolution No. 156/2010. This resolution established the methodology and general criteria for the valuation of our regulatory asset base to be used for purposes of tariff review processes and auditing. In May 2011, ARSESP disclosed the applicable weighted average cost of capital (8.06%) and disclosed in April 2012 the methodology for tariff revisions. In November 2012, ARSESP published a preliminary technical note for public consultation, proposing a preliminary initial maximum average tariff (P0) and X Factor, based on a preliminary evaluation of assets held by us.

In 2012 and 2011, we readjusted our prices by 5.15% and 6.83% starting on September 11, 2012 and on September 11, 2011, respectively. On April 22, 2013, ARSESP approved a preliminary tariff revision of 2.3509% to be applied equally on all customer tariffs. These adjustments were valid for all municipalities we serve, except for the municipalities that possess specific contractual tariff clauses.

### ***First Ordinary Tariff Revision (2013-2016)***

On November 1, 2013, ARSESP issued Resolution No. 435/2013 which authorized us to implement a tariff adjustment. Initially, this adjustment considered an inflation rate of 6.2707% as measured by the IPCA for the period from August 2012 to July 2013. From this number, ARSESP deducted the efficiency factor, or “X Factor”, of 0.4297% for the period, and this resulted in an adjustment of 5.8410%. Additionally, ARSESP estimated the gain that we had with the preliminary tariff revision of 2.3509% beginning in April 2013, and this resulted in a further reduction of 0.9249% in the indicator. Moreover, ARSESP also estimated our loss of 0.6538% resulting from the delay in the repositioning of the IPCA and added that estimated amount. The product of these estimations and considerations resulted in a linear increase of 3.1451% in tariffs beginning December 11, 2013.

In April 2014, ARSESP issued Resolution No. 484/2014 (further ratified by ARSESP Resolution No. 520/2014), which, among other things: (i) established that, as of May 11, 2014, a tariff repositioning index of 5.4408% in relation to our tariffs at the time and an annual X Factor of 0.9386%, which will be deducted in the upcoming annual tariff adjustments, shall be applied to water services bills; (ii) allowed us to apply the repositioning index arising from the tariff revision at a more opportune future date, when we proceeded with a recalculation and monetary adjustment of the applicable amounts, in order to ensure our economic and financial balance, taking into account the atypical situation in our market due to the lack of rainfall and our measures to encourage water savings in order to ensure supply; (iii) established that the next annual tariff adjustments would occur on the following dates: on April 11, 2015 and April 11, 2016, with the next tariff revision on April 11, 2017; and (iv) ratified the readjustment rules set forth on Resolution No. 406/2013 and updated the X Factor for the tariff cycle from 0.836% to 0.9386%. The tariff structure was in place with respect to our services until the new structure was approved by ARSESP and implemented. Considering what was established by Resolution No. 484/2014, we decided to postpone the application of the repositioning index to an opportune date no later than the end of December 2014.

ARSESP Resolution No. 520/2014, published on November 27, 2014, authorized us to implement a final tariff revision as of December 27, 2014 with a repositioning index of 6.4952%. This percentage corresponds to the index of the 5.4408% tariff revision increase already granted as a result of the conclusion of the tariff revision, approved by ARSESP Resolution No. 484/2014 of April 10, 2014, and an additional 1% index, accrued to the index for partial compensation regarding the postponement of the tariff revision application. This additional 1% index may be revised or supplemented after ARSESP analyzes data related to our loss in revenue on account of the application postponement.

*Water Consumption Reduction Incentive Program and Contingency Tariff as a Result of the Water Crisis*

ARSESP Resolution No. 469, published in February 2014, authorized us to adopt a Water Consumption Reduction Incentive Program for consumers whose consumption of water was reduced by 20% in comparison with their consumption in the period from February 2013 through January 2014.

In April 2014, the incentive program was extended for the entire São Paulo metropolitan region until the end of 2014 or until the water level in the reservoirs normalized. In May 2014, the incentive program was extended to the municipalities we served in Piracicaba, Capivari and the Jaguari River Basin in the Cantareira System catchment area, and remained in effect for invoices issued between June and December 2014. This latter extension of the incentive program was suspended on April 17, 2015.

In October 2014, we implemented changes to the discount ranges in the bonus program: (i) customers who reduced their water consumption by 10-15% became entitled to a 10% discount on their service bill; (ii) customers who reduced their water consumption by 15-20% became entitled to a 20% discount; and (iii) customers who reduced their water consumption by 20% or more became entitled to a 30% discount.

ARSESP Resolution No. 536, published in December 2014, authorized us to extend the Water Consumption Reduction Incentive Program until the earlier of either the end of 2015 or the date on which levels in the reservoirs normalizes.

In December 2015, we requested ARSESP to ratify the continuity and update of the Water Consumption Reduction Incentive Program through the Bonus grant to the Water and Sewage Bill, as well as the continuity of the Contingency Tariff. In response, ARSESP published the following 2 resolutions:

(1) Resolution No. 614/2015, published in December 2015, authorized the extension until December 31, 2016, or until hydrological conditions become more predictable, of the effects of ARSESP Resolution No. 545/2015, maintaining the current rules and conditions for the application of the contingency tariff by us envisaged in Resolution No. 545/2015; and

(2) Resolution No. 615/2015, also published in December 2015, authorized the extension of the Water Consumption Reduction Incentive Program until December 31, 2016, or until hydrological conditions become more predictable, and updated of the reference consumption value used to determine when discounts should be offered to our customers. Prior to this resolution, the reference consumption value by which we calculated the discounts was the average consumption of our customers in the period between February 2013 and January 2014. As of December 2015, we modified the reference consumption value, which was set at 78% of the prior reference consumption value. The updated reference consumption value began to be applied to our customers' bills as of February 1, 2016. The bonus ranges of 10%, 20% and 30%, were maintained, following the rules of our discount (bonus) program which established that if a client consumes 10% less water during a certain period compared to his reference consumption value, he will obtain a discount of 20% in his water bill, and if the client consumes 20% less water, he obtains a discount of 30%.

ARSESP Resolution No. 545/2015, published in January 2015, authorized us to implement a contingency tariff mechanism consisting of additions to water and sewage bills for customers whose monthly consumption exceeds the average monthly consumption verified, between February 2013 and January 2014. The tariff is subject to a contingency as follows:

- I. a 40% increase on the tariff amount applicable to the water consumption portion that exceeds up to 20% of the average; or
- II. a 100% increase on the tariff amount applicable to the water consumption portion that exceeds more than 20% of the average.

#### *Extraordinary Tariff Revision as a Result of the Water Crisis*

In March 2015, we filed a request with ARSESP for an extraordinary tariff revision due to the decline in the volume of water billed because of the water crisis and the unforeseen increase in electricity tariffs. After analyzing our request and receiving opinions through public consultations, ARSESP published Resolutions No. 560/2015 and No. 561/2015:



I. Resolution No. 560/2015, published May 4, 2015, authorized a readjustment of 7.7875% on existing tariffs, which constituted of: (i) an annual tariff readjustment for the year of 2015 of 7.1899%, calculated based on the 8.1285% variation in the IPCA in the period between March 2014 and March 2015, minus the efficiency factor of 0.9386%; and (ii) the additional adjustment of 0.5575% due to the postponement of the application of the Ordinary Tariff Review (the tariff review that adjusts tariffs according to inflation), authorized in May 2014 but only applied in December 2014, when it was partially compensated; and

II. Resolution No. 561/2015, also published May 4, 2015, established the 6.9154% index of the Extraordinary Tariff Revision (the tariff revision we requested due to the decline in the volume of water billed due to the water crisis and the unpredicted increase in electricity tariffs) of the Company, applicable to the tariffs authorized on this date by Resolution No. 550. Both tariff adjustments, combined, resulted in the 15.24% index. The new tariff values began apply on June 5, 2015.

*Cancellation of Water Consumption Reduction Incentive Program and Contingency Tariff*

In March 2016, we filed with ARSESP a request to cancel the Water Consumption Reduction Incentive Program and the Contingency Tariff. In response, ARSESP published on March 31, 2016, the following Resolutions:

I. Resolution No. 640/2016, authorizing the cancellation of the Contingency Tariff, which was applied to water meter readings as of May 1, 2016; and

II. Resolution No. 641/2016 authorizing the cancellation of the Water Consumption Reduction Incentive Program, which granted discounts to water and sewage bills. This cancellation was applied to water meter readings as of May 1, 2016.

*Second Ordinary Tariff Revision (2017-2020)*

The Second Ordinary Tariff Revision was originally expected to occur in April 2017. To this effect, on October 15, 2016, ARSESP released Resolution No. 672/2016, after public consultation, establishing the methodology and criteria for the update of our regulatory asset base in the Second Ordinary Tariff Revision.

Due to delays in retaining a consulting company to advise ARSESP on the tariff revision and to the fact that it was impossible to predict when this consulting would be retained, ARSESP released Resolution No. 706/2017 on January 19, 2017. This resolution divided the Second Ordinary Tariff Revision process into two parts. Due to extensions resulting from the need for supplemental information from us, the first part, which was initially expected to be concluded by June 30, 2017, was completed on October 10, 2017. The second part was concluded in May 2018.

On October 6, 2017, ARSESP published the Final Technical Note NT/F/004/2017 and the Detailed Report on the first part of the Second Ordinary Tariff Revision. These publications set the initial regulatory remuneration asset base at R\$40.3 billion (although this value is not yet final), increased the annual rate (WACC) from 8.06% to 8.11% and set the preliminary tariff revision (Preliminary P0) at R\$3.6386/m<sup>3</sup> using the April 2017 price. On October 10, 2017, ARSESP approved Resolution No. 753/2017, authorizing us to apply the tariff repositioning index of 7.8888% to the current rates beginning 30 days after the publication of Resolution No. 753/2017.

On November 10, 2017, ARSESP approved the increase of the Regulatory, Control and Inspection Fee (*Taxa de Regulação, Controle e Fiscalização*, or TRCF) by 0.5%. This increase is reflected in customer bills in the municipalities regulated by ARSESP, pursuant to Paragraph 2 of Article 2 of ARSESP Resolution No. 406/2013. This fee was initially established by the State Complementary Law No. 1.025/2007.



With respect to the second stage of the Second Ordinary Tariff Revision, on March 26, 2018, ARSESP released Preliminary Technical Note NT/F/0004-2018 with the proposed calculation of the maximum average tariff (P0) and the X Factor. This technical note established a final regulatory asset base of R\$38.4 billion, a WACC of 8.11%, an X Factor of 0.9287%, a P0 of R\$3.8207/m<sup>3</sup> and a tariff repositioning index of 4.7744%. After Public Consultation and Public Hearings on the Final P0 proposal during the period from March 27, 2018 to April 17, 2018, ARSESP released, on May 9, 2018, Final Technical Note NT/F/0006/2018 and Resolution No. 794/2018 with tariffs effective 30 days after publication.

The final result of the second stage of the Second Ordinary Tariff Revision established a final regulatory asset base of R\$39 billion, a WACC of 8.11%, an X Factor of 0.8888%, a P0 of R\$3.7702/m<sup>3</sup> and a tariff repositioning index of 3.5070%.

On May 24, 2018, as a result of the final result of the Second Ordinary Tariff Revision, we filed a reconsideration request as well as a clarification and revision request with ARSESP.

The reconsideration request includes an administrative appeal requesting that the regulatory decision substantiated by ARSESP Resolution No. 794/2018 be revised to apply due compensatory adjustments for revenue, cost of electricity and investments executed between 2013 and 2016.

The clarification and revision request includes requests for (i) an explanation of the significant reduction in the final Operational Expenditure 2017-2020 forecast; and (ii) a revision of the X Factor calculation, a revision to account for compensatory adjustments for the delay in the Second Ordinary Tariff Revision's effectiveness and a revision of the calculation of the financial component related to municipal funds.

*Contract with the State and the City of São Paulo, dated June 23, 2010*

With regard to the contract dated June 23, 2010, executed with the State and the city of São Paulo to regulate the provision of water and sewage services for the next 30 years, among other principal terms of this agreement, we must transfer 7.5% of our gross revenues, subtracting the COFINS and PASEP taxes and unpaid bills of publicly owned properties in the city of São Paulo, to the Municipal Fund for Environmental Sanitation and Infrastructure (Fundo Municipal de Saneamento Ambiental e Infraestrutura), ARSESP issued the following resolutions:

- In March 2013, ARSESP issued Resolution No. 407/2013, authorizing us to pass on to our consumers the 7.5% transfer to the Municipal Fund for Environmental Sanitation and Infrastructure, as defined by municipal legislation. Pursuant to the Sewage and Water Supply Service Contracts, this charge must be considered in the tariff revision.
- In April 2013, ARSESP issued Resolution No. 413/2013, which effectively suspended Resolution No. 407/2013 until the first tariff revision process is concluded, thereby postponing our authorization to pass on to our consumers' service bill the charge for the Municipal Fund for Environmental Sanitation and Infrastructure. The postponement of Resolution No. 407 was due to a request from the Government of the State of São Paulo to analyze, among other matters, methods of reducing the impact on consumers.
- In May 2014, ARSESP issued Resolution No. 488/2014, which maintained the suspension of ARSESP Resolution No. 407/2013 until the outcome of the revision of the contract signed between us, the city of São Paulo and the State of the São Paulo is known, thereby delaying the authorization to pass on to our consumers' service bill the charge for the Municipal Fund for Environmental Sanitation and Infrastructure. We cannot be certain when the contract will be revised or when we will be able to pass the 7.5% charge on to consumers through the service bill.

- In December 2016, we concluded the first four-year revision of our contract with the city of São Paulo, which altered our service quality, investment and investment tracking targets. However, the issue of the 7.5% charge was not discussed.
- In January 2018, the second step of our Second Ordinary Tariff Revision was initiated. In this review, the possibility of including the average tariff in the portion related to transfers to municipal funds, as is the case with the 7.5% that we transfer to the São Paulo Municipal Fund for Environmental Sanitation and Infrastructure, was discussed.
- On May 9, 2018 ARSESP announced the final results of the Second Ordinary Tariff Revision, recognizing the regulatory limit of 4% of each municipality's direct operating revenue in the tariff calculation. As a result, 1.84% was declared the tariff for the Municipality of São Paulo, corresponding to the 4% regulatory limit.
- On May 24, 2018, as a result of the final result of the Second Ordinary Tariff Revision, we filed a reconsideration request as well as a clarification and revision request with ARSESP. As part of the clarification and revision request, we requested that ARSESP provide a revision of the calculation of the financial component related to municipal funds. For more information, see "Item 4.B. Business Overview—Tariffs—Second Ordinary Tariff Revision (2017-2020)."

For more information see "Item 3.D. Risk Factors—Risks Relating to Our Business—The terms of our agreement to provide water and sewage services in the city of São Paulo could have a material adverse effect on us."

## **Tariff Structure**

Regarding the tariff structure, ARSESP Resolution No. 463/2014, published in January 2014, established April 10, 2014, as the deadline for publication of the timetable for implementation of our new tariff structure. However, on April 17, 2014, ARSESP issued Resolution No. 484/2014, which maintains the current Tariff Structure and does not set a date for implementation of the new tariff structure.

Despite not having a concrete date for the implementation of the new tariff structure, we are conducting a series of studies on a new structure that will be delivered to ARSESP. Considering the various alterations that this new structure could bring about for the consumer, we plan to implement it over one or more tariff cycles. To date, we cannot predict when we will be able to send our proposal to ARSESP or when implementation may start.

Until the new tariff structure is approved by ARSESP, we will continue to use our current tariff structure. As such, we currently divide tariffs into two categories: residential and non residential. The residential category is subdivided into standard residential, residential-social and shantytown (*favela*). The residential-social tariffs apply to residences of low income families, residences of persons unemployed for up to 12 months and collective living residences. The *favela* tariffs apply to residences in shantytowns characterized by a lack of urban infrastructure. The latter two sub categories were instituted to assist lower income customers by providing lower tariffs for consumption. The non residential category consists of: (i) commercial, industrial and public customers; (ii) "not for profit" entities that pay 50.0% of the prevailing non residential tariff; (iii) government entities that have entered into a water loss reduction agreement with us and pay 75.0% of the prevailing non residential tariff; and (iv) public entities that have entered into program agreements, for municipalities with a population of up to 30.0 thousand and with half or more classified according to their degree of social vulnerability by the Social Vulnerability Index of São Paulo (*Índice Paulista de Vulnerabilidade Social*) 5 and 6, of the SEADE, obtained through the analysis of the 2000 Census figures, and start to receive tariff benefits, in accordance with our normative ruling, for the category of public use, at the municipality level. The tariffs are equal to those offered to the commercial/entity of social assistance and that corresponds to 50.0% of the public tariffs without contractual provisions referred to in item (iv) above.

#### *Fixed Demand Agreements (Take or Pay)*

We established a new tariff schedule, effective May 2002, for commercial and industrial customers that consume at least 5,000 cubic meters of water per month and that enter into fixed demand agreements (take or pay) with us for at least one year terms, with the aim of retaining these industrial and commercial customers. In October 2007, the minimum volume for entering into these agreements was reduced from 5.0 thousand cubic meters per month to 3.0 thousand cubic meters per month. We believe this tariff schedule will help prevent our commercial and industrial customers from switching to the use of private wells. Since 2008, we have been authorized by ARSESP to establish tariffs for non residential customers, such as industrial and commercial customers, that consume more than 3.0 thousand cubic meters per month, with a maximum tariff equal to the tariffs applicable to non residential customers that consume more than 50 cubic meters per month. In 2010, ARSESP authorized a reduction in the minimum volume of consumption for customers that enter into fixed demand agreements with us to a minimum of 500 cubic meters per month.

In May 2016, we reinitiated the fixed demand requirement, and the volumes of those contracts were revised according to clients' new consumption profiles. We started 2017 with 466 formal contracts and, after revision of the charge and volume, ended the year with 482 contracts. 18 contracts were terminated because they did not meet the minimum amount required. Of the remaining 482 contracts, 40 were entered into in 2017. For more information about the water crisis, see "—The Recent Water Crisis".

#### *Water and sewage services tariffs*

We establish separate tariff schedules for our services in each of the São Paulo metropolitan regions and each of the interior region of São Paulo State and coastal regions which comprise our Regional Systems. Each tariff schedule incorporates regional cross subsidies, taking into account the customers' type and volume of consumption. Tariffs paid by customers with high monthly water consumption rates exceed our costs of providing water service. We use the excess tariff billed to high volume customers to compensate for the lower tariffs paid by low volume customers. Similarly, tariffs for non residential customers are established at levels that subsidize residential customers. In addition, the tariffs for the São Paulo metropolitan region generally are higher than tariffs in the interior region of São Paulo State and coastal regions.

Sewage charges in each region are fixed and are based on the same volume of water charged. In the São Paulo metropolitan region and the coastal region, the sewage tariffs are equal to the water tariffs. In the majority of the municipalities of the interior region of the State of São Paulo, sewage tariffs are approximately 20.0% lower than water tariffs. Wholesale water rates are the same for all municipalities served. We also make available sewage treatment services to those municipalities in line with the applicable contracts and tariffs. In addition, various industrial customers pay an additional sewage charge, depending on the characteristics of the sewage they produce. Each category and class of customer pays tariffs according to the volume of water consumed. The tariff paid by a certain category and class of customer increases progressively according to the increase in the volume of water consumed. The first category (0-10) corresponds to the minimum fee that is charged to our customers for the consumption of water. The following table sets forth the water and sewage services tariffs by (i) customer category and class; and (ii) volume of water consumed, charged in cubic meters during the years and period stated in the São Paulo metropolitan region:

<b>Customer Category Consumption</b>	<b>As of Nov 10, 2017</b>	<b>As of May 12, 2016</b>	<b>As of June 4, 2015</b>
Residential			
Standard Residential:			(reais per m <sup>3</sup> )
0 10 <sup>(1)</sup>	2.42	2.24	2.06
11 20	3.78	3.50	3.23
21 50	9.44	8.75	8.07
Above 50	10.40	9.64	8.89
Social:			
0 10 <sup>(1)</sup>	0.82	0.76	0.70
11 20	1.41	1.31	1.21
21 30	5.01	4.64	4.28
31 50	7.14	6.62	6.10
Above 50	7.89	7.31	6.74
Shantytown ( <i>favela</i> ):			
0 10 <sup>(1)</sup>	0.63	0.58	0.53
11 20	0.71	0.66	0.61
21 30	2.36	2.19	2.02
31 50	7.14	6.62	6.10
Above 50	7.89	7.31	6.74
Non Residential			
Commercial/Industrial/Governmental:			
0 10 <sup>(1)</sup>	4.85	4.50	4.15
11 20	9.44	8.75	8.07
21 50	18.08	16.76	15.45
Above 50	18.84	17.46	16.10
Social Welfare Entities:			
0 10 <sup>(1)</sup>	2.42	2.25	2.07
11 20	4.71	4.37	4.03
21 50	9.08	8.42	7.76
Above 50	9.43	8.74	8.06
Government entities that employ the Rational Use of Water Program ( <i>Programa de Uso Racional da Água – PURA</i> ), with reduction agreement:			
0 10 <sup>(1)</sup>	3.63	3.37	3.11
11 20	7.07	6.55	6.04
21 50	13.60	12.61	11.63
Above 50	14.13	13.10	12.08

(1) The minimum volume charged is for ten cubic meters per month.

In 2017, 2016 and 2015, the average tariff calculated for the Regional Systems was approximately 25% below the average tariff of the São Paulo metropolitan region.

On April 11, 2016, ARSESP issued Resolution No. 643/2016, which authorizes us to implement an 8.4478% tariff adjustment to our current tariffs, effective on May 12, 2016.

On October 10, 2017, ARSESP issued Resolution No. 753/2017, which authorizes us to implement a 7.8888% repositioning index to our current tariffs, effective on November 10, 2017.



On November 10, 2017, ARSESP approved the increase of the TRCF by 0.5%. This increase is reflected in customer bills in the municipalities regulated by ARSESP, pursuant to Paragraph 2 of Article 2 of ARSESP Resolution No. 406/2013. This fee was initially established by the State Complementary Law No. 1.025/2007.

On May 9, 2018, ARSESP issued Resolution No. 794/2018, which authorizes us to implement a 3.5070% repositioning index to our current tariffs, effective 30 days after publication.

**Government Regulations Applicable to our Contracts**

Basic sanitation services in Brazil are subject to extensive federal, state and local legislation and regulation that, among other matters, regulates:

- the development of public private partnerships, or PPPs;
- the need of a public bidding process for the appointment of water and sewage services providers via concession agreements;
- the need of setting up an agreement for the appointment of public water and sewage services providers;
- the joint management of public services through cooperation agreements, allowing for a program agreement without the need for a public bidding process for the service provider;
- the planning, regulation and inspection of basic sanitation services prohibited by service providers;
- minimum requirements for water and sewage services;
- water usage;
- water quality and environmental protection; and
- governmental restrictions on the incurrence of debt applicable to state controlled companies.

### ***PLANASA***

In 1978, the operations of basic sanitation services, integrated to the National Plan of Basic Sanitation (*Plano Nacional de Saneamento Básico*), or “PLANASA”, were regulated by Law No. 6,528/1978, which regulated and supervised state sanitation companies, such as SABESP. SABESP was created under State Law No. 119/1973 as a mixed capital company to provide basic sanitation services in the state of São Paulo while also acknowledging the autonomy of the municipalities within the State.

Pursuant to the Brazilian Constitution, the authority to develop and provide public water and sewage services are the joint responsibility of the federal government, the states and the municipalities. Article 216 of the Constitution of the State of São Paulo establishes that the State must provide the conditions for the efficient management and adequate expansion of water and sewage services rendered by its agencies and State controlled companies or any other concessionaire under its control.

Pursuant to Article 175 of the Brazilian Constitution, the rendering of public services, such as water and sewage services, is the responsibility of the applicable public authority. However, any such public authority has the right to render these services directly or through a concession granted to a third party after a bidding process.

Additionally, Article 241 of the Brazilian Constitution establishes the legal regime for managing the rendering of public services among different federal, state and municipal government entities, including the total or partial transfer among these entities of fees, services, personnel and essential goods needed to render such public services. For example, such service can be rendered through a public consortium or a cooperation agreement under Federal Law No. 11,107 of April 6, 2005, also known as the Law on Public Consortia and Cooperation Agreements (*Lei de Consórcios Públicos e Convênio de Cooperação*), which, in turn, created a contract program which allowed for the waiver of the bidding process for companies like ours.

*The Basic Sanitation Law*

The Basic Sanitation Law No. 11,445/2007, or “The Basic Sanitation Law”, went into effect on January 5, 2007, effectively revoking and substituting the PLANASA model, establishing nationwide guidelines for basic sanitation and seeking to create the appropriate solutions for the provision of basic sanitation considering the particular conditions in each state and municipality. The Basic Sanitation Law also sought to facilitate the cooperation between the state and municipalities in the rendering of public services.

The Basic Sanitation Law establishes the following guiding principles for the public service of basic sanitation: universalization, integrality, efficiency and economic sustainability, transparency of actions, social control and integration of infrastructure and services with the management of water resources. It does not define the ownership of the sanitation services, but establishes certain minimum liability thresholds, such as the development of local and regional sanitation plans, the need to create norms for the regulation and supervision of services, the creation of the entities responsible for such regulation and establishment of the rights and obligations of the users and of social control mechanisms, in addition to the principles listed below:

- for public-private partnership contracts (or program contracts), public hearings must be held with respect to bid announcements;
- the carrying out of technical and financial feasibility studies;
- the holding of public hearings regarding concession bidding notices and contract drafts;
- the rights and obligations of customers and service providers, including penalties, are determined by the owner of the public service, not by the regulatory agency (since its function is to ensure full compliance of legislative and contractual conditions);
- the regulatory agency's function is to ensure compliance with the law and with the contractual conditions;
- the technical and financial viability of the provision of water and sewage services;
- the interruption of the provision of sanitation services by the service provider in the event of a default of payment of the tariffs by the customer, among other reasons, provided that minimum conditions for maintaining health are assured;
- when parts of a regulated service are to be provided by different service providers, those providers must execute an agreement regulating their respective activities;
- the definition of principles and guidelines which must be respected when securing public funds generated or operated by agencies or entities of the federal government;
- the possibility of using subsidies as an instrument of social policy in order to ensure access to basic sanitation services to everyone, particularly for low income families; and
- the obligation to adopt environmental criteria that include, among other measures, individual management of water consumption per habitation unit.

By establishing the principles listed above, the Basic Sanitation Law defines the laws and regulations under which a water and basic sanitation provider may provide its services to several regions controlled by different owners (*i.e.*, one single provider serves two or more owners, for which there may be one plan for the combination of services).

The rules for implementation of the new principles and directives set forth in Federal Law No. 11,445/2007 are established by Federal Decree No. 7,217 / 2010, dated June 21, 2010; as amended by Federal Decree No. 8,211, dated March 21, 2014; Federal Decree No. 8,629, dated December 30, 2015; and Federal Decree No. 9.254, dated December 29, 2017.

In addition, the Basic Sanitation Law defines the rules for the delegation of the regulation, control and monitoring of sanitation services by the states and municipalities to contracted parties and the conditions for any such provision of public services. The Basic Sanitation Law also significantly amends Article 42 of the Federal Concessions Law No. 8,987/1995, which establishes the administrative proceedings necessary for the termination of concessions prior to the expiration date and the reversibility conditions for unamortized investments that create assets upon the termination of a concession. The amendment to Article 42 establishes that when a concession is terminated prior to its expiration date, the service provider must be indemnified for unamortized investments that create assets, preferably through an amicable settlement between the parties defining the criteria for the calculation and payments of indemnity.

Furthermore, the Basic Sanitation Law also provides that the provision of sanitation services may be interrupted by the service provider, in the event of a default of payment of the tariffs by the customer, among other reasons. The provision of sanitation services may only be interrupted after a written notice, and as long as minimum health requirements are met.

The Basic Sanitation Law defines the criteria for the reversal of assets at the time of termination of the water and sewage public service contract, which term also encompasses concession agreements such as those that have expired or are effective for an indefinite term, or those that were not formalized by an agreement. In addition, the Basic Sanitation Law provides the criteria for calculating the amount of an indemnity due, which may be calculated by a specialized institution chosen by mutual agreement between the parties in a formal payment agreement.

Pursuant to the Basic Sanitation Law, the parties involved in a concession may enter into an agreement with respect to the payment of the indemnification due to the concessionaire. However, in the absence of an agreement, the Basic Sanitation Law establishes that the indemnification must be paid in no more than four equal and successive annual installments, with the first installment payable by the last business day of the fiscal year in which the assets are reversed. The provision of public services will remain valid until the conclusion of any administrative measures undertaken by the entity responsible for such services.

According to the Basic Sanitation Law, the existing concession or water and sewage public service contract will remain in effect until the responsible public entity concludes the administrative proceedings necessary for termination.

The Basic Sanitation Law provides that our new water and sewage public service contracts must be planned, supervised and regulated by the municipalities together with the State under a new model of associated management that will allow for better control, supervision, transparency and efficiency in the provision of public services.

### ***Contracts for the Provision of Essential Basic Sanitation Services in Brazil***

In Brazil, there are three federal legal regimes for contracting water and sewage services: (i) public concessions, regulated by Law No. 8,987/1995, which require a prior public bidding process; (ii) administration of public services through cooperation agreements between the federal government and local public authorities at State and municipal level without the need for a public bidding process, regulated by the Public Consortia and Cooperation Agreement Law No. 11,107/2005; and (iii) PPPs regulated by Law No. 11,079/2004, used to grant concessions to private companies to provide public services and used in relation to construction works associated with the provision of public services.

The Federal Concessions Law No. 8,987/1995 and the State Concessions Law No. 7,835/1992 require that the granting of a concession by the government be preceded by a public bidding process. However, the Federal Public Bidding Law No. 8,666/1993, which establishes the rules for the public bidding process, provides that a public bidding process can be waived under certain circumstances, including in the case of services to be provided by a public entity created for such specific purpose on a date prior to the effectiveness of this law, provided that the contracted price is compatible with what is practiced in the market. Furthermore, a provision of the Federal Public Bidding Law, as amended by the Public Consortia and Cooperation Agreement Law, provides that the program contracted can be executed with waiver of a public bidding process.

The Constitution of the State of São Paulo provides that the State shall ensure the adequate provision and efficient administration of water and sewage services in the state territory by a company under its control, such as our company.

### ***Our Concession Agreements***

From 1998 to 2005, our contracts with municipalities have been regulated by the Federal Concessions Law No. 8,987/1995. Generally, these contracts have a 30 year term, and the total value of the concession is set by the discounted cash flow method. Under this method, when the expected contractual cash flow is reached, the total value of the concession and assets is amortized to zero on our books and we receive no payment for the assets. If the concession is terminated prior to the end of the 30 year term, thereby interrupting the normal contractual cash flow, we are paid an amount equal to the present value of the expected cash flow over the years remaining in the concession, adjusted for inflation.

Concessions for providing water and sewage services are formalized by agreements executed between the state or municipality, as the case may be, and a concessionaire to which the performance of these services is granted in a given

municipality or region. Our concessions normally have a contractual term of up to 30 years. However, our concessions in general can be revoked unilaterally at any time if certain standards of quality and safety are not met, in the event of default of the terms of the concession agreement, or due to changes in public interest since the concession was granted.

A municipality that chooses to assume the direct control of its water and sewage services must terminate the current relationship by duly compensating the service provider and the investments unamortized. Subsequently, the municipality will be in charge of rendering services or of conducting a public bidding process to grant the concession to potential concessionaires, including agreements with public companies directly. The Basic Sanitation Law reduced the maximum time period for payment of indemnification in such cases to four years. See “Item 3.D. Risk Factors—Risks Relating to Our Business—Municipalities may terminate our concessions before they expire in certain circumstances. The indemnification payments we receive in such cases may be less than the value of the investments we made”.

### ***Program Agreements***

On April 6, 2005, the federal government enacted Federal Law No. 11,107/2005, or the Federal Public Consortia and Cooperation Agreement Law, which regulates Article 241 of the Brazilian Constitution. This statute provides general principles to be observed when a public consortium enters into contracts with the Brazilian federal government, state governments, the Federal District and municipalities, regulating the joint management of public services.

Federal Law No. 11,107/2005 introduces significant changes in the relationship among municipalities, states and companies providing public sanitation services, prohibiting the latter from exercising the activities of planning, oversight and regulation, including tariff regulation, of the services. The law also created the program agreement, a contract to be followed when Brazilian states and municipalities enter into agreements for the provision of public services with mixed capital companies. The program agreement provides the guidelines for the joint management of public services by Brazilian states and municipalities with mixed capital companies. Furthermore, this agreement allows states and municipalities to waive the public bidding process and still be in compliance with concession legislation when entering into contracts with entities that are owned by the Brazilian states or municipalities.

Federal Decree No. 6,017/2007 details the conditions for the establishment of joint management entities and the execution of the program agreement regulating the Public Consortia and Cooperation Agreement Law.

Pursuant to the Brazilian Constitution, in metropolitan regions, urban conurbations and microregions, the authority to develop public water and sewage systems is shared by the states and municipalities. However, for municipalities which are not a part of the types of regions cited above (metropolitan regions, urban conurbations and microregions), the primary responsibility for providing water and sewage services to residents rests with the municipality.

The Constitution of the State of São Paulo provides that the State shall assure the correct operation, necessary expansion and efficient administration of water and sewage services in the state of São Paulo by a company under its control. On January 13, 2006, the Governor of the State of São Paulo enacted State Decree No. 50,470/2006, amended by State Decrees No. 52,020/2007, dated July 30, 2007, and No. 53,192/2008, dated July 1, 2008, which regulate the provision of water and sewage services in the State of São Paulo. Pursuant to these decrees, we may enter into agreements with municipalities in connection with the provision of water and sewage services by means of a “program agreement without a public bidding process”. In addition, these decrees established that we will continue to render services in the areas covered by the concession granted by the State. Following the entry into force of the Public Consortia and Cooperation Agreements Law, we adopted the administration of public services through cooperation agreements and program agreement which can be used simultaneously.

### ***Public Private Partnerships***

Public-Private Partnerships, or “PPPs”, are long-term contracts between private parties and government entities, for providing a public asset or service, in which the private parties bears significant risk and management responsibility, and remuneration is linked to performance. PPPs are regulated by the State of São Paulo through Law No. 11,688/2004, which was enacted on May 19, 2004. PPPs may be used for: (i) implantation, expansion, improvement, reform, maintenance or management of public infrastructure; (ii) provision of public services; and (iii) exploitation of public assets and non material rights belonging to the State.

Payment is conditioned upon performance. The payment may be collected through: (i) tariffs paid by users; (ii) use of resources from the budget; (iii) assignment of credits belonging to the State; (iv) transfer of rights related to the commercial exploitation of public assets; (v) transfer of real property and other property of assets; (vi) public debts securities; and (vii) other revenues.



We do not currently provide any basic sanitation services to municipalities through PPPs.

***Agreements with Municipalities and Metropolitan Regions***

The state of São Paulo, pursuant to Article No. 25, Paragraph 3 of the Brazilian Constitution, enacted the LCE to create the metropolitan regions of São Paulo (LCE No. 94/1974), Baixada Santista (LCE No. 815/1996), Campinas (LCE No. 870/2000), Vale do Paraíba and Litoral Norte (LCE No. 1,166/2012), and Sorocaba No. (LCE 1,241/2014) and the urban clusters of Piracicaba (LCE No. 1,178/2012) and Jundiaí (LCE No. 1,146/2011).

Pursuant to the Brazilian Constitution, in metropolitan regions, urban conurbations and microregions, the authority to develop public water and sewage systems is shared by the states and municipalities. However, for municipalities which are not a part of the types of regions cited above (metropolitan regions, urban conurbations and microregions), the primary responsibility for providing water and sewage services to residents rests with the municipality.

We provide basic sanitation services for municipalities, urban conurbations and metropolitan regions. In these municipalities, operations are regionalized and contracts are structured considering the financial and economic conditions of the entire region. The regulation including taxes, control and oversight are the responsibilities of ARSESP (LCE 1,025/2007 – Articles No. 6 and No. 10). With regard to local operations, the municipalities are responsible for providing basic sanitation services. Thus, we operate through new contracts executed pursuant to a legal waiver of public tender under cooperation agreements between the state and municipalities which permit sharing the management of basic sanitation services. With regard to metropolitan regions, we conduct our operations based on state legislation and contracts and make a note of any pending litigation addressing the delineation of responsibilities regarding basic sanitation services in municipalities, metropolitan regions, urban conurbations and microregions.

On March 6, 2013, the Brazilian Supreme Court decided a matter related to the shared management of basic sanitation services in the state of Rio de Janeiro, whose effects may impact other ongoing legal proceedings. In its decision, the court ruled that the state of Rio de Janeiro must establish new entity, owned by both the state of Rio de Janeiro and the relevant municipalities, to oversee the planning, regulation and auditing of basic sanitation services in its metropolitan region with the non-partisan participation of all the municipalities located in the metropolitan region; creating a requirement that the state and the municipalities must participate jointly in the shared management of public services.

However, this decision is not yet fully effective, and therefore does not yet alter the legislative framework regarding basic sanitation that is currently in effect for the State of São Paulo.

In January 2015, the Federal Government issued the Metropolitan Bylaws (Law No. 13,089/2015), amended by Provisional Measure No. 818 of January 11, 2018, establishing within the term of five years, counted from the date of the institution of the metropolitan region or urban cluster: (i) the general guidelines for the planning, management and performance of public initiatives in metropolitan regions and in urban clusters instituted by the states; (ii) the general planning standards for integrated urban development and other intergovernmental instruments; and (iii) the criteria to receive federal loans related to urban development. In addition, the Metropolitan Bylaws foresees mechanisms for integrated management and intergovernmental governance as well as the sharing of decisions by regional entities.

Despite the Brazilian Supreme Court's March 6, 2013 decision and the Metropolitan Bylaws, some municipalities in metropolitan regions and urban clusters, including in metropolitan regions where we operate, have been conducting bidding processes for the concession of sanitation services without including shared management.

### ***Establishment of ARSESP***

On June 8, 2006, the State of São Paulo enacted Decree No. 50,868/2006, creating the Commission for the Regulation of Sanitation Service of the State of São Paulo (*Comissão de Regulação do Serviço de Saneamento do Estado de São Paulo*), or "CORSANPA", to regulate basic sanitation services. CORSANPA was directly subordinated to the State Secretariat for Sanitation and Water Resources. The main duty of CORSANPA was conducting studies for the creation of a regulatory agency for the basic sanitation industry and the presentation of legal and regulatory measures.

The completion of such duties resulted in the publication of supplementary Law No. 1,025/2007 of December 7, 2007, which created the São Paulo State Sanitation and Energy Regulatory Agency (*Agência Reguladora de Saneamento e Energia do Estado de São Paulo*), or “ARSESP”, and partially revoked Supplementary Law No. 7,750/1992. Furthermore, Supplementary Law No. 1,025/2007 maintained CONESAN, as an advisory council to define and implement the state basic sanitation policy, and the State Sanitation Fund (*Fundo Estadual de Saneamento*) or “FESAN”. FESAN is connected to the State Secretariat for Sanitation and Water Resources, and collects and manages resources that support State approved programs, as well as the development of technology, management and human resources and a sanitation information system, in addition to other support programs.

On August 5, 2009, the State of São Paulo enacted Decree No. 54,644/2009, which revoked Decree No. 50,868/2006 and regulated the composition, organization and operation of the State Sanitation Council (*Conselho Estadual de Saneamento*), or “CONESAN” created by Supplementary Law No. 7,750/1992.

In connection with the scope of our services, Supplementary Law No. 1,025/2007 expanded the range of services that we can render, with the inclusion of urban rainwater drainage and management, urban cleaning and solid waste management, as well as the operation of power generation, storage, conservation and sales activities, for our own or third party use.

In addition, the rules simplified the process for the expansion of our business in Brazil and abroad, authorizing us to:

- participate in the controlling block or the capital of other companies;
- create subsidiaries, which may become majority or minority shareholders in other companies; and
- establish partnerships with national or foreign companies, including other state or municipal basic sanitation companies, in order to expand our activities, share technology and expand investments related to basic sanitation services.

ARSESP regulates the basic sanitation services that belong to the State, relating to the federal and municipal jurisdictions and prerogatives, and is responsible for:

- the compliance with and enforcement of state and federal basic sanitation legislation;
- the publication of the organizational platform for the services, indicating the types of services provided by the State, as well as the equipment and facilities that compose the system;
- the acceptance, where applicable, of the legal attributions of the jurisdictional authority;
- the establishment, in accordance with the tariff guidelines defined by Decree No. 41,446/96, of tariffs and other methods that provide compensation for our services, adjustment and review of such tariffs and methods to ensure the financial economic balance of services and low cost tariffs through mechanisms that increase service efficiency and lead to the distribution of productivity gains to society; and
- the approval, oversight and regulation (including tariff issues) of the sewage treatment and wholesale water supply agreements entered into between the state supplier and other suppliers, pursuant to Article 12 of the Basic Sanitation Law.

With respect to municipal basic sanitation, ARSESP oversees and regulates services (including tariff issues) that have been delegated by municipalities to the State as a result of cooperation agreements that authorize program agreements between the municipalities and us for as long as it is convenient to the municipality’s public interest.

For its services, ARSESP charges 0.50% of the annual total invoice from net operating revenue (excluding revenues relating to the construction of concession infrastructure) of the municipality. This fee is collected from municipalities that have a signed program agreement with us and the municipalities located in the metropolitan regions.

#### ***Rules Enacted by ARSESP***

In 2009, ARSESP enacted rules regarding the following:

- general terms and conditions for water and sewage services;
- procedures for communication regarding any failure in our services;
- penalties for deficiencies in the provision of basic sanitation services; and

- procedures for confidential treatment of our customers' private information.

### *Consumer Relations in the State of São Paulo*

In 2011, ARSESP altered the standard contract that we are required to use in our relationships with retail customers. This alteration requires that invoices be sent to the user of the service rather than the owner of the property connected to the public water supply and sewage systems. Since 2011, we have implemented several measures and instituted new rules to update our client registry. Currently, more than 90% of our water and sewage connections are billed to the user of our services, as foreseen under current regulations. Related to the collection of debt, we are also faced with the challenge of collecting customers' taxpayer identification numbers, which are required to register for our services and are needed for the judicial collection of outstanding fees in the event of nonpayment. We continuously update our customers' registration information, but we face difficulties in updating this information in areas with high concentrations of social vulnerability and noncompliance.

Regarding changes to the communication process for the reporting of failures, ARSESP has modified the rules and standards for supervision and reporting of incidents. We have implemented these requested changes. Currently, we receive a portion of the reported incidents online, through the Incident Reporting System (“*Sistema de Comunicação de Incidentes*”) established by ARSESP, which introduces greater transparency and control to our operations.

In 2013, in compliance with rules enacted by ARSESP, we established procedures for communicating scheduled interruptions in the provision of water services by developing the Communication of Scheduled Interruptions of Basic Sanitation, or “SISCIP-S”.

We are currently evaluating the enforceability and legality of some of these rules. Implementation of these rules started during 2011, is currently ongoing, and is expected to continue for the next few years. The implementation of these rules will impact our commercial and operations processes, and may adversely affect us in ways we cannot currently predict.

We are attentive to these regulatory changes, have been working toward meeting ARSESP's requirements and recommendations, and have presented technical, legal and factual reasons for any conduct that ARSESP may find irregular. As a result, we are subject to few regulatory infractions and to limited fines. See “Risk Factors—Risks Relating to Our Business—Current regulatory uncertainty, especially with regard to implementation and interpretation of the Brazilian Basic Sanitation Law, may have an adverse effect on our business”

Following the increase in the demand for regulatory work, we created a regulatory affairs department, which focuses on regulatory matters and has centralized communication with the regulatory agencies, driving business to the new regulatory regime and proposing matters in which we have an interest to ARSESP.

In April 2011, we created a specific department in our Financial, Economic and Investor Relations Office responsible for costs and tariffs, given the subject's importance to the continuation of our business. We also created a statutory Regulatory Affairs Committee, which was responsible for defining the guidelines, strategies and regulatory recommendations for our Company and coordinating the work of the Regulatory Affairs Department. This committee was terminated in April 2018 due to revisions to our bylaws. Regulatory matters are currently handled by our executive officers.

### *Our Current Concession Agreements*

The current concessions are based on a standard form of agreement between us and the relevant municipality. Each agreement received the prior approval of the legislative council of each municipality. The assets comprising the existing municipal water and sewage systems are transferred from the municipality to us in order for us to provide the contracted services. Until 1998, we acquired municipal concessions and the existing water and sewage assets in exchange for our common shares issued at book value. Since 1998, we have acquired concessions and water and sewage assets by paying the municipality an amount equal to the present value of 30 years of estimated cash flows from the date of acquisition of the concession, assuming a discount of at least 12%. For reference purposes, in 2011 ARSESP set the discount rate for our contracts at 8.06% and in October 2017 the discount rate was updated to 8.11% due to the Second Ordinary Tariff Revision. See “—Tariffs”.

The main provisions of our existing concession agreements are as follows:

- we assume all responsibility for providing water and sewage services in the municipality;
- according to the municipal laws authorizing the concession, we are permitted to collect tariffs for our services and tariff readjustments follow the guidelines established by the Basic Sanitation Law and ARSESP;
- as a general rule, to date, we are exempt from municipal taxes, and no royalties are payable to the municipality with respect to the concession;
- we are granted rights of way on municipal property for the installation of water pipes and water transmission lines, and sewage lines; and
- upon termination of the concession, for any reason, we are required to return the assets that comprise the municipality's water and sewage system to the municipality and the municipality is required to pay us the non-amortized value of the assets relating to the concession.

These assets have been considered to be intangible assets since January 2008. See Note 3.8 to our financial statements. Under concession agreements executed prior to 1998, the reimbursement for the assets may be through payment of either:

- the book value of the assets; or
- the market value of the assets as determined by a third-party appraiser in accordance with the terms of the specific agreement.

Our new agreement model follows the provisions of the Basic Sanitation Law. Its main contractual provisions include the joint execution of planning, supervision and regulation of services, the appointment of a regulatory authority for the services, and periodic disclosure of financial statements.

Furthermore, the economic and financial formulas in new agreements must be based on the discounted cash flow methodology and on the revaluation of returnable assets. Pursuant to the Basic Sanitation Law, the preexisting assets will be returned to the grantor of the concession. We will carry out all new investments and the municipalities will record them as assets. The municipalities will then transfer possession of these assets to us for our use and management and will also record a credit in the same amount of the assets recorded in our favor. According to Article 42 of the Basic Sanitation Law and the new agreement model, investments made during the contractual period are the property of the applicable municipality, which in turn generates receivables for us that are to be recovered through the operation of the services. These receivables may also be used as guarantees in funding operations.

Another important development was that the new agreement model includes exemptions from municipal taxes applicable on our operational areas and the possibility of the revaluation of our assets that existed prior to the execution of the program agreements in cases involving the early resumption of services by the concession authority.

As of December 31, 2017, we provided water and sewage services to 368 municipalities. The majority of these concessions have 30-year terms. Due to court orders, we temporarily suspended our services in two other municipalities (Macatuba and Cajobi). For more information, see "Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings". Between January 1, 2007 and December 31, 2017, we entered into agreements with 287 municipalities (including our services agreement with the city of São Paulo) in accordance with the Basic Sanitation Law, of which six were entered into in 2017. As of December 31, 2017, these 287 municipalities



accounted for 81.7% of our gross operating revenues (including revenues relating to the construction of concession infrastructure). In addition to the contracts that have 30-year terms, the municipalities entered into cooperation contracts with the State of São Paulo, delegating the regulation and monitoring of the provision of services to ARSESP. As of December 31, 2017, 51 of our agreements or concessions had expired but we continued to provide water and sewage services to these municipalities and were in negotiations to execute program agreements to substitute the expired concessions. From January 1, 2018 through 2030, 32 concessions will expire.

Municipalities have the inherent power under Brazilian law to terminate concessions prior to their contractual expiration dates for reasons of public interest. The municipality of Mauá, which we previously served, terminated our concession in December 1995. As arranged, we transferred ownership of the related assets as well as of the provision of services to the municipality of Mauá. In another contract we entered into with the Basic Sanitation Company of the Municipality of Mauá (*Saneamento Básico do Município de Mauá* – SAMA) and the municipality of Mauá, we were responsible for providing water on a wholesale basis. However, neither SAMA nor the municipality of Mauá complied with the stipulations of the agreement, culminating in a lawsuit brought against both parties. We demanded monetary compensation for our basic sanitary services. In a separate suit, we are demanding SAMA pay us the correct amount of tariffs for water services it has been receiving without our authorization at a cost below that contracted.

The receivables owed to us by Mauá, due to the termination of the concession, total R\$85.9 million and have not been recognized in our financial statements due to the uncertainty of our ability to collect them as of December 31, 2017. Despite these developments, we currently supply water on a wholesale basis to Mauá. In January 2016, the municipality of Mauá executed a Protocol of Intentions with us for the preparation of studies and evaluations aiming to resolve commercial relations and existing debts between the municipality and us. However, the negotiations with Mauá ended June 2016. On April 19, 2018, we published a press release stating that we have been in contact with the municipality of Mauá regarding directly supplying water to four neighborhoods that have been affected by a water shortage, and that we will initiate formal discussions to engage in negotiations with the municipality.

We currently do not anticipate that other municipalities will seek to terminate concessions due to our close relationship with municipal governments, recent improvements in the water and sewage services we provide, and the obligation of the municipality to repay us for the return of the concession. However, we cannot be certain that other municipalities will not seek to terminate their concessions in the future. See “Item 3.D. Risk Factors—Risks Relating to Our Business—Municipalities may terminate our concessions before they expire in certain circumstances. The indemnification payments we receive in such cases may be less than the value of the investments we made”.

In addition, we are currently involved in litigation with respect to municipalities that intend to expropriate our water and sewage systems, or to terminate concession agreements before paying us any indemnification. For a detailed discussion on these proceedings, see “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”.

#### ***Operations in the City of São Paulo and Certain Metropolitan Regions***

We are a concessionary of the state of São Paulo tasked with providing operate basic sanitary services in metropolitan regions, microregions and urban conglomerates instituted by state law.

The state of São Paulo, pursuant to Article No. 25, Paragraph 3 of the Brazilian Constitution, enacted the LCE to create the metropolitan regions of São Paulo (LCE No. 94/1974), Baixada Santista (LCE No. 815/1996), Campinas (LCE No. 870/2000), Vale do Paraíba and Litoral Norte (LCE No. 1,166/2012), and Sorocaba No. (LCE 1,241/2014) and the urban clusters of Piracicaba (LCE No. 1,178/2012) and Jundiaí (LCE No. 1,146/2011).

On June 18, 2009, Municipal Law No. 14,934/2009 repealed Municipal Law 13,670/2003, which had assigned the responsibility for the city of São Paulo’s planning, regulating and supervising the provision of water supply and sewage collection services exclusively to the city of São Paulo. On June 23, 2010, the State and the city of São Paulo entered into a formal agreement with the purpose of sharing the planning of the provision of water supply and sewage collection services; delegating oversight and regulation, including tariff regulation, to ARSESP; and authorizing the maintenance of water supply and sewage collection services in the city of São Paulo for a 30-year term (renewable for the same period).

In January 2015, the Federal Government issued the Metropolitan Bylaws (Law No. 13,089/2015), amended by Provisional Measure No. 818 of January 11, 2018, establishing within the term of five years, counted from the date of the institution of the metropolitan region or urban cluster: (i) the general guidelines for the planning, management and performance of public interest initiatives in metropolitan regions and in urban clusters instituted by the states; (ii) the general planning standards for integrated urban development and other intergovernmental governance instruments; and (iii) the criteria to receive federal loans related to urban development.



On March 6, 2013, the Brazilian Supreme Court decided a matter related to the shared management of basic sanitation services in the state of Rio de Janeiro. In its decision, the court ruled that the state of Rio de Janeiro must establish a new entity, owned by both the state of Rio de Janeiro and the relevant municipalities, to oversee the planning, regulation and auditing of basic sanitation services in its metropolitan region with the non-partisan participation of all the municipalities located in the metropolitan region; creating a requirement that the state and the municipalities must participate jointly in the shared management of public services.

However, this decision is not yet fully effective, as a ruling on a motion for clarification is currently pending, and therefore does not yet alter the legislative framework regarding basic sanitation that is currently in effect for the State of São Paulo. The São Paulo metropolitan region (including the municipalities to which we provide water on a wholesale basis, but excluding the concession infrastructure construction revenue) accounted for 70.7% of our gross operating revenue from services in 2017.

The São Paulo metropolitan region accounted for 70.7% of our gross operating revenue in 2017 (excluding revenues relating to the construction of concession infrastructure) and including the formal agreement with the municipality of São Paulo. We cannot predict how the shared management of these operations will be carried out in the São Paulo metropolitan region and other metropolitan regions we operate in or what effect it may have on our business, financial condition or results of operations. See “Item 3.D. Risk Factors—Risks Relating to Our Business—Current regulatory uncertainty, especially with regard to implementation and interpretation of the Brazilian Basic Sanitation Law, may have an adverse effect on our business”.

#### ***Tariff Regulation in the State of São Paulo***

The tariffs for our services are subject to Federal and State regulation.

On December 16, 1996, the Governor of the State of São Paulo issued a decree which approved the existing tariff system and allowed us to continue to set our own tariffs. We used to set our tariffs based on the general objectives of maintaining our financial condition and preserving “social equality” in terms of the provision of water and sewage services to the population while providing a return on investment. The governor’s decree also directs us to apply the following criteria in determining our tariffs:

- category of use;
- capacity of the water meter;
- characteristics of consumption;
- volume consumed;
- fixed and floating costs;
- seasonal variations of consumption; and
- social and economic conditions of residential customers.

With the enactment of the Basic Sanitation Law and Federal Consortium Law, we are prohibited from planning, overseeing and regulating services, which includes determining the tariff policy to be adopted. Such activities are to be exercised by the owner of the concession. Other than the responsibility for planning, the remaining activities may not be delegated.

The current tariff structure maintains different tariff schedules, depending upon whether a customer is located in the São Paulo metropolitan region or the Regional Systems. There are four levels of volume consumed for each category of customer, except for the residential-social and shantytown (*favelas*) categories. The residential-social tariffs apply to residences of low income families, residences of persons unemployed for up to 12 months and collective living residences. The *favela* tariffs apply to residences in shantytowns characterized by a lack of urban infrastructure. The latter two sub categories were instituted to assist lower income customers by providing lower tariffs for consumption. Customers are billed on a monthly basis. Water and sewage bills are based upon water usage determined by monthly water meter readings. Larger customers, however, have their meters read every 15 days to avoid nonphysical loss resulting from faulty water meters. Sewage billing is included as part of the water bill and is based on the water meter reading. We are also authorized to enter into individual contracts with certain customers, such as municipalities, to supply water or sewage services on a wholesale basis.

Furthermore, since Law No. 11,445/2007 permits municipalities to create their own regulatory agencies rather than being subjected to overview by ARSESP, a number of municipalities created their own regulatory agencies. The municipality of Lins, which decided in 2007 to create its own regulatory authority, revisited this decision in 2010 and transferred the regulation of water activities, including the setting of tariffs, to ARSESP. The municipality of Lins has reserved, however, the power to ultimately approve the tariff set by ARSESP.

The municipalities in which the hydrographic basins of the Piracicaba, Capivari and Jundiá rivers are located created a consortium known as the Regulatory Agency of Sanitation Services for the Piracicaba, Capivari and Jundiá River Basin (*Agência Reguladora dos Serviços de Saneamento das Bacias dos Rios Piracicaba, Capivari e Jundiá*), or ARES-PCJ, in 2011 to regulate and supervise our activities in those areas, and for similar purposes, in November 2013 the Regulatory Agency of São Bernardo do Campo (AR/SBC) was created. As a result of the creation of ARES/PCJ, we are currently involved in legal proceedings in which ARES/PCJ is claiming that it has jurisdiction over the regulation and supervision of our activities in three municipalities (Mombuca, Santa Maria da Serra and Aguas de São Pedro). We cannot predict the outcome of this case or how it may impact our business. See “Item 3.D. Risk Factors—Risks Relating to Our Business—Current regulatory uncertainty, especially with regard to implementation and interpretation of the Brazilian Basic Sanitation Law, may have an adverse effect on our business”.

### **The Recent Water Crisis**

Prior to 2014, we planned our supply of water to the São Paulo metropolitan region based on the water supply during the driest period on record, which was from 1953 to 1954. However, water inflow to the Cantareira reservoirs throughout 2014 and most of 2015 was less than half the inflow recorded in 1953, the previous most critical year. Consequently, the volume of water stored in the reservoirs in 2014 and 2015 declined significantly until September 2015, when the reservoirs once again held more water than 12 months previously for the first time since the beginning of the water crisis. In the rainy season from October 2015 to March 2016 rainfall returned to historical averages and water levels in the reservoirs that provide water to the São Paulo metropolitan region, our largest market, increased. With the return of the rainfall to its historical average and the level of water in the reservoirs that provide water to the population of the São Paulo metropolitan region at normal levels, the measures taken during the water crisis to continue services to consumers were gradually discontinued. At December 31, 2017, the reservoirs in the São Paulo metropolitan region contained 916.8 million m<sup>3</sup> of water storage for treatment, compared to 951.1 million m<sup>3</sup> available for treatment as of December 31, 2016 not including the technical reserve of 287.5 million m<sup>3</sup>. The average monthly water production in 2017 for the São Paulo metropolitan region was 60.6 cubic meters per second, or m<sup>3</sup>/s, compared to 58.5 m<sup>3</sup>/s in 2016 and 52.0 m<sup>3</sup>/s in 2015.

For more information on the water production systems which we use to produce water for the São Paulo metropolitan region, see “Item 4.B. Business Overview—Description of Our Activities—Water Operations—Water Resources”.

#### *Cantareira System*

The Cantareira System is located in the northern area of the São Paulo metropolitan region. It uses water extracted from the PCJ River Basin and the Juqueri River Basin and consists of six reservoirs interconnected by a complex water network of tunnels and pipes, located along the municipalities of São Paulo, Mairiporã, Nazaré Paulista, Piracaia, Vargem, and Joanópolis. The latter two are located on the border of the state of Minas Gerais, approximately 100 kilometers from the city of São Paulo. Gravity forces the flow of water from one reservoir to another, and once the water reaches the Paiva Castro reservoir, located in the Juqueri River Basin, it is pumped to the Guaraú water treatment plant.

Prior to February 2014 and the water crisis, this system supplied water to approximately 8.9 million people, with an average extraction of up to 33 m<sup>3</sup>/s to serve the São Paulo metropolitan region. After the water crisis, when conditions returned to normal levels, this system supplies water to approximately 7.8 million people, with an annual average extraction of up to 25.1m<sup>3</sup>/s in 2017 in order to serve the São Paulo metropolitan region. The volume of water that may be extracted from the Cantareira System is now based on the volume of water available in the reservoirs. A minimum of 10 m<sup>3</sup>/s of water may be released to serve the metropolitan region of Campinas and Jundiá, which is located downstream from the reservoirs. This flow is defined in Joint Resolution n° 926/2017 and 925/2017, both dated May 29, 2017.

*Water Inflow to the Cantareira System*

During the October 2013 – March 2014 rainy season rainfall and water inflow levels into the reservoirs reached the lowest stream flow measurements in over 80 years. This drought persisted in the rainy season between October 2014 and March 2015. During the October 2015 – March 2016 and during the October 2016 – March 2017 rainy season, the level of rainfall in the region returned to the normal levels expected for the period and water inflow levels consequently improved. With the return of the rainfall to its historical average, the measures taken during the water crisis to continue services to consumers were gradually discontinued.

The table below sets forth water inflow (volume of water that flows into the reservoirs or natural inflow from the river basin), showing: (i) historical average and minimum flows; (ii) 1953, previously the driest year on record; (iii) inflow during the 2013-2014, 2014-2015 and 2015-2016 hydrological years; (iv) inflow during the 2016-2017 hydrological year; and (v) inflow during the 2017-2018 hydrological year (through April 2018).

	For the month of											
	Oct.	Nov.	Dec.	Jan.	Feb.	March	April	May	June	July	Aug.	Sep.
	<i>(in m<sup>3</sup>/s)</i>											
<b>Water Inflow</b>												
Historical Average	30.6	35.0	53.1	70.9	73.9	66.9	48.4	38.4	35.3	28.8	24.5	25.6
Historical Minimum	14.0	14.0	21.8	26.9	27.6	28.1	24.7	19.9	16.5	13.9	12.0	11.8
Drought of 1953	17.5	26.0	31.5	26.9	34.5	29.8	34.6	23.8	20.7	17.6	16.3	16.2
2013/14	25.1	22.1	22.5	15.4	10.5	18.9	17.2	10.1	10.0	6.4	8.2	9.0
2014/15	5.2	8.8	16.0	11.5	40.7	42.6	18.1	14.0	16.2	11.3	5.8	18.3
2015/16	14.8	27.1	52.3	73.8	49.6	69.8	24.1	25.0	62.9	19.4	19.3	14.9
2016/17	24.2	29.5	30.2	76.0	36.4	36.9	24.3	33.8	22.6	13.9	14.9	9.0
2017/18	13.7	23.0	18.8	57.4	35.8	33.2	17.8					

As a result of the drought and low water volume in the Cantareira System, DAEE and ANA regulated the volume of water we were permitted to extract from this system from March 2014 to May 2017. However, in May 2017, the water right that regulates the volume of water that may be extracted from the Cantareira System, the main water system we use to serve the São Paulo metropolitan region, based on the volume of water available in the reservoirs was renewed. Under the new terms, the water we are permitted to draw from the system is divided into five tranches: (i) if the volume of water available is higher than 60% of the reservoirs' capacity, we can draw up to 33m<sup>3</sup>/s; (ii) if the volume of water is between 40% and 60% of the reservoirs' capacity, we can draw up to 31m<sup>3</sup>/s; (iii) if the volume of water is between 30% and 40% of the reservoirs' capacity, we can draw up to 27m<sup>3</sup>/s; (iv) if the volume of water is between 20% and 30% of the reservoirs' capacity, we can draw up to 23m<sup>3</sup>/s; and (v) if the volume of water available is lower than 20% of the reservoirs' capacity, we can draw up to 15.5m<sup>3</sup>/s.

As of December 31, 2017, the reservoirs in the São Paulo metropolitan region, where our largest market is located, contained 916.8 million m<sup>3</sup> of water storage for treatment, compared to 951.1 million m<sup>3</sup> available for treatment as of December 31, 2016. These figures do not include the Cantareira System's technical reserve of 287.5 million m<sup>3</sup>.

The following table shows the volume of water stored in the systems that serve the São Paulo metropolitan region as of December 2015, March 2016, December 2016, March 2017, December 2017 and March 2018 at the end of the rainy season:

	For the month						Total Storage Capacity
	December		December		December		
	March 2018	2017	March 2017	2016	March 2016	2015	
Cantareira	532.3	405.23	931.96	740.06	641.90	290.69	1,269.5 <sup>(1)(2)</sup>
Guarapiranga	141.4	101.61	135.40	123.62	150.01	147.12	171.19
Rio Grande	97.2	92.20	98.95	99.31	108.41	106.18	112.18
Rio Claro	13.9	10.08	13.98	11.30	14.02	9.71	13.67
Alto Tietê	362.8	294.76	314.60	248.08	247.94	135.55	573.81



Cotia	15.2	12.94	16.39	16.20	16.53	14.20	16.50
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(1) The Cantareira system's total storage capacity is 982.0 million m<sup>3</sup> available above the water intake level, plus 287.5 million m<sup>3</sup> below the water intake level (known as the "technical reserve").

(2) Amounts included since the May 2017 water right renewal do not include the water from the Cantareira System's technical reserve, which is water stored below the water intake level. For more information, see "—Extracting Water from the Technical Reserve".

In order to continue to meet consumer demand in the São Paulo metropolitan region and reduce water production in the Cantareira system to the limits set by ANA and DAEE, we adopted the following measures from February 2014 to early 2016 to maintain continuous water supply:

- use of treated water from other production systems to serve consumers originally supplied by the Cantareira system;
- implementation of a bonus program and contingency tariff;
- reduction of pressure in pipes in order to decrease leakage;
- adjustment to the volume of treated water sold to municipalities that operate their own distribution network, due to the reduced availability of water; and
- extraction of water from the technical reserve.

The first four measures resulted in significant water savings and helped to offset the reduced volume of water extracted from the Cantareira System. The extraction of water from the technical reserve was critical to maintaining a continuous supply of water to the population.

With the return of historical average rainfall in the rainy season from October 2015 to March 2016, water levels for the São Paulo metropolitan region returned to normal and we gradually discontinued the measures that we had taken during the water crisis.

The rain levels and water inflows into the reservoirs that supply the metropolitan region of São Paulo during the October 2017-March 2018 rainy season were below the historical average. However, when taking into account accumulated volume, the completion of the São Lourenço Project and the Jaguari-Atibainha interconnection, and the lower level of water production due to the reduction in demand after the water crisis, we believe that in terms of water security, the Metropolitan Region is prepared to face situations of similar magnitude as those observed in 2014 and 2015.

#### Using Water from Other Production Systems to Serve Consumers Originally Supplied by the Cantareira System

The Cantareira System is part of the Integrated Water Supply System (*Sistema Integrado de Abastecimento de Água*), or SIM, of the São Paulo metropolitan region together with another seven production systems that are interconnected through a system of large water mains known as the Metropolitan Water Main System (*Sistema Adutor Metropolitano*), or SAM. The SAM transports treated water to regional reservoirs. From there, treated water is distributed to the population through distribution networks. This system serves approximately 20 million people.

Throughout the years, we have expanded the capacities of a number of SIM production systems and major SAM water mains, which further integrated the systems and, among other things, allowed water to be transferred from different production systems to areas that, under normal conditions, would have been supplied by the Cantareira System. The Alto Tietê and Guarapiranga systems contributed most to this process.

The Guarapiranga System, with a storage capacity of 171 billion liters, maintained favorable levels of water availability for the duration of the drought and was the system that supplied most water during the water crisis, serving an additional 1.4 million people in the south and southeast regions of the city of São Paulo who had previously been served by the Cantareira System. As a result, the number of people served by the Guarapiranga System increased from 3.8 million before the water crisis to 5.2 million during the crisis. As of December 31, 2017, the Guarapiranga System served a population of 4.4 million people.

Throughout 2014 and 2015, with the adoption of these measures, almost three million people who used to be served by the Cantareira System began to be served by other systems. As of December 31, 2017, the Cantareira System

served 7.8 million people, compared to 8.9 million people before the drought.

Bonus Program

In February 2014, we implemented a water consumption reduction incentive program based on a bonus system, pursuant to which customers served by the Cantareira System who achieve a 20% reduction in water consumption are entitled to a 30% discount on their service bill. Initially, this incentive program was scheduled to last seven months or until the water level in the reservoirs normalized and became sufficient to supply the customers in the São Paulo metropolitan region served by the Cantareira System.

In April 2014, the incentive program was extended for the entire São Paulo metropolitan region until the end of 2014 or until the water level in the reservoirs normalized. In May 2014, the incentive program was extended to the municipalities we served in Piracicaba, Capivari and the Jaguari River Basin in the Cantareira System catchment area, and remained in effect for invoices issued between June and December 2014. This latter extension of the incentive program was suspended on April 17, 2015.

In October 2014, we implemented changes to the discount ranges in the bonus program: (i) customers who reduced their water consumption by 10-15% became entitled to a 10% discount on their service bill; (ii) customers who reduced their water consumption by 15-20% became entitled to a 20% discount; and (iii) customers who reduced their water consumption by 20% or more became entitled to a 30% discount.

In December 2014, we extended the Water Consumption Reduction Incentive Program until the end of 2015 or until reservoir levels normalized, whichever was to occur first.

In December 2015, we modified our bonus program by updating the reference value used to determine the discounts. Prior to this change, the reference value for the discounts was average consumption between February 2013 and January 2014. In December 2015, we reduced the reference value to 78% of the prior reference value, applicable as of February 1, 2016. The bonus ranges previously established were maintained.

On March 24, 2016, with the return of historical average rainfall and increased predictability of reservoir levels, we applied to ARSESP for cancellation our Water Consumption Reduction Incentive Program. ARSESP approved this request on March 31, 2016, with effect on water meter readings recorded as of May 1, 2016. There have been no further updates since that date.

#### Contingency Tariff

In January 2015, ARSESP authorized us to implement a contingency tariff mechanism consisting of additions to water bills for customers who did not reduce consumption. Under this contingency tariff mechanism, increases of up to 20% above average consumption result in a tariff increase of 40% and increases in consumption of more than 20% above average result in a tariff increase of 100%.

In December 2015, ARSESP authorized us to extend the contingency tariff, maintaining the current rules and conditions for its application, until December 31, 2016 or until inflows of water into our systems returned to predictable levels.

On March 24, 2016, with the return of historical average rainfall and increased predictability of reservoir levels, we applied to ARSESP for cancellation of the Contingency Tariff. ARSESP approved this request on March 31, 2016, with effect on water meter readings recorded as of May 1, 2016. There have been no further updates since that date.

#### Reducing Pressure in the Water Distribution Lines in order to Decrease Leakage

Reducing water pressure in water distribution lines through operational maneuvers is a routine measure taken by sanitation companies to reduce water losses. We have been carrying out this measure in the São Paulo metropolitan region water supply network since 1997.

Due to the severity of the recent water crisis, during 2014 and 2015 we intensified measures to decrease water pressure in the water supply network. As a result, some areas of the São Paulo metropolitan region temporarily had less water availability during part of the day and night. The improvement of hydraulic and data transmission equipment allows us to monitor the volume of water used in a certain region in real time, remotely gauge existing pressure in the local water distribution line, and reduce the volume of water loss from leakages, mitigating any effects on water supply.

With the return of historical average rainfall beginning in October 2015, we returned to the normal pre-crisis policy of reducing pressure only at night starting in December 2015.

Adjusting the Volume of Treated Water Sold to Municipalities that Operate their own Distribution Network

One of the measures adopted to offset the decreased volume of water extracted from the Cantareira System was to reduce the volume of water transferred to municipalities located in the area covered by the Cantareira System that we serve on a wholesale basis. The volume of water transferred was reduced by almost 2 m<sup>3</sup>/s during the water crisis. As the situation improved, the volume of water provided to these municipalities was restored.

### Extracting Water from the Technical Reserve

When our simulations indicated that the working volume of the Cantareira System would be depleted before the following rainy season, we obtained an authorization from ANA and DAEE to use part of the water from the Cantareira System's technical reserve, which is water stored below the water intake level.

Water from the technical reserve had never been used before. As a result, we built dams, water lines, water pipe facilities, and floating pumps to extract this water. We began using the first layer of the technical reserve, totaling 187 billion liters of water, in mid-May 2014, and the second layer, totaling 105 billion liters of water, at the end of October 2014. With the return of normal rainfall in the October 2015 – March 2016 rainy season, the technical reserve was fully restored in December 2015. We have reserved the right to access the technical reserve in our operational contingency plan in case this action becomes necessary again in the future.

### *Emergency Projects and Projects Implemented to Meet the Water Demand of the São Paulo Metropolitan Region*

In addition to the measures discussed above, we made and continue to make short and medium-term investments in projects to increase water availability, transfer water between different reservoir systems and expand water treatment production capacity.

Our production of treated water was expanded by 8.6 m<sup>3</sup>/s with the completion of the São Lourenço Project. In addition, an additional 13 m<sup>3</sup>/s was made available to our reservoirs through interconnections to other reservoirs in the state of São Paulo, which will be available to us if reservoirs levels once again become low. Completion of these projects results in improved water security for the SIM.

The main projects include:

- Alto Tietê System – transfer of an additional 1 m<sup>3</sup>/s from the Guaió River to the Taiacupeba reservoir, in order to recover the reserve volume of the Alto Tietê System. This project was concluded in June 2015.
- Alto Tietê System – transfer of additional up to 4.0 m<sup>3</sup>/s from Rio Grande - Billings reservoirs to the Alto Tietê System. This project was concluded in September 2015.
- Guarapiranga System – transfer of an additional 1 m<sup>3</sup>/s of which results from the expansion of the transfer capacity of the Billings reservoir to the Guarapiranga reservoir. This project was concluded in December 2015.
- Interconnection of the Jaguari and Atibainha reservoirs – the purpose of this project is to recover water levels and increase the water security of the Cantareira System. The interconnection increases water availability in the Cantareira System by 5.13 m<sup>3</sup>/s (annual average) to 8.5 m<sup>3</sup>/s (maximum) by transferring water from the Jaguari reservoir to the Atibainha reservoir. Construction of the interconnection began in February 2016 and was completed in March 2018. Upon completion of construction, we began transferring water from the Jaguari reservoir (part of the Paraíba do Sul Basin) to the Atibainha reservoir (part of the PCJ River Basin). For more information, see “Item 4.A. History and Development of the Company—Capital Expenditures Program”.
- Alto Tietê System – transfer of an additional average 1.9 m<sup>3</sup>/s and up to 2.5 m<sup>3</sup>/s from the Itapanhaú river to the Biritiba reservoir, providing more volume to the Alto Tietê System. This project is currently under development and is expected to be concluded in 2019.
- Implementation of the São Lourenço Production System – this project was commenced in April 2014 and was completed in April 2018. Upon completion in April 2018, pre-operation commenced. This system has an average water treatment capacity of 6.4 m<sup>3</sup>/s. For more information, see “Item 4.A. History and Development of the Company—Capital Expenditures Program”.

*The Drought Committee*

On February 3, 2015, the State approved Decree No. 61,111, which established the Drought Committee for the São Paulo metropolitan region (*Comitê de Crise Hídrica no Âmbito da Região Metropolitana de São Paulo*), or Drought Committee, as coordinated by the State Department for Sanitation and Water Resources (*Secretaria de Saneamento e Recursos Hídricos*). The Drought Committee holds meetings when necessary.

The Drought Committee's main purposes are exchanging information and planning joint actions between its members in relation to the drought affecting regions in the state. The Drought Committee shall be composed of the Secretaries of (a) Sanitation and Water Resources (who shall chair the Drought Committee); (b) Chief of Staff; (c) Health; (d) Public Security; (e) the Environment; (f) Agriculture and Supplies; (g) Energy; and (h) the State Coordinator of Civil Defense. In addition, if invited, the following parties may also compose the Drought Committee: the mayors of São Paulo and Campinas, as well as the Chairmen of (a) the Intermunicipal Greater ABC Consortium (*Consórcio Intermunicipal do Grande ABC*); (b) the Development Consortium of the Alto Tietê Municipalities (*Consórcio de Desenvolvimento dos Municípios do Alto Tietê*); (c) the Intermunicipal Consortium of the Juqueri Basin (*Consórcio Intermunicipal dos Municípios da Bacia do Juqueri*); (d) the Intermunicipal Consortium of the Western Region of the São Paulo Metropolitan Area (*Consórcio Intermunicipal da Região Oeste Metropolitana de São Paulo*); and (e) the Intermunicipal Consortium of the Southeast Region of Greater São Paulo (*Consórcio Intermunicipal da Região Sudeste da Grande São Paulo*). Representatives of professional associations, civil society groups and public administration entities may also be included in the Drought Committee by means of invitations. The State Chief of Staff will monitor the Drought Committee.

In order to fulfill its purposes, the Drought Committee will be in charge of: (i) providing the mayors of the respective São Paulo metropolitan cities and the users of the water system with information regarding the status of the water systems, the severity of the water crisis and the decisions made on a governmental level regarding the water supply, in order to provide sufficient time for adaptation; (ii) examining alongside the city mayors the need to implement restrictions on the use of drinking water for purposes other than human consumption and animal consumption, by means of enacting local law; (iii) obtaining from the city mayors information necessary to update and/or amend contingency plans; and (iv) communicating to the public measures and risks related to restrictions on the supply of drinking water.

### **Marketing Channels**

As of December 31, 2017, we were the concessionaire for the provision of water supply and collection, treatment and disposal of sewage services directly to end consumers for 368 municipalities in the state of São Paulo. We also supply water on a wholesale basis to five municipalities located in the São Paulo metropolitan region. It is the responsibility of these municipalities to then distribute the water to end consumers. We provide sewage services to four of these municipalities. Because of our distribution infrastructure, end consumers to whom we offer water services on a wholesale basis cannot alternatively acquire such services directly from us. For more information on service concessions, see "—Wholesale Operations".

### **Energy Consumption**

Energy is essential to our operations, and as a result we are one of the largest users of energy in the state of São Paulo. In the year ended December 31, 2017, we used approximately 1.79% of the total energy consumption in the state of São Paulo. To date, we have not experienced any major disruptions in energy supply. Any significant disruption of energy to us could have a material adverse effect on our business, financial condition, results of operations or prospects. Energy prices have a significant impact on our results of operations. In 2017, we purchased approximately 54% of our total energy consumption in the "free market," where we can more efficiently negotiate the supply of energy; and the remainder of our energy consumption comes from the Regulated Market. This allowed us to save approximately R\$158 million in 2017, compared to what we expect we would have spent if we purchased all of our total energy consumption in the Regulated Market.

Most of the energy produced in Brazil comes from hydroelectric power plants. For more information on energy, see "Item 3.D. Risk Factors—Risks Relating to Our Business—We are exposed to risks associated with the provision of water and sewage services".



## **Insurance**

We maintain insurance covering, among other things, fire or other damage to our property and office buildings and third party liability. We also maintain insurance coverage for directors' and officers' liability (D&O insurance). We currently obtain our insurance policies by means of public bids involving major Brazilian and international insurance companies that operate in Brazil. As of December 31, 2017, we had paid a total aggregate amount of R\$4.7 million in premiums. In addition, we paid R\$1.6 million for a D&O insurance policy, covering R\$3.7 billion in assets, third party liabilities and D&O insurance. We do not have insurance coverage for business interruption risk because we do not believe that the high premiums for such insurance are justified by the low risk of major interruption of our activities. In addition, we do not have insurance coverage for liabilities arising from water contamination or other problems involving our water supply to customers and for environmental related liabilities and damages. We believe that we maintain insurance at levels customary in Brazil for our type of business.

## **Intellectual Property**

### ***Trademarks***

We have secured registration of our logo and composite trademark (“Sabesp”) at the Brazilian Institute of Industrial Property (*Instituto Nacional da Propriedade Industrial*), or INPI. In addition, we have registered with the INPI several other trademarks, such as: “Sabesp Soluções Ambientais”, “Projeto Tietê”, “Programa Córrego Limpo”, “Programa Onda Limpa”, “Prol – Programa de Reciclagem do Óleo de Fritura”, “Revista DAE”, “Ligação Sabesp”, “Agente da Gente – Sabesp Comunidade”, “PURA – Programa de Uso Racional da Água”, “Sabesp Inteligência Ambiental”, “Reúso de Água”, “Uso Racional da Água”, “Parque da Integração”, “Sabesp Semana do Meio Ambiente”, “Água Sabesp Aquífero Guarani”, “Água Sabesp Estação Cantareira”, “Contrato de Fidelização Sabesp”, “Esgoto não Domésticos Sabesp”, “PEA – Programa de Educação Ambiental – Sabesp”, “Sabesp Abraço Verde”, “Água de Reúso Sabesp”, “Eu Sou Guardião das Águas Sabesp Eu Não Desperdiço”, “Calculadora de Sonhos”, “Parque Sabesp Mooca”, “Parque Sabesp Butantã”, “Parque Sabesp Cangaíba” and “Clubinho Sabesp”, which is a tool for environmental education directed to children through our website, and of its characters: “SuperH2O”, “Gota Borracheira”, “Gotucho”, “Ratantan”, “Dr. Gastão”, “Cauã”, “Denis”, “Gabi”, “Iara”, “Sayuri”

We have also filed applications with the INPI for registration of the following trademarks: “Signos Sistema de Informação Geográfica no Saneamento”, “Acertando suas contas com a Sabesp”, “Sistema de Suporte a Decisões Sabesp” and “Programa Água Legal Sabesp”.

### ***Patents***

We have a patent granted by the INPI for a device for the removal of supernatants during the sewage treatment process. Our patent for a constructive device in a building hydraulic simulator used for didactic purposes has expired and therefore, the rights associated with such patent have fallen into the public domain. We have also filed patent requests for the following additional devices:

- a biofilter odor control unit;
- rotary devices used to clean water reservoirs transported by trucks with high-pressure hydrojetting systems;
- a digital leakage detection system;
- a chemical composition sensor, its fabrication process and use to measure pH in microfluid systems; and
- a bubble removal system, autonomous microlaboratory and use of autonomous microlaboratory to monitor water quality.

We are currently awaiting responses to our patent requests from the INPI. While the requests are under consideration, we are granted the exclusive right to use these devices.

### ***Software***

We have adopted an internal policy that provides for an active and effective audit and prevention of unauthorized software. We have acquired the software licenses for all our workstations.

We have also developed certain computer programs for management and control of water and sewage treatment facilities, as well as for third party services management, called “AQUALOG” (Control Water Treatment Plants), “SGL” (Bid Management System), “SCORPION” (Software to Operational Control), “Electronic Price Quotation”, “PREGÃO SABESP ONLINE”, “SISDOC” (Document Control System), “system for analyzing the metrological behavior of water meters”, “MPLT” (Standardized Model of Technical Report), “SGH” (Hydrometry Management System), “SAI” (Audit Information System), “CSI” (Business System: Information Services), “NETCONTROL” (Automation System of Sanitary Control Laboratories), “SACE” (External Commercial Service System), “SAN” (Navigation Support System), “online software for managing specific articles published in the DAE magazine”, “Dashboard panel”, “COP” (Online Control of Water Losses), “GEL” (Power Management System), “CADGEO”, “LIGGEO”, “Intellectual Property Management System”, “SOE” (Business Organization System) and “Application for Predicting the Concentration of Cyanobacteria through Artificial Intelligence”.

Among them, we highlight:

- AQUALOG is a software designed to monitor water treatment through the employment of artificial intelligence. In 2001, we completed the first rendering of services based on the AQUALOG software to a third party with the automation of a water treatment plant in the city of Jaguará do Sul, State of Santa Catarina. We have entered into an agreement to license the software to Sanesul, in the state of Mato Grosso do Sul and to Teuto's drugs factory, in the city of Anapólis, state of Goiás.
- SGL is an electronic price quotation system that allows us to view and control all bid and acquisition proceedings in real time.
- CADGEO and LIGGEO are computer programs used to locate the water and sewage infrastructure in times of installation, maintenance or expansion in real time via satellite.
- "Application for Predicting the Concentration of Cyanobacteria through Artificial Intelligence", is an application that was developed as a result of a joint research project by us, the São Paulo State Foundation for Research Support (*Fundação de Amparo à Pesquisa do Estado de São Paulo – FAPESP*) and the Federal University of São Paulo – UNIFESP.

We have also registered all of these programs at the INPI.

#### ***Domain Names***

We own the domain names described below which have been registered with the relevant entity in Brazil, Registro.br:

- [www.sabesp.com.br](http://www.sabesp.com.br);
- [www.corregolimpo.com.br](http://www.corregolimpo.com.br);
- [www.projetotiete.com.br](http://www.projetotiete.com.br);
- [www.revistadae.com.br](http://www.revistadae.com.br);
- [www.blogdasabesp.com.br](http://www.blogdasabesp.com.br);
- [www.blogsabesp.com.br](http://www.blogsabesp.com.br);
- [www.sustentabilidadesabesp.com.br](http://www.sustentabilidadesabesp.com.br);
- [www.inovasabesp.com.br](http://www.inovasabesp.com.br);
- [www.ondalimpa.com.br](http://www.ondalimpa.com.br);
- [www.programaondalimpa.com.br](http://www.programaondalimpa.com.br);
- [www.clubinhosabesp.com.br](http://www.clubinhosabesp.com.br); and
- [www.superh2o.com.br](http://www.superh2o.com.br).

### **Environmental Matters**

Our environmental management, which is guided by the directives established in our environmental policy, is inherent to the provision of our services and the essence of our business. In order to consolidate our environmental culture, we prioritize the internal and external dissemination of knowledge and experience on the best environmental practices.

There are actions of our environmental management corporate program that rely on the involvement of collaborators, the communities we service and partnerships with non-governmental organizations.

We have the following ongoing environmental management programs:

- development of the Corporate Greenhouse Gas Management Program (*Programa Corporativo de Gestão de Emissões de Gases de Efeito Estufa*), in line with the guidelines from the São Paulo State Climate Change Policy (PEMC), including the preparation of inventories of greenhouse gases, totaling 10 inventories concluded since 2007;
- continuation of the actions set forth in the corporate programs for obtaining and maintaining environmental licenses and grants for the right to use water;
- the Environmental Education Program (*PEA-SABESP*), an important tool for the effectiveness of our sanitation activities, which propitiates connections with the communities we service through over a hundred environmental education projects. The activities developed by the PEA are organized with the following objectives: increment the intrinsic value of water; protect the environment; preserve the streams; improve the quality of the environment; valorize sanitation activities; valorize the conscious use of water; direct capacitation and production of guiding material;
- Management of our institutional representation in the State and National Systems of Water Resources, including training of company representatives to participate in: (i) the creation of criteria for water usage charges, (ii) the monitoring of river basin plans (*Planos de Bacias*), (iii) review of water bodies' classifications, and (iv) analysis of legislations regarding the protection of water sources;
- the SABESP 3 Rs Program (*Programa SABESP 3Rs*) for the reduction, re use and recycling of waste from administrative activities, in partnership with waste and recycling collecting cooperatives and which includes employee training enabling them to act as multipliers in the roll-out of the program;
- the progressive implementation and maintenance of the Environmental Management System (EMS) in our water and sewage treatment plants. The EMS is currently in place in 177 treatment plants, 35 of which are ISO 14001 certified. There are perspectives of implementing the EMS in all stations by 2024, whereby the scope of 14001 certification may be expanded according to the strategy of the Business Units, which scope is evaluated annually by means of external audits. Since 2015, we have been working on the EMS with a mixed model, whereby the ISO 14001 standard is applied to the certified scope, while the other stations adopt their own environmental management model (named SGA-SABESP); and
- in the development of our activities related to the execution of works and interventions, we go through a process of obtaining permits and environmental licenses, according to the current legislation. As a result of these processes, we undertake environmental compensation commitments. In order to meet our current and future obligations, we developed and are implementing a program that includes the planting and the maintenance of 1 million seedlings in the next ten years. The work has already started and is included within the context of the "Programa Nascentes" of the Government of the State of São Paulo. Currently, 213 thousand seedlings have already been planted and are being maintained in the Cantareira System and in the surrounding area of the Cachoeira Reservoir. The planting and maintenance of another 168 thousand seedlings has already been contracted for in the municipalities of Igaratá and Mirante do Paranapanema. We are also in the process of contracting, planting and maintaining another 350 thousand seedlings in the Cantareira System, further expanding forest coverage in the area.

In addition to corporate environmental management initiatives, we have several projects and initiatives underway to benefit the environment by engaging the population at large. In 2017, we invested R\$19.9 million in environmental programs and projects directly concerned with the development and implementation of corporate environmental management programs as well as the Program for Rational Use of Water (*Programa de Uso Racional da Água – PURA*), among other environmental initiatives with a local scope executed by our Business Units.

Other investments and expenses associated with environmental protection are included in the total value of operational expenses and investments mentioned in this annual report, due to the direct relationship of our environmental activities with our overall purpose. For example, we have made, among others, significant investment in sewage, effluent monitoring, payment for the use of water in federal and state water bodies, maintenance of reserves in protected areas, environmental education actions.

***Climate Change Regulations: Reduction of Greenhouse Gases (GHG) Emissions***

We are required to comply with laws and regulations related to climate change, including international agreements and treaties to which Brazil is a signatory.

The São Paulo State Climate Change Policy (Law No. 13,798/2009), enacted on November 9, 2009, and regulated by Decree No. 55,947 of June 24, 2010, aims to reduce global emissions of carbon dioxide by 20.0% by 2020 compared with 2005 levels. Brazil's Climate Change Policy (Law No. 12,187/2009), enacted on December 29, 2009 and regulated by Decree No. 7.390/2010 establishes a voluntary national commitment to reduce Brazil's currently projected GHG emissions for 2020 by a percentage between 36.1% and 38.9%. Such targets have not been established for the sanitation sector yet. In this sense we are currently developing a Corporate Greenhouse Gas Management Program, aimed at reducing the amount of greenhouse gases released into the atmosphere, including the creation of an inventory to record releases of greenhouse gases.

In 2017, we concluded the corporate inventory of greenhouse gases for 2016, thus totaling ten inventories since 2007. We noted that the trend observed in the previous inventories persists, specifically that activities regarding sewage collection and treatment remain our largest sources of greenhouse gas release, representing approximately 89% of total greenhouse gas release. Electric energy represents approximately 9% and other activities represent approximately 2%.

We have projects in the research and development stages that entail using biogas generated in the treatment of sewage and recycling sewage sludge as a possible way to reduce the gases released in the treatment processes. We also have initiatives to reduce our emission of greenhouse gases, such as the coverage of stabilization ponds and the implementation of composting systems.

At this point, it is still not possible to predict if climate change policies will provide opportunities or generate new costs for us. Reducing our emissions of carbon dioxide will involve costs and expenses related to implementing more stringent control mechanisms, adopting pollution prevention measures and actions to minimize the generation of GHGs. We may not receive financial incentives to offset all or part of these costs. In addition, if limitations in GHG emissions affect our supply chain and increase our costs, we may not be able to pass on these costs to our end consumers. See “—Tariffs”.

#### *Physical Effects of Extreme Weather Events*

Since our financial performance is closely linked to climate patterns that influence the qualitative and quantitative availability of water, extreme weather conditions may cause adverse effects on our business and operations. Long-term effects of extreme weather conditions cause significant alterations in the physical environment that may create unfavorable circumstances, which could affect the costs of services and tariffs.

An increase in heavy rainfall can impact the regular operation of water sources, including abstraction of water from our dams, through potential increased soil erosion, silting and runoff of pollutants that can affect aquatic ecosystems. In addition, increased flows of rainwater into sewage systems may overwhelm the capacity of sewage treatment plants.

In the case of prolonged periods of drought, for example, reduced water levels in dams can greatly impact the production process. Droughts also lower reservoir levels available for hydroelectric plants, which may lead to power shortages, particularly since hydroelectric power accounts for most of Brazil's electric power supply. Lack of electric energy could lead to instability in water supply and sewage collection and treatment services, which could damage our reputation. In addition, because we are one of the largest consumers of electricity in the state of São Paulo, a potential increase in electricity tariffs due to a shortage of hydroelectric power could have a significant economic impact on us.

We are also the concessionaire for water and sewage services for all the coastal municipalities of the state of São Paulo. A rise in the sea level could result in increased salinity in the river estuaries where we abstract water, which could affect water treatment in these areas. Rising sea levels could also cause damage in our sewage collection



network.

Extreme climate events may also affect the extraction, production and transportation of the materials necessary for our operations, such as water treatment materials, and may lead to an increase in the cost of these materials. A drastic rise in air temperature could also increase consumer demand for water, increasing the need to expand both water supply and sewage treatment.

In this context, our strategy calls for identifying mitigating actions and enlarging their coverage in the areas we operate in, as well as identifying opportunities to increase our effectiveness and to implement new technologies. With regard to the risk of reduced water availability, we are working to adapt to a new scenario of water scarcity due to the risks associated with the effects of climate change through initiatives such as the Corporate Programs for Reduction of Water Loss, the Program for Rational Water Usage and the expansion of the planned reutilization of effluents for urban and industrial purposes, among others.

See “Item 3.D. Risk Factors—Risks Relating to Our Business—New laws and regulations relating to climate change and changes in existing regulation, as well as the escalation of the physical effects of extreme weather events, may result in increased liabilities and increased capital expenditures, which could have a material adverse effect on us”.

### ***Public Bidding Procedures***

Pursuant to the Federal Public Bidding Law, the public bid process commences with publication by the granting authority in a federal, state or municipal official newspaper, as the case may be, and another leading Brazilian newspaper. The publication announces that the granting authority will carry out a public bidding contest pursuant to provisions set forth in an *edital* (invitation to bid). The invitation to bid must specify, among other terms: (i) the purpose, duration and goals of the bid; (ii) the participation of bidders, either individually or forming a consortium; (iii) a description of the qualifications required for adequate performance of the services covered by the bid; (iv) the deadlines for the submission of the bids; (v) the criteria used for the selection of the winning bidder; and (vi) a list of the documents required to establish the bidder’s technical, financial and legal capabilities.

The invitation to bid is binding on the granting authority. Bidders may submit their proposals either individually or in consortia, as provided for in the invitation to bid. After receiving proposals, the granting authority will evaluate each proposal according to the following criteria, which must have been set forth in the invitation to bid:

- the technical quality of the proposal;
- lowest cost or lowest public service tariff offered;
- a combination of the criteria above; or
- the largest amount offered in consideration for the concession.

The provisions of State Law No. 6,544/1989 of November 2, 1989, as amended, or the State Public Bidding Law, parallel the provisions of the Federal Public Bidding Law. The Federal and State bidding laws will apply to us in the event that we seek to secure new concessions. Moreover, these bidding laws currently apply to us with respect to obtaining goods and services from third parties for our business operations or in connection with our capital expenditure program, in each case subject to certain exceptions.

On June 30, 2016, Federal Law No. 13,303/16 came into force in Brazil. This law sets new corporate governance standards for Brazilian government-owned and mixed capital companies like our company, as well as their subsidiaries. Federal Law No. 13,303/16 also sets new rules that these companies must follow in public bidding procedures and when contracting third parties. We are working to implement the requirements of this federal law and expect to conclude the implementation process by June 30, 2018.

### ***Water Usage***

State law establishes the basic principles governing the use of water resources in the state of São Paulo in accordance with the State constitution. These principles include:

- rational utilization of water resources, ensuring that their primary use is to supply water to the population;
- optimizing the economic and social benefits resulting from the use of water resources;
- protection of water resources against actions which could compromise current and future use;

- defense against critical hydrological events which could cause risk to the health and safety of the population or economic and social losses;
- development of hydro transportation for economic benefit;
- development of permanent programs of conservation and protection of underground water against pollution and excessive exploitation; and

- prevention of soil erosion in urban and rural areas, with a view to protecting against physical pollution and silting of water resources.

Among other instruments established by the State Water Policy, Law No. 7,663 of December 30, 1991, the competent public authority grants for the right to use water for the implementation of any enterprise that demands the use of surface or underground water resources (for water collection and release of effluents), as well as for the execution of services that alter the regime or quality of such water resources. In the case of rivers under the federal government's domain (rivers crossing more than one state), ANA is the public authority which grants the authorization. With respect to the rivers under a state's domain, the applicable state authority has jurisdiction to grant the right of use. In the state of São Paulo, DAEE is the public authority responsible for granting such authorizations.

In conducting our principal activities, we have the majority of grants for the rights to use water, and there is a multi-annual corporate program in place to obtain and maintain the rights to use water for the remaining activities. However, all of our water-usage activities included in the corporate program have filed requests for grants for the right to use water with the competent authority; many of these requests have been granted and others are under analysis by DAEE and ANA. Another phase of the corporate program is predicted to meet new demands.

State Law No. 12,183/2005, which was enacted on December 29, 2005, established the basis for charging for the use of the water resources under the domain of the State of São Paulo. To apply such charging, the law provides for, among other provisions, the participation of the River Basins Committees, the formulation of criteria by such committees, the creation of basin agencies and the organization of a registered list of water resource users. The basin committee's proposals regarding the criteria to calculate the amounts to be charged at each basin must be approved by the State Water Resource Council, and formalized by a decree issued by the State Governor.

According to existing law, the hydrographic basins committees are authorized to charge users, such as us, for the abstraction of water from, or dumping of sewage into, water bodies.

Charging for the use of water is under gradual implementation by the State of São Paulo, where the largest individual contributors are located, and it is a management tool of the Policy on Water Resources to promote the rational use of water and finance programs and actions established by the basin plans. In 2017, we paid approximately R\$60.8 million for the use of water resources.

Charging for the use of water from rivers of federal domain began in 2003 in the Paraíba do Sul basin, and charging for the use of water from rivers of state domain began in 2007 in the Paraíba do Sul, Piracicaba, Capivari and Jundiá basins. Subsequently, charges were implemented for the use of water from the Sorocaba, Baixo Tietê, Médio Tietê and Baixada Santista river basins. In 2014, charges were implemented for the use of water from the Alto Tietê river basin, and in 2016, from the Tietê / Batalha, Tietê / Jacaré and Ribeira de Iguape river basins. In 2017, charges were implemented for the use of water from the Sapucaí Mirim/Grande, Baixo Pardo/Grade, Mogi Guaçu and Pardo river basins. It is probable that the same will occur in 2018 in the other river basins of the State of São Paulo.

### ***Water Quality***

Attachment XX of the Consolidation Administrative Rule No. 5 from September 28, 2017, issued by the Ministry of Health of the federal government, provides the standards for potable water for human consumption in Brazil. This rule is similar to the U.S. Safe Drinking Water Act and the regulations enacted by the U.S. Environmental Protection Agency, which establishes rules for sampling and limits related to substances that are potentially hazardous to human health.

In compliance with Brazilian law, the physical chemical, organic and bacteriological analyses carried out for water quality control must follow several national and international standards, such as: Standard Methods for the Examination of Water and Wastewater from the institutions such as the American Public Health Association (APHA), American Water Works Association (AWWA) and Water Environment Federation (WEF); United States Environmental Protection Agency (EPA); standards published by the International Standardization Organization (ISO); and methodologies proposed by the World Health Organization (WHO).

Decree No. 5,440/2005 provides that the quality of water must be disclosed to consumers. We have been complying with this regulation by publishing the required information in monthly bills and annual reports delivered to all consumers that we serve.

***Environmental Regulation***

The implementation and operation of water and sewage systems are subject to strict federal, state and municipal laws and regulations on environmental and water resource protection. The National Environmental Council (*Conselho Nacional de Meio Ambiente*), or the CONAMA, is the federal agency responsible for the regulation of potentially polluting activities. In the state of São Paulo, CETESB is the governmental entity responsible for the control, supervision, monitoring and licensing of polluting activities, pursuant to State Law No. 997/1976 and State Law No. 13,542/2009.

The control and environmental planning instruments are defined by several legal instruments, such as State Law No. 997/1976, which regulates environmental pollution control; CONAMA Resolution No. 05/1988, which requires licensing of sanitation projects that cause significant alterations to the environment; Complementary Law No. 140/2011 CONAMA Resolution No. 237/1997, which regulates (i) environmental licenses; (ii) federal, state and local jurisdiction over environmental issues; (iii) the list of activities subject to licensing; and (iv) environmental impact studies and reports; State Decree No. 8,468/1976, State Decree No. 47,400/2002 and related articles from State Law No. 9,509/1997 regarding environmental licensing; State Decree No. 8,468/1976, CONAMA Resolution No. 357/2005, which establish standards of quality for receiving bodies of water; State Decree No. 8,468/1976 and CONAMA Resolution No. 430/2011 which establish the standards for discharge of effluents; and DAAE Ordinance No. 1,630/2017 and ANA Resolution No. 1,941/2017, which regulate the concession of grants for the right to use water and interfere in water resources on the State and federal level, respectively.

The licensing process, usually, is composed of three stages, including the following licenses:

- preliminary license – granted in the planning stage, approving the location and concept and attesting to the project’s environmental feasibility;
- installation license – authorizing the beginning of works for the installation of the project, subject to compliance with approved plans, programs and projects, including environmental control measures and other necessary technical requirements; and
- operation license – authorizing the operation of a unit or activity, subject to compliance with the technical requirements contained in the installation license.

There are cases, according to the type of business to be licensed, in which the preliminary license may be issued with the installation license. The environmental licenses are renewable.

Projects with significant environmental impact are subject to specific studies prepared by multidisciplinary teams that present a series of recommendations focused on minimizing the environmental impact. These studies are then submitted for analysis and approval by the government authorities.

We have a multi-annual corporate program to obtain and maintain the environmental licenses for our water treatment plants, sewage treatment plants and sewage pumping stations in order to comply with environmental regulations.

#### *Sewage Requirements*

State law sets forth regulations regarding pollution control and environmental preservation in the state of São Paulo. According to this law, in areas in which there is a public sewage system, all effluents of a “polluting source” must be discharged to such system, as is the case for industrial enterprises. It is the responsibility of the polluting source to connect itself to the public sewage system. All effluents to be discharged are required to meet the standards and conditions established by the applicable environmental law, which allows such effluents to be treated by our treatment facilities and discharged in an environmentally safe manner. Effluents that do not comply with such criteria are

prohibited from being discharged into the public sewage system. State legislation also establishes that liquid effluents, except those related to basic sanitation, be subjected to pre treatment so that they meet the required mandatory levels before being discharged into the public sewage system. Effluents from our treatment facilities must comply with effluent limitation guidelines and meet the water quality standards of the receiving water bodies established by federal and state legislation. See “—Sewage Operations—Sewage System”.

The CETESB is authorized under State law to monitor discharges of effluents into the water bodies, among other things. The CETESB also issues the environmental licenses to the polluting sources, including sewage treatment plants. For more information, see “—Environmental Matters”.

State and federal water resource legislation establishes the charging of fees for the discharge of treated effluents into water bodies. This charge is already in force for some river basins, and it is in different implementation stages for the remaining basins. See “—Environmental Matters—Water Usage”.

### ***Governmental Restrictions on Incurrence of Debt***

On June 29, 1998, the CMN issued Resolution No. 2,515/1998 amending certain conditions that must be observed with respect to external credit operations (i.e., foreign currency borrowings) of states, the Federal District of Brasília, municipalities and their respective *autarquias* (agencies), foundations and non financial companies, including us. This resolution provides, among other things, that, with certain exceptions applicable to the importation of goods and services:

- the proceeds of external credit operations must be exclusively used to refinance outstanding financial obligations of the borrower, with preference given to those obligations that have a higher cost and a shorter term, and, until used for such purposes, the proceeds shall remain deposited, as directed by the Central Bank, in a pledged account; and
- the total amount of the contractual obligation must be subject to monthly deposits in a pledged account, equal to the total debt service obligation, including principal and interest, divided by the number of months that the obligation is to be outstanding.

The CMN resolution further provides that the requirements described above do not apply to financing transactions involving multilateral or official organizations such as the International Bank for Reconstruction and Development, or IBRD, the IADB or the JICA. The Central Bank regulation implementing this resolution provides, among other things, that the account referred to in the first bullet point above must be an account opened in a federal financial institution, which is to hold such funds until released for the purpose of refinancing outstanding obligations of the borrower. The Central Bank regulation further provides that the account described in the second bullet point above must be an escrow account to be opened in a federal financial institution and to secure the payment of principal and interest on the external debt.

Our foreign currency denominated transactions are also subject to the approval of the National Secretariat of Treasury (*Secretaria do Tesouro Nacional*) and the Central Bank. After reviewing the financial terms and conditions of the transaction, the National Secretariat of Treasury and the Central Bank will issue an approval for the closing of the foreign exchange transaction relating to the entry of the funds into Brazil and, following such entry and at our request, an electronic certificate of registration through which all scheduled payments of principal, interest and expenses will be remitted by us. The electronic certificate of registration grants the borrower access to the market for foreign exchange.

### ***Lending Limits of Brazilian Financial Institutions***

The CMN Resolution No. 2,827/2001 dated as of March 30, 2001, as amended, limits the amount that Brazilian financial institutions may lend to public sector companies, such as us. Financing of projects which are put up for international bid and any financing in *reais* provided to the Brazilian counterpart of such international bids are excluded from these limits.

### ***Scope of Business***

State Law No. 12,292/2006, dated as of March 2, 2006, and amended State Law No. 119/1973, dated as of June 29, 1973, which created our Company, authorizes us to provide water and sewage services outside São Paulo (in other



states of Brazil and other countries). This law also authorizes us to own interests in other public or private public companies and Brazilian or international consortia. In addition, this law permits us to incorporate subsidiaries and enter into a partnership with or acquire interests in a private company with a corporate purpose related to the sanitation business.

**C. Organizational Structure**

Not applicable.

**D. Property, Plant, Equipment and Intangible Assets**

Our principal property, plant and equipment comprise administrative facilities which are stated at historical costs less depreciation. The reservoirs, water treatment facilities, water distribution networks consisting of water pipes, water transmission lines, water connections and water meters, sewage treatment facilities, and sewage collection networks consisting of sewer lines and sewage connections are recorded as intangible assets (concession assets). As of December 31, 2017, we operated through 74,396 kilometers of water pipes and water transmission lines and 50,991 kilometers of sewer lines. As of the same date, we operated 240 water treatment facilities and 557 sewage treatment facilities (including nine ocean outfalls), as well as 16 water quality control laboratories.

As of December 31, 2017, the total net book value of our property, plant and equipment and intangible assets (including concession assets) was R\$33,721.2 million.

All of our material properties are located in the state of São Paulo.

#### **ITEM 4A. UNRESOLVED STAFF COMMENTS**

Not applicable.

#### **ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

The following management's discussion and analysis of financial condition and results of operations should be read in conjunction with our audited financial statements included elsewhere in this annual report. The financial statements included elsewhere in this annual report have been prepared in accordance with IFRS as issued by the IASB. This annual report contains forward looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward looking statements as a result of various factors, including, without limitation, those set forth in "Risk Factors".

In the following discussion, references to increases or decreases in any period are made by comparison with the corresponding prior period, except as the context otherwise indicates.

##### **A. Operating and Financial Review and Prospects**

###### **Overview**

As of December 31, 2017, we operated water and sewage systems in the state of São Paulo, including in the city of São Paulo, Brazil's largest city. Our operations extended into a total of 368 municipalities, or 57% of all municipalities in the state. We also provided water services on a wholesale basis to five municipalities located in the São Paulo metropolitan region in which we did not operate water distribution systems.

The São Paulo metropolitan region, which includes the city of São Paulo, is our most important service region. With a total population of approximately 20.8 million, the São Paulo metropolitan region accounted for 70.7%, 69.7% and 67.3% of our gross operating revenue in 2017, 2016 and 2015 (excluding revenues relating to the construction of concession infrastructure), respectively. As of December 31, 2017, 64.5% of the concession intangible assets reflected on our balance sheet were located in this region. In an effort to respond to demand in the São Paulo metropolitan region, we have concentrated a major portion of our capital expenditure program to expand the water and sewage systems and to increase and protect water sources in this region. Our capital expenditure program is our most significant liquidity and capital resource requirement.

###### **Factors Affecting Our Results of Operations**

Our results of operations and financial condition are generally affected by our ability to raise tariffs, control costs and improve productivity, general economic conditions in Brazil and abroad, and extreme weather events.

In 2015, our business was significantly affected by the most severe drought recorded in our service area in over 80 years. During the rainy season that began in October 2015 and ended in March 2016, rainfall returned to its historical average, resulting in the level of water in the reservoirs that provide water to the population of the São Paulo metropolitan region returned to normal and the measures taken during the water crisis to continue to services consumers were gradually discontinued. However, heightened public awareness of the need to conserve water during

the crisis resulted in our customers adopting lower water consumption practices during the water crisis and these practices have been partially integrated into our consumers' daily habits. Another probable factor of the reduction of consumption during 2016 is the contraction of the Brazilian economy, which may have resulted in lower consumption of water by industry and other businesses. In 2017, consumption levels largely recovered in the residential category, while consumption in the industrial category continued to decline mainly due to the low level of growth in the Brazilian economy. As a result of this new behavior, despite our reservoirs having a higher volume of water available for treatment, the volume of water billed to our clients has not returned to the 2013 pre-water crisis levels.

***Effects of Tariff Increases***

Our results of operations and financial condition are highly dependent on tariff increases for our water and sewage services. Since the enactment of the Basic Sanitation Law in 2007, as a general rule, regulatory agencies are responsible for setting, adjusting and reviewing tariffs, taking into consideration, among other factors, the following:

- political considerations arising from our status as a State controlled company;
- anti inflation measures enacted by the federal government from time to time; and
- when necessary, the readjustment to maintain the original balance between each party's obligation and economic gain (*equilíbrio econômico financeiro*) under the agreement.

Readjustment of our tariffs continues to be set annually and depend on the parameters established by the Basic Sanitation Law and ARSESP. The guidelines also establish procedural steps and the terms for annual adjustments. The annual adjustments must be announced 30 days prior to the effective date of the new tariffs. See "4.B. Business Overview—Tariffs".

The following table sets forth, for the years indicated, the percentage increase of our tariffs, as compared to three inflation indexes:

	<b>Year ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Increase in average tariff <sup>(1)</sup>	7.89%	8.45%	15.24%
Inflation – IPC – FIPE	2.27%	6.54%	11.07%
Inflation – IPCA	2.95%	6.29%	10.67%
Inflation – IGP M	(0.52)%	7.17%	10.54%

(1) See "Item 4.B. Business Overview—Tariffs" for addition information on tariff increases.

Sources: Central Bank, *Fundação Getulio Vargas*, or FGV, Instituto Brasileiro de Geografia e Estatística, or IBGE, and *Fundação Instituto de Pesquisas Econômicas*.

***Effects of Brazilian Economic Conditions***

As a company with all of its operations in Brazil, our results of operations and financial condition are affected by general economic conditions in Brazil, particularly by the economic activity and the inflation rate. For example, the general performance of the Brazilian economy may affect our cost of capital and inflation may affect our costs and margins. The Brazilian economic environment has been characterized by significant variations in economic growth rates. However, as our product is viewed as essential, in normal conditions our sales revenue demonstrates stability.

***General Economic Conditions***

In 2015, Brazilian GDP decreased 3.8% in comparison with 2014, the worst result in 25 years. Also in 2015, Brazil had US\$368.4 billion in currency reserves and its trade surplus was US\$19.7 billion. The average unemployment rate in Brazil was 8.5%.

In 2016, Brazilian GDP decreased 3.6% in comparison with 2015. Brazil's trade surplus in 2016 was US\$47.7 billion, the highest surplus recorded since the start of the historical series in 1989 and at year-end the country had US\$372.2 billion in currency reserves. The average unemployment rate in Brazil in 2016 was 11.5%.

In 2017, Brazilian GDP increased 1% in comparison with 2016. Brazil's trade surplus in 2017 was US\$67 billion and at year-end the country had US\$381.9 billion in currency reserves. The average unemployment rate in Brazil in 2017 was 12.7%, the highest rate ever recorded by IBGE.

#### *Interest Rates*

As a political monetary instrument of the federal government, the SELIC rate influences the behavior of other interest rates in the country, including the rates related indebtedness denominated in local currency. In 2011, until the month of August, the Central Bank continued increasing the SELIC rate, reaching 12.50% in July. In the month of August, the Central Bank started decreasing the SELIC, closing 2011 at 11.00%. This downward trend was maintained in 2012, with the SELIC rate closing the year of 2012 at 7.25%. In 2013, the SELIC rate was kept at 7.25% until April, after which the Central Bank started to gradually raise it. The SELIC rate was 11.65% at December 31, 2014 and increased to 14.15% at December 31, 2015. The SELIC rate increased to 13.65% at December 31, 2016. A series of rate reductions in 2017, brought the SELIC rate down to 6.90% as of December 7, 2017, where it remained at year-end 2017.

We have not contracted any derivative financial instruments or any hedging instruments to mitigate interest rate fluctuations.

### *Inflation*

Inflation affects our financial performance by increasing our costs of services rendered and operating expenses. Part of our *real* denominated debt is directly indexed to take into account the effects of inflation. Additionally, we are exposed to the mismatch between the inflation adjustment indices of our loans and financing and those of our receivables. Water supply and sewage service tariffs do not necessarily follow the increases in inflation adjustment and interest rates affecting our debt. We cannot assure you that our tariffs will be increased, in future periods, to offset, in full or in part, the effects of inflation.

Inflation adjustments derive from collections from or payment to third parties, as contractually required by law or court decision, and are recognized on an accrual basis. Inflation adjustments included in these agreements and decisions are not considered embedded derivatives, since they are deemed as inflation adjustments for us. See Notes 3.20, 5.1 and 28 of the financial statements for the impacts of inflation adjustments on our financial performance and debt.

### *Currency Exchange Rates*

We had total foreign currency denominated indebtedness of R\$5,672.8 million as of December 31, 2017, of which R\$547.4 million relates to the current portion of our long-term foreign currency denominated obligations. In the event of significant devaluations of the *real* in relation to the U.S. dollar or other currencies, the cost of servicing our foreign currency denominated obligations would increase as measured in *reais*, particularly as our tariff and other revenue is based solely in *reais*. In addition, any significant devaluation of the *real* will increase our financial expenses as a result of foreign exchange losses that we must record. In 2015, the 47.01% depreciation of the *real* against the dollar and the 45.95% depreciation of the *real* against the yen led to a foreign exchange loss of R\$1,992.0 million. In 2016, the 16.54% appreciation of the *real* against the U.S. dollar and the 13.89% appreciation of the *real* against the yen led to a foreign exchange gain of R\$1,090.5 million. In 2017, the 1.50% depreciation of the *real* against the dollar and the 5.38% depreciation of the *real* against the yen led to a foreign exchange loss of R\$96.3 million. However, since most of our debt denominated in foreign currencies is long-term debt with a long amortization schedule, a devaluation of the *real* would principally impact cash flows regarding the current portion of our long-term debt.

We manage our indebtedness portfolio closely to decrease the cost of servicing our indebtedness as a whole and our exposure to exchange rate fluctuations. We do not have any exposure to derivatives tied to foreign currencies.

The following table shows the fluctuation of the *real* against the U.S. dollar, the period end exchange rates and the average exchange rates as of or for the years indicated:

	<b>Year ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
	<i>(in reais, except percentages)</i>		
Depreciation (appreciation) of the <i>real</i> versus U.S. dollar <sup>(1)</sup>	1.50%	(16.54)%	47.0%
Period end exchange rate – US\$1.00	3.3080	3.2591	3.9048
Average exchange rate – US\$1.00 <sup>(1)</sup>	3.1925	3.3523	3.3387

<sup>(1)</sup> Represents the comparison with period-end exchange rate. Source: Central Bank.

(2) Represents the average for period indicated.

The following table shows the fluctuation of the *real* against the yen, the period end exchange rates and the average exchange rates as of or for the years indicated:

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	<b>Year ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
	<i>(in reais, except percentages)</i>		
Depreciation (appreciation) of the <i>real</i> versus yen <sup>(1)</sup>	5.38%	(13.89)%	46.0%
Period end exchange rate – ¥1.00	0.0294	0.0279	0.0324
Average exchange rate – ¥1.0 <sup>(2)</sup>	0.0291	0.0289	0.0276

(1) Represents the comparison with period-end exchange rate. Source: Central Bank.

(2) Represents the average for period indicated.

During the years ended December 31, 2017, 2016 and 2015 we had no forward exchange transactions.

For further information on exchange rates, see “Item 3.D. Risk Factors—Risks Relating to Brazil—The devaluation of the real to foreign currencies may adversely affect us and the market price of our common shares or ADSs” and “Item 5.B. Liquidity and Capital Resources—Indebtedness Financing—Financial Covenants”.

### ***Effects of Extreme Weather Events***

The southeastern region of Brazil, particularly the southern region of the state of Minas Gerais, the PCJ River Basin (from which we extract the water used in the Cantareira System), and the northern area of the São Paulo metropolitan region, experienced below average rainfall since 2012. In the October 2013 – March 2014 rainy season, rain levels and water inflow into the reservoirs reached the lowest levels in more than 80 years of recorded rainfall in the region, a scenario that continued in the October 2014 – March 2015 rainy season. During the October 2015 – March 2016 rainy season, the level of rainfall in the region returned to the normal levels expected for the period. Improved rainfall in the rainy season that began in October 2015, the collaborative efforts between us and the population we serve and emergency construction works conducted by us throughout 2014 and 2015 to combat the water crisis, resulted in a partial restoration of the water levels of the Cantareira system.

As of December 31, 2017, the reservoirs in the São Paulo metropolitan region, where our largest market is located, contained 916.8 million m<sup>3</sup> of water storage for treatment, compared to 951.1 million m<sup>3</sup> available for treatment as of December 31, 2016. The measurements for these years do not include the technical reserve of 287.5 million m<sup>3</sup>. In December 2017, this system served 7.8 million residents, compared to 8.9 million in February 2014, the last month before the water crisis started.

In order to balance supply and demand despite restricted water availability, we adopted from February 2014 until April 2016 a series of measures. With the return of the rainfall to its historical average for the rainy season that began in October 2015 and ended in March 2016, the level of water in the reservoirs that provide water to the population of the São Paulo metropolitan region returned to normal and the measures taken during the water crisis to continue to services consumers were gradually discontinued. See “Item 4.B. Business Overview—The Recent Water Crisis”.

### **Critical Accounting Estimates and Judgments**

We make estimates and judgments concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and judgments that have a significant risk of causing material adjustment to the carrying amount of our assets and liabilities within the next financial year are mentioned below.



*Allowance for Doubtful Accounts*

We establish an allowance for doubtful accounts in an amount that our management considers sufficient to cover expected losses, based on an analysis of customer accounts receivable, in accordance with the accounting policy stated in Note 3.4 to our financial statements as of December 31, 2017 and 2016 and for the years ended December 31, 2017, 2016 and 2015. Bad debt expense, net of recoveries, is included in selling expenses, and was R\$82.7 million, R\$90.5 million and R\$2.4 million for the years ended December 31, 2017, 2016 and 2015, respectively. Wholesale sales losses, amounting to R\$203.5 million, R\$328.7 million and R\$273.0 million in 2017, 2016 and 2015, respectively, were also recorded as a reduction of revenue.

The methodology for determining the allowance for doubtful accounts requires significant estimates, considering a number of factors, including historical collection experience, current economic trends, estimates of forecast write offs, the aging of the accounts receivable portfolio and other factors. Actual results could differ from those estimates.

### ***Intangible Assets Arising from Concession and Program Contracts***

As of December 31, 2017, we had intangible assets of R\$33,466.1 million.

We recognize intangible assets arising from concession contracts under IFRIC 12. We estimate the fair value of construction and other work on the infrastructure to recognize the cost of the intangible asset, which is recognized when the infrastructure is built and provided that it will generate future economic benefits. The great majority of our contracts for service concession arrangements entered with each grantor is under service concession agreements in which we have the right to receive, at the end of the contract, a payment equivalent to the asset balance of the concession intangible asset, which in this case, is amortized over the useful life of the underlying physical assets; thus at the end of the contract, the remaining value of the intangible would be equal to the residual value of the related physical asset.

The fair value of construction and other work on the infrastructure is recognized as revenue, at its fair value, when the infrastructure is built, provided that this work is expected to generate future economic benefits. The accounting policy for the recognition of construction revenue is described in Note 3.3 “Operating Revenue” to our financial statements.

Intangible assets related to concession agreements and program contracts, when there is no right to receive the residual value of the assets at the end of the contract, are amortized on a straight-line basis over the period of the contract or the useful life of the underlying asset, whichever is shorter.

Investments made and not recovered through rendering of services, within the terms of our agreement, must be indemnified by the concession grantor; (1) with cash or cash equivalents or also, in general, (2) with a contract extension. These investments are amortized over the useful life of the asset.

Law No.11,445/2007 prescribes that, whenever possible, basic sanitation public utilities shall have their economic and financial sustainability ensured through the consideration received from service collection, preferably as tariffs and other public charges, which may be established for each service or both. Therefore, investments made and not recovered through these services, within the original term of the contract, are recorded as intangible assets and amortized over the useful life of the asset, taking into consideration a solid track record of concession renewal and, therefore, the continuity of services.

The recognition of fair value for the intangible assets arising on concession contracts is subject to assumptions and estimates, and the use of different assumptions could affect the carrying amounts of these assets. The amortization of intangible assets and estimated useful lives of the underlying assets also requires significant assumptions and estimates, which different assumptions and estimates, and changes in future circumstances, could affect amortization of intangible assets and remaining useful lives of the underlying assets and can have a significant impact on the results of operations.

### ***Provisions and Contingent Liabilities***

We are a party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among other types, disputes with customers and suppliers and tax, labor, civil, environmental and other proceedings. For a more detailed discussion of these legal proceedings, see Note 19 to our financial statements included in this annual report. We recognize provisions for legal proceedings in which our company has a present obligation as a result of past events (either due to an explicit agreement or duty, known as a legal obligation; or due to our past actions, known as a constructive obligation), it is probable that an outflow of resources embodying economic benefits will be necessary to settle the obligation and the amount of obligation can be estimated reliably. Therefore, we are required to make judgments regarding future events for which we often seek the advice of legal counsel. As a

result of the significant judgment required in assessing and estimating these provisions, actual losses realized in future periods could differ significantly from our estimates and could exceed the amounts which we have provisioned.

As of December 31, 2017, we were party to judicial and administrative proceedings, relating to civil, environmental and tax matters, amounting to R\$1,078.2 million (after deducting court escrow deposits in the amount of R\$344.4 million) with respect to which we recognized provisions based on the criteria described above, as shown in Note 3.15 to our financial statements included in this annual report. As of the same date, the proceedings with respect to which we have contingent liabilities (i.e., no provisions have been recognized) totaled R\$54,627.0 million, of which we believe R\$46,396.0 million of those have a remote probability of an outflow of resources embodying economic benefits exists.

### ***Pension Benefits***

The present value of the pension obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include a discount rate and a mortality table. Any changes in these assumptions will impact the carrying amount of pension obligations.

We determine the appropriate discount rates at the end of each year, which is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. The discount rate was decreased from 5.71% in 2016 to 5.30% in 2017 under Plan G0 and from 5.74% in 2016 to 5.35% in 2017 under Plan G1 in order to follow the decrease in the rates applicable to the Brazilian Government NTN – B, long term notes, which term is similar to the duration of the pension benefits, as described in Notes 3.19 (a) and 20 (b) to our financial statements included in this annual report.

Other key assumptions for pension obligations are based in part on current market conditions. Additional information on the pension plans under Plan G0 and G1 is disclosed in Note 20 to our financial statements included in this annual report.

### ***Deferred income tax and social contribution***

We recognize and settle taxes on income based on the results of operations verified according to the Brazilian Corporate Law, taking into consideration the provisions of the tax laws. We recognize deferred tax assets and liabilities based on the differences between the accounting balances and the tax bases of assets and liabilities.

We regularly review the recoverability of deferred tax assets and do not recognize deferred tax assets if it is probable that these assets will not be realized, based on historic taxable income, the projection of future taxable income and the estimated period to reverse temporary differences. This process requires the use of estimates and assumptions. The use of different estimates and assumptions could result in the non-recognition of a significant amount of deferred tax assets.

As of December 31, 2017 and 2016, we have recognized R\$36.8 million and R\$186.3 million as deferred income tax liabilities and deferred income tax assets, respectively, in each case, net of the deferred tax assets and liabilities, as disclosed in Note 18 to our financial statements included in this annual report.

### **Certain Transactions with Controlling Shareholder**

#### ***Reimbursement Due from the State***

Reimbursement due from the State for pensions paid represent supplementary pensions (Plan G0) that we pay, on behalf of the State, to former employees of State owned companies which merged to form our Company. These amounts must be reimbursed to us by the State, as primary obligor.

In November 2008, we entered into the third amendment to the agreement with the State relating to payments of pension benefits made by us on its behalf. The State acknowledged that it owed us an outstanding balance of R\$915.3 million as of September 30, 2008, relating to payments of pension benefits made by us on its behalf. We provisionally accepted, but it is not recognized in our books, the reservoirs in the Alto Tietê System as partial payment in the amount of R\$696.3 million, subject to the transfer of the property rights of these reservoirs to us. Since

November 2008, the State has been paying the remaining balance in the amount of R\$219.0 million in 114 successive monthly installments. See Note 10 to our financial statements included in this annual report and “Item 7. Major Shareholders and Related Party Transactions”.

On March 18, 2015, we, the State and DAEE, with the intervention of the Department of Sanitation and Water Resources, executed an agreement in the amount of R\$1,012.3 million, consisting of R\$696.3 million in principal amount and R\$316.0 million in monetary adjustment of the principal through February 2015. For detailed information on this agreement, see “Item 7.B. Related Party Transactions—Agreements with the State” and Note 10(a)(vii) to our financial statements included in this annual report.

As of December 31, 2017 and 2016, the amounts not recognized related to pension benefits paid by us on behalf of the State totaled R\$1,021.7 million and R\$937.0 million respectively. As a result, we also recognized the obligation related to pension benefits, maintained with the beneficiaries and pensioners of Plan G0. As of December 31, 2017 and 2016, the pension benefit obligations of Plan G0 totaled R\$2,543.9 million and R\$2,512.1 million, respectively. For detailed information on the pension benefit obligations refer to Note 20 to our financial statements included in this annual report.

***Accounts Receivable from the State for Water and Sewage Services Rendered***

Certain of these accounts receivable have been overdue for a long period. We have entered into agreements with the State with respect to these accounts receivable. For further information on these agreements, see Note 10 to our financial statements included in this annual report and “Item 7. Major Shareholders and Related Party Transactions”.

***Use of Guarapiranga and Billings reservoirs***

We draw water for use in the São Paulo metropolitan area from the Guarapiranga and Billings reservoirs. EMAE, a company that is also controlled by the State of São Paulo, has a concession to produce hydroelectric energy using water from the same reservoirs. EMAE commenced various lawsuits against us in the past seeking compensation for the water we draw from these reservoirs. Those lawsuits have now been settled, by way of an agreement between EMAE and our company.

The settlement agreement requires us to make certain installment payments to EMAE in settlement of the claim for compensation for our capture and use of the water, as well as apportionment of the maintenance, operation and monitoring costs for the reservoirs. See “Item 7. Major Shareholders and Related Party Transactions” and See Note 10(c) to our financial statements included in this annual report.

## Results of Operations

The following table sets forth, for the years indicated, certain items from our income statements of operations, each expressed as a percentage of net operating revenue:

	Year ended December 31,					
	2017		2016		2015	
	<i>(in millions of reais, except percentages)</i>					
Net operating revenue	14,608.2	100.0%	14,098.2	100.0%	11,711.6	100.0%
Cost of services	(8,778.9)	(60.1)%	(9,013.1)	(63.9)%	(8,260.8)	(70.5)%
Gross profit	5,829.3	39.9%	5,085.1	36.1%	3,450.8	29.5%
Selling expenses	(768.7)	(5.3)%	(730.0)	(5.2)%	(598.1)	(5.1)%
Administrative income (expenses)	(1,099.0)	(7.5)%	(934.9)	(6.6)%	45.0	0.4%
Other operating income (expenses), net and equity in results of investments in affiliates	0.1	0.0%	9.5	0.1%	146.4	1.3%
Profit from operations before finance income (expenses) and income tax and social contribution	3,961.7	27.1%	3,429.7	24.3%	3,044.1	26.0%
Financial income (expenses), net	(458.1)	(3.1)%	699.4	5.0%	(2,456.5)	(21.0)%
Profit before income tax and social contribution	3,503.6	24.0%	4,129.1	29.3%	587.6	5.0%
Income tax and social contribution	(984.3)	(6.7)%	(1,182.0)	(8.4)%	(51.3)	(0.4)%
Profit for the year	2,519.3	17.2%	2,947.1	20.9%	536.3	4.6%

### *Year Ended December 31, 2017 Compared to Year Ended December 31, 2016*

#### *Net operating revenue*

Net operating revenue increased by R\$510.0 million, or 3.6%, to R\$14,608.2 million in 2017 from R\$14,098.2 million in 2016.

Net operating revenue, disregarding the effect of construction revenue, as of December 31, 2017, increased R\$1,092.0 million, or 10.5%, from R\$10,365.3 million in 2016 to R\$11,457.3 million in 2017. In 2017, the construction revenue was R\$3,150.9 million compared to R\$3,732.9 million in 2016. The variations in net operating revenue were principally due to:

- an increase of 8.4% in tariffs since May 2016 (ordinary tariff adjustment);
- an increase of 7.9% in tariffs since November 2017 (extraordinary tariff revision);
- an increase of 4.3% in our total billed volume (4.3% in water and 4.2% in sewage);

- the cancelation of the Water Consumption Reduction Incentive Program, concluded in April 2016, resulting in no bonus granted in 2017, compared to a bonus granted in the amount of R\$187.4 million in 2016 which resulted in a decrease in revenue in 2016; and
- a lower estimated loss of wholesale revenue in 2017, in the amount of R\$125.1 million, due to the payment received in the period, mainly from the municipality of Guarulhos.

These increases were partially offset by the suspension of the Contingency Tariff in April 2016, in the amount of R\$224.7 million in 2016.

***Cost of services***

Our cost of services decreased by R\$234.2 million, or 2.6%, to R\$8,778.9 million in 2017 from R\$9,013.1 million in 2016.

The decrease in cost of services was principally due to the following factors:



- a decrease of R\$570.9 million in construction costs due to lower investments in the municipalities we serve; and
- a decrease of R\$138.1 million in the cost of electricity, mainly due to an average decrease of 12.7% in free market tariffs, with a 16.9% increase in consumption; an average decrease of 27.5% in the Tariff for the Use of Distribution System (TUSD), with a 19.6% decrease in consumption; and an average decrease of 5.3% in regulated market tariffs, with a 5.7% decrease in consumption.

The decrease in cost of services was partially offset by:

- an increase of R\$303.2 million in salaries and payroll charges and pension plan obligations due to the reduction in non-recurring expenses in 2016 in connection with the migration of participants from the Defined Benefit Plan (G1) to the Defined Contribution Plan (Sabesprev Mais), which generated an early reduction of R\$223.5 million in the actuarial deficit. The increase in salaries and payroll charges is also due to an increase of R\$72.5 million, principally driven by the 1% increase related to the Career and Salary Plan since December 2016 and the 3.71% pay rise in May 2017;
- an increase of R\$100.8 million in depreciation and amortization, mainly due to the increase in operating intangible assets in 2017, principally due to new assets entering into operation; and
- an increase of R\$34.5 million in the provision for the Municipal Fund for Environmental Sanitation and Infrastructure, as a result of the increase in revenues generated from the municipality of São Paulo.

### ***Gross Profit***

As a result of the factors discussed above, gross profit for the year ended December 31, 2017 increased by R\$744.2 million, or 14.6 %, to R\$5,829.3 million in 2017 from R\$5,085.1 million in 2016.

### ***Selling Expenses***

Selling expenses increased by R\$38.7 million, or 5.3%, to R\$768.7 in 2017 from R\$730.0 million in 2016. The increase in selling expenses was primarily due to:

- an increase of R\$59.0 million in salaries and payroll charges and pension plan obligations due to the reduction in non-recurring expenses in 2016 in connection with to the migration of participants from the Defined Benefit Plan (G1) to the Defined Contribution Plan (Sabesprev Mais), which generated an early reduction of R\$30.4 million in the actuarial deficit in 2016. The increase in salaries and payroll charges is also due to an increase of R\$13.2 million, principally driven by the 1% increase related to the Career and Salary Plan since December 2016 and the 3.71% pay rise in May 2017;

The increase in selling expenses was partially offset by the decrease of R\$20.3 million related to outsourced services.

### ***Administrative Income (Expenses)***

Administrative expenses increased by R\$164.1 million, or 17.6%, to an expense of R\$1,099.0 million in 2017 from income of R\$934.9 million in 2016.

The increase in administrative expenses was principally due to:

- an increase of R\$70.9 million in salaries and payroll charges and pension plan obligations resulting from the reduction in non-recurring expenses in 2016 in connection with the migration of participants from the Defined Benefit Plan (G1) to the Defined Contribution Plan (Sabesprev Mais), which generated an early reduction of R\$80.3 million in the actuarial deficit in 2016. The increase in salaries and payroll charges is also driven by the 1% increase related to the Career and Salary Plan since December 2016 and the 3.71% pay rise in May 2017;
- an increase of R\$48.5 million in depreciation and amortization, mainly due to the implementation of the Integrated Business Management System (Enterprise Resource Planning – SAP ERP) in 2017; and
- an increase of R\$28.8 million related to outsourced services.

***Other Operating Income (Expenses), Net and Equity in Results of Investments in Affiliates***

Other operating income, net was R\$0.1 million in 2017 compared with R\$9.5 million operating income, net in 2016.

Other operating income, net consists of gains and losses from sales of property, plant and equipment, sale of contracts awarded in public bids, right to sell electricity, indemnities and reimbursement of expenses, fines and collaterals, property leases, reuse of water, PURA projects and services.

Other operating income decreased by R\$9.4 million, mainly due to the estimate for losses in 2017 on discontinued concessions, in the amount of R\$24.1 million, partially offset by higher revenues from the sale of surplus energy, in the amount of R\$8.5 million.

Our other operating expenses consist mainly of write-offs of concessions assets due to obsolescence, discontinued construction works, unproductive wells, projects considered economically unfeasible, losses on property, plant and equipment and exceeding cost of electricity sold.

***Financial Income (Expenses), Net***

Financial income (expenses), net consists primarily of interest on our indebtedness and foreign exchange losses (or gains) in respect to our indebtedness, offset partially by interest income on cash and cash equivalents and inflation based indexation accruals, mainly relating to agreements entered into with some customers to settle overdue accounts receivable.

Financial income (expenses), net increased by R\$1,157.5 million to financial expense, net of R\$458.1 million in 2017 from financial income, net of R\$699.4 million in 2016.

The variation was due to a positive variation of R\$1,186.6 million in the cost of currency variations on borrowings and financing, due to the strengthening of the *real* against the U.S. dollar and the Japanese Yen in 2017 (1.5% and 5.3%, respectively), compared to a devaluation of the *real* in 2016 (16.5% and 13.9%, respectively).

***Profit before income tax and social contribution***

As a result of the factors discussed above, profit before income tax and social contribution decreased by R\$625.5 million, to R\$3,503.6 million in 2017 from R\$4,129.1 million in 2016. As a percentage of net operating revenue, our profit before income tax and social contribution increased to 24.0% in 2017 compared to 29.3% in 2016.

***Income Tax and Social Contribution***

Income tax and social contribution expense decreased by R\$197.7 million, or 16.7%, to R\$984.3 million in 2017 from R\$1,182.0 million in 2016. This decrease was mainly due to our lower taxable result in 2017, which was impacted by the exchange rate variation.

***Profit for the year***

As a result of the factors discussed above, our profit for the year decreased to R\$2,519.3 million in 2017 from R\$2,947.1 million in 2016. As a percentage of net operating revenue, our profit for the year decreased to 17.2% in 2017 from 20.9% in 2016.

***Year Ended December 31, 2016 Compared to Year Ended December 31, 2015***

*Net operating revenue*

Net operating revenue increased by R\$2,386.6 million, or 20.4%, to R\$14,098.2 million in 2016 from R\$11,711.6 million in 2015. These variations were principally due to:

- an increase of 15.2% in tariffs since June 2015 (7.8% ordinary tariff adjustment and 6.9% extraordinary tariff revision);
- an increase of 8.4% in tariffs since May 2016;

- an increase of 4.4% in our total billed volume (4.0% in water and 4.8% in sewage); and
- a reduction in the bonus granted within the Water Consumption Reduction Incentive Program, concluded in April 2016, which amounted to R\$187.4 million in 2016 compared to the R\$926.1 million granted in 2015.

These increases were partially offset by the suspension of the Contingency Tariff in April 2016, in the amount of R\$224.7 million in 2016 compared to the R\$499.7 million in 2015.

Construction revenue increased by R\$396.2 million, or 11.9%, to R\$3,732.9 million in 2016 from R\$3,336.7 million in 2015. See Note 3.3(b) to our financial statements included in this annual report for a description of the accounting policies applicable to our construction services business.

### *Cost of services*

Our cost of services increased by R\$752.3 million, or 9.1%, to R\$9,013.1 million in 2016 from R\$8,260.8 million in 2015. As a percentage of net operating revenue, cost of services decreased to 63.9% in 2016 from 70.5% in 2015.

The increase in cost of services was principally due to the following factors:

- an increase of R\$387.6 million in construction costs due to higher investments in 2016;
- an increase of R\$117.3 million in the cost of the electricity, mainly due to an average increase of 15.4% in the free market tariffs, with an 2.3% increase in consumption; an average increase of 21.5% in the Tariff for the Use of Distribution System (TUSD), with a 5.0% increase in consumption; and an average increase of 1.5% in the regulated market tariffs, with consumption remaining stable;
- an increase in the provision for the Municipal Fund for Environmental Sanitation and Infrastructure, in the amount of R\$101.1 million, as a result of the increase in revenues generated from the municipality of São Paulo; and
- an increase of R\$72.0 million in depreciation and amortization, mainly due to the increase in operating intangible assets in 2016, arising principally from entry into operation of new assets.

### *Gross Profit*

As a result of the factors discussed above, gross profit for the year ended December 31, 2016 increased by R\$1,634.3 million, or 47.4%, to R\$5,085.1 million in 2016 from R\$3,450.8 million in 2015. As a percentage of net operating revenue, gross profit margin increased to 36.1% in 2016 from 29.5% in 2015.

### *Selling Expenses*

Selling expenses increased by R\$131.9 million, or 22.1%, to R\$730.0 in 2016 from R\$598.1 million in 2015. As a percentage of net operating revenue, selling expenses increased slightly to 5.2% in 2016 from 5.1% in 2015. The increase in selling expenses was primarily due to:

- an increase of R\$88.0 million, mainly resulting from (i) increase in default, causing a R\$165.4 million impact, and (ii) lower recovery of funds, in the amount of R\$34.5 million. This increase was partially offset by increased receipts of court-ordered debt payments, especially from the municipality of Guarulhos, amounting to R\$110.9 million;

- an increase of R\$30.9 million in services expenses, due to the increase in the scope of water meter readings and increased use of credit recovery services in 2016.

***Administrative Income (Expenses)***

Administrative expenses increased by R\$979.9 million, to an expense of R\$934.9 million in 2016 from income of R\$45.0 million in 2015. As a percentage of net operating revenue, administrative expenses amounted to 6.6% in 2016.

The increase in administrative expenses was principally due to:

- a credit in the amount of R\$696.3 million received in 2015 as a result of an agreement with the government of the state of São Paulo to receive an undisputed amount owed to us related to the payment of the benefits to former employees (see Note 10 (a) (vii) to our financial statements included in this annual report and;
- an increase of R\$278.4 million in general expenses, mainly due to increased provisions for court proceedings in 2016 and provision reversals in 2015, resulting from judicial decisions.

***Other Operating Income (Expenses), Net and Equity in Results of Investments in Affiliates***

Other operating income, net was R\$9.5 million in 2016 compared with R\$146.4 million operating expenses, net in 2015.

Other operating income, net consists of gains and losses from sales of property, plant and equipment, sale of contracts awarded in public bids, right to sell electricity, indemnities and reimbursement of expenses, fines and collaterals, property leases, reuse of water, PURA projects and services.

Our other operating income decreased by R\$128.3 million, mainly due to: (i) decrease in gain in sale of properties (R\$47.4 million); (ii) decrease in sales of the exceeding cost of electricity (R\$42.8 million); (iii) lower amounts received from the Hydrographic Basin Depollution Program (R\$22.6 million); and (iv) lower amounts received related to contractual fines on suppliers (R\$16.8 million).

Our other operating expenses consist mainly of write-offs of concessions assets due to obsolescence, discontinued construction works, unproductive wells, projects considered economically unfeasible, losses on property, plant and equipment and exceeding cost of electricity sold.

***Financial Income (Expenses), Net***

Financial income (expenses), net consists primarily of interest on our indebtedness and foreign exchange losses (or gains) in respect to our indebtedness, offset partially by interest income on cash and cash equivalents and inflation based indexation accruals, mainly relating to agreements entered into with some customers to settle overdue accounts receivable.

Financial income (expenses), net increased by R\$3,155.9 million to financial income, net of R\$699.4 million in 2016 from financial expense, net of R\$2,456.5 million in 2015. As a percentage of net operating revenues, financial income amounted to 5.0% in 2016 compared with financial expenses amounting to 21.0% in 2015. The variation was due to:

- a positive variation of R\$3,082.9 million in the cost of currency variations on borrowings and financing, due to the strengthening of the *real* against the U.S. dollar and the Japanese Yen in 2016 (16.5% and 13.9%, respectively), when compared to the devaluation of the *real* in 2015 (47.0% and 45.9%, respectively); and
- an increase in the cost of other monetary variations by R\$65.2 million, principally due to higher provisioning for court proceedings in 2016.

***Profit before income tax and social contribution***

As a result of the factors discussed above, profit before income tax and social contribution increased by R\$3,541.5 million, to R\$4,129.1 million in 2016 from R\$587.6 million in 2015. As a percentage of net operating revenue, our profit before income tax and social contribution increased to 29.3% in 2016 compared to 5.0% in 2015.

***Income Tax and Social Contribution***

Income tax and social contribution expense increased by R\$1,130.7 million to R\$1,182.0 million in 2016 from R\$51.3 million in 2015. This increase was mainly due to the upturn in our operating revenues and our financial income, net, which was impacted by the exchange rate variation. These increases were partially offset by the increases in our operating costs and expenses. Additionally, the effective tax rate increased from 9% in 2015 to 29% in 2016, mainly due to the agreement entered into with the State of São Paulo on March 18, 2015, which was considered a non-taxable income (see reconciliation of the effective tax rate in Note 18(d) to our financial statements included in this annual report.

***Profit for the year***



As a result of the factors discussed above, our profit for the year increased to R\$2,947.1 million in 2016 from R\$536.3 million in 2015. As a percentage of net operating revenue, our profit for the year increased to 20.9% in 2016 from 4.6% in 2015.

We assess the performance of our enterprise by analyzing the results of the sanitation services provided, our single reportable segment that includes all our operations results except for revenue and costs associated with the construction of concession services infrastructure, recognized in accordance with IFRIC 12 and as discussed in “Item 4.B. Business Overview—Description of Our Activities”. Consequently, management discussion and analysis of the performance of the sanitation services segment is substantially the same as our results discussed above.

## **B. Liquidity and Capital Resources**

### **Capital Sources**

In order to satisfy our liquidity and capital requirements, we have primarily relied on cash provided by operating activities, long-term borrowings from Brazilian federal governmental financial institutions, and long-term financing from multilateral organizations and from domestic and international development banks, and also from capital markets. As of December 31, 2017, we had R\$2,283.0 million of cash and cash equivalents. The outstanding current portion of our long-term indebtedness was R\$1,746.8 million as of December 31, 2017, of which R\$547.4 million was denominated in foreign currency. Long term indebtedness was R\$10,354.2 million as of December 31, 2017, of which R\$5,125.4 million consisted of foreign currency-denominated obligations.

Our management expects that the cash and cash equivalents available on December 31, 2017, the operating cash generation estimated for 2018 and the lines of credit available for investments are sufficient to meet our short-term liabilities, in light of our current financial position and our expected cash generated by operating activities. In our opinion, the working capital is sufficient for the company's present requirements.

### **Cash Flows**

#### ***Net Cash Generated from Operating Activities***

Cash generated from operating activities is the single largest source of our liquidity and capital resources, and we expect that it will continue to be so in the future. Our net cash generated from operating activities was 3,301.9 million, R\$3,003.6 million and R\$2,641.4 million in 2017, 2016 and 2015, respectively. The main driver of our cash flow from operating activities relates to our cash collections from customers, which is due to the nature of our business and to the fact that we are expanding our infrastructure. The increase in net cash generated in 2017 is due principally to the end of the water crisis, which led to an increase of 4.3% in our total billed volume (4.3% in water and 4.2% in sewage). This increase was partially offset by the income tax and social contribution paid in 2017.

#### ***Net Cash Used in Investing Activities***

Net cash used in investing activities was R\$1,971.4 million, R\$2,130.7 million and R\$2,459.5 million in 2017, 2016 and 2015, respectively. The main driver of our net cash outflow for investing activities relates to purchases of intangible assets, as required under our concession and program contracts, which is due to the fact that we are expanding our infrastructure and service coverage. Although we invested approximately R\$867.3 million (including capitalized interest) in the São Lourenço PPP, a construction project planned and initiated before the water crisis, this project did not impact our cash flow in 2017.

*Net Cash Generated By (Used in) Financing Activities*

Our net cash used in financing activities was R\$933.6 million, R\$625.9 million, and 265.7 million in 2017, 2016 and 2015, respectively. The main driver of our cash flows from financing activities relates to the proceeds and repayments of loans used to finance purchases of intangible assets related to our concession and program contracts, in order to support the expansion of our services and our payment of interest on shareholders' equity.

**Indebtedness Financing**

Our total financial indebtedness increased by 1.1%, from R\$11,964.1 million as of December 31, 2016 to R\$12,101.0 million as of December 31, 2017. In addition, during the same period, our total indebtedness denominated in foreign currency increased by 0.2%, from R\$5,660.4 million as of December 31, 2016 to R\$5,672.8 million as of December 31, 2017.

As of December 31, 2017, we had R\$10,354.2 million in long-term indebtedness outstanding (excluding the current portion of long-term indebtedness), of which R\$5,125.4 million consisted of foreign currency-denominated long-term debt. We had an outstanding current portion of long-term indebtedness of R\$1,746.8 million as of December 31, 2017. As of December 31, 2017, R\$547.4 million of this current portion of long-term indebtedness was denominated in foreign currency. As of December 31, 2017, our S&P domestic rating was brAA- and our S&P global rating was BB. Our Moody's national rating was Aa2.br and our Moody's global rating was Ba2 as of December 31, 2017, while our Fitch national rating was AA(bra) and our Fitch global rating was BB, as of the same date.

Various contractual agreements we have entered into, including certain financing agreements with *Caixa Econômica Federal* and BNDES, provide for liens over a portion of our cash flows from the payment of water and sewage provision tariffs. In addition, we provide as guarantees a portion of our cash flow generation to transactions related to PPPs.

Pursuant to these agreements, cash received from operations is required to pass through designated accounts. In the event of a default under the relevant agreement, such cash and future cash flows that are required to be deposited in such accounts become restricted and are subject to security interests in favor of the relevant creditor. As of December 31, 2017, a substantial portion of our monthly cash flows from operations was subject to these liens. As of that date, the total amount of our secured debt, including indebtedness benefiting from these liens, was R\$3,747.0 million (R\$3,720.4 million of principal and R\$26.6 million related to interest and charges). See “—Indebtedness Financing—Financial Covenants—Local currency denominated indebtedness” and Note 16 to our financial statements included in this annual report.

The following table sets forth information on our indebtedness outstanding as of December 31, 2017:

	<b>December 31, 2017</b>			<b>Final Maturity</b>	<b>Interest Rates*</b>
	<b>Current</b>	<b>Noncurrent</b>	<b>Total</b>		
<b>Denominated in local currency:</b>					
10 <sup>th</sup> issue debentures	41,702	80,953	122,655	2020	TJLP + 1.92% (1 <sup>st</sup> & 3 <sup>rd</sup> series) & IPCA + 9.53% (2 <sup>nd</sup> series)
12 <sup>th</sup> issue debentures	45,450	294,702	340,152	2025	TR + 9.5%
14 <sup>th</sup> issue debentures	40,503	141,351	181,854	2022	TJLP + 1.92% (1 <sup>st</sup> & 3 <sup>rd</sup> series) & IPCA + 9.19% (2 <sup>nd</sup> series)
15 <sup>th</sup> issue debentures	346,414	345,788	692,202	2019	CDI + 0.99% (1 <sup>st</sup> series) & IPCA + 6.2% (2 <sup>nd</sup> series)
17 <sup>th</sup> issue debentures	144,391	781,922	926,313	2023	CDI + 0.75% (1 <sup>st</sup> series) & IPCA + 4.5% (2 <sup>nd</sup> series) & IPCA + 4.75% (3 <sup>rd</sup> series)
18 <sup>th</sup> issue debentures	33,020	194,872	227,892	2024	TJLP + 1.92% (1 <sup>st</sup> and 3 <sup>rd</sup> series) & IPCA + 8.25% (2 <sup>nd</sup> series)
20 <sup>th</sup> issue debentures	250,000	246,890	496,890	2019	CDI + 3.80%
21 <sup>st</sup> issue debentures	-	499,628	499,628	2022	CDI + 0.60% & CDI + 0.90%
<i>Caixa Econômica Federal</i>	78,487	1,154,599	1,233,086	2018/2038	TR + 5% to 9.5%
National Bank for Economic and Social Development (BNDES) Coastal region	16,782	16,782	33,564	2019	2.5% + TJLP
National Bank for Economic and Social Development (BNDES) PAC	11,143	50,028	61,171	2023	2.15% + TJLP
National Bank for Economic and Social Development (BNDES) PAC II 9751	4,334	22,991	27,325	2027	1.72% + TJLP
National Bank for Economic and Social Development (BNDES) PAC II 9752	2,367	19,526	21,893	2027	1.72% + TJLP
National Bank for Economic and Social Development (BNDES) Onda Limpa	23,469	146,461	169,930	2025	1.92% + TJLP
National Bank for Economic and Social Development (BNDES) Tietê III	30,378	280,825	311,203	2028	1.66% + TJLP
National Bank for Economic and Social Development (BNDES) 2015	10,050	397,922	407,972	2035	2.5% + TJLP
Financial leasing	17,573	544,044	561,617	2035	7.73% to 10.12% + IPC
Other	1,466	9,477	10,943	2018/2025	

				TJLP + 1.66% (FINEP) & TR + 12.00% (Presidente Prudente)
Interest and others charges	101,855	-	101,855	
<b>Total denominated in local currency</b>	<b>1,199,384</b>	<b>5,228,761</b>	<b>6,428,145</b>	
<b>Denominated in foreign currency:</b>				
Inter-American Development Bank (IADB) US\$527,096,000 (2016 - US\$555,671,000)	115,757	1,613,358	1,729,1152025 to 2035	2.33% to 2.74%
International Bank for Reconstruction and Development (IBRD) US\$91,286,000 (2016 – US\$79,946,000)	-	301,665	301,6652034	1.71%
Deutsche Bank – US\$150,000,000 (2016 - US\$150,000,000)	248,100	242,343	490,4432019	Libor + 4.50%
Eurobonds - US\$350,000,000 (2016 – US\$ 350,000,000)	-	1,155,331	1,155,3312020	6.25%
JICA 15 - ¥ 13,829,160,000 (2016 - ¥ 14,981,590,000)	33,881	372,696	406,5772029	1.8% & 2.5%
JICA 18 - ¥ 12,433,920,000 (2016- ¥ 13,470,080,000)	30,463	334,849	365,3122029	1.8% & 2.5%
JICA 17 - ¥ 1,534,959,000 (2016- ¥ 1,596,251,000)	2,507	41,835	44,3422035	1.2% & 0.01%
JICA 19 - ¥ 29,777,232,000 (2016 - ¥ 27,569,009,000)	-	873,383	873,3832037	1.7% & 0.01%
IADB 1983AB – US\$ 82,404,000 (2016 – US\$ 106,346,000)	79,201	189,990	269,1912023	Libor + 1.88% to 2.38%
Interest and others charges	37,462	-	37,462	
<b>Total denominated in foreign currency</b>	<b>547,371</b>	<b>5,125,450</b>	<b>5,672,821</b>	
<b>Total loans and financing</b>	<b>1,746,755</b>	<b>10,354,211</b>	<b>12,100,966</b>	

\* TR was 0.00% per month as of December 31, 2017; CDI stands for Interbank Deposit Rate (*Certificado de Depósitos Interbancários*), which was 6.89% per annum as of December 31, 2017; IGP M was -0.52% per annum as of December 31, 2017; TJLP stands for Long term Interest Rate (*Taxa de Juros a Longo Prazo*), published quarterly by the Central Bank, which was 6.90% per annum as of December 31, 2017; and USD LIBOR was 1.69 as of December 31, 2017.

The following table shows the maturity profile of our debt, as of December 31, 2017, for the period indicated:

	2018	2019	2020	2021	2022	After 2023	Total
	<i>(in millions of reais)</i>						
Loans and financing	1,746.8	1,779.3	2,242.5	858.4	843.5	4,630.5	12,101.0

Referring to all of our foreign currency-denominated indebtedness, the amount of R\$3,945.8 million, net of transaction costs, as of December 31, 2017 was denominated in U.S. dollars and R\$1,689.6 million was denominated in Japanese Yen. This indebtedness consisted principally of:

- R\$1,729.1 million (US\$527.1 million) in U.S. dollar denominated loans contracted with the Inter-American Development Bank, or the IADB, composed of the following:
  - (i) two loans to finance the first phase of the Tietê Project in 1992, one of which was terminated in December 2016 and the other terminated in December 2017;
  - (ii) one loan to finance the second phase of the Tietê Project in 2000, under which payments of principal are made in semiannual installments with final maturity in July 2025. The principal amount accrues interest at USD LIBOR plus a variable spread paid semiannually; and
  - (iii) one loan to finance the third phase of the Tietê Project in 2010, under which payments of principal are made in semiannual installments with final maturity in September 2035. The principal amount accrues interest at USD LIBOR plus a variable spread paid semiannually;
- R\$301.7 million (US\$91.3 million) in U.S. dollar denominated loans contracted with the IBRD which was entered into on October 28, 2009, amounting to US\$100.0 million, for the financing of the Water Source Program (*Programa Mananciais*). The loan matures in March 2034. Repayments of principal will be made in semiannual installments starting in September 2019 after a grace period of ten years. The principal amount accrues interest at USD LIBOR plus a variable spread, paid semiannually;
- R\$269.2 million (US\$82.4 million) in U.S. dollar denominated loans from the AB Loan financing contracted with the IADB in May 2008. Under this loan, payments of principal are made in annual installments with final maturity in May 2023. The principal amount accrues interest at USD LIBOR plus a rate varying from 1.88% to 2.38%, paid semiannually. The proceeds were used to repay an outstanding series of debt securities in connection with the implementation of our investment plan;
- R\$1,155.3 million (US\$350.0 million) in U.S. dollar denominated Eurobonds issued in December 2010 with an interest rate of 6.25%. The bonds pay interest semi annually and mature in 2020. The proceeds from the offering were used to repay financial commitments throughout 2007 and 2011. In November 2016, the US\$140.0 million 7.5% notes due to 2016 were completely amortized;



- R\$1,689.6 million (¥57,575.3 million) in Japanese yen denominated loans contracted with the JICA, composed of the following: (i) ¥21,320.0 million denominated loans contracted in August 2004 for the financing of the environmental recovery program for the Baixada Santista metropolitan region, called the Clean Wave Program (*Programa Onda Limpa*). Under these loans, the payments of principal are made in semi-annual installments with final maturity in August 2029. The principal amount accrues interest at a rate that varies from 1.8% to 2.5% per year, paid semiannually; (ii) ¥6,208 million in denominated loans contracted in October 2010 for the financing of the environmental improvement program in the basin of the Billings dam. The loan matures in October 2035, with repayments of principal made in semiannual installments. The principal amount accrues interest at a rate that varies from 0.01% to 1.2% per year, paid semiannually; (iii) ¥19,169.0 million denominated loans contracted in February 2011 to complement the financing for the first stage of the Clean Wave Program (*Programa Onda Limpa*), with commercial conditions similar to the loan entered into in August 2004. These funds were used for the provision of works and services in the Baixada Santista metropolitan region. The credit agreement expires in 18 years with final maturity in August 2029. The principal amount accrues interest at a rate that varies from 1.8% to 2.5% per year, paid semiannually; and (iv) ¥33,584 million denominated loan in February 2012 for the financing of the Corporate Program for Water Loss Reduction (*Programa Corporativo para Redução de Perdas*). The loan matures in February 2037. Repayments of principal will be made in semiannual installments starting in February 2019 after a grace period of seven years. The principal amount accrues interest at a rate that varies from 0.01% to 1.7% per year, paid semiannually; and
- R\$490.4 (US\$150.0 million), in U.S. dollar denominated loan contracted in October 2016, with Deutsche Bank AG, London Branch and Banco Bradesco S.A., New York Branch, with an interest rate of 3-month LIBOR plus 4.50% interest per year and with final maturity in October 2019. Interest under this loan is paid quarterly and the principal amount is amortized in semiannual installments after an 18 month grace period. The proceeds from the loan were used to repay the US\$140.0 million Eurobond issued in November 2006, which matured in November 2016, and other financial commitments throughout 2016. The loan agreement includes financial covenants requiring our debt service coverage ratio to be higher than 2.35:1.00; and our ratio of total adjusted debt to EBITDA, determined on a consolidated basis, to be lower or equal than 3.65:1.00.

Our borrowings from multilateral institutions and with Government Agency, such as the IADB, IBRD and JICA are guaranteed by the federal government, and have a counter-guarantee from the state of São Paulo. For further information on the terms of these loan agreements, see “Item 7.B. Related Party Transactions—Government Guarantees of Financing”.

Our outstanding domestic debt was R\$6,428.2 million as of December 31, 2017 and consisted primarily of *real* denominated loans from federal and state-owned banks, in particular, *Caixa Econômica Federal* and BNDES, as well as debentures issued in November 2009, June 2010, February 2011, February 2012, November 2012, January 2013, October 2013, June 2014, December 2015, June 2017 and February 2018 and financial leasing.

The following summarizes our principal borrowings from federal and State-owned banks:

- from 2003 to 2017, we entered into several financing agreements with *Caixa Econômica Federal*, pursuant to which repayments of principal are paid in up to in 60, 180 or 240 months in monthly installments commencing 30 days following the applicable grace period, which varies from 10 to 48 months from the date of signature of the line of credit agreement. The final maturity is 2039. The principal amount accrues interest from 5.0% to 8.0%. The financing agreements are collateralized (i) by collections of daily billings of water supply and sewage services up to the total amount of the debt, or (ii) by a monthly plan of billings corresponding to the minimum of three times the monthly charge, depending on the terms of the relevant financing agreement. As of December 31, 2017, the outstanding debt was R\$1,233.1 million;



- in November 2007, we entered into a R\$129.9 million financing agreement with BNDES. Repayments of the principal amount are being made in 96 successive monthly installments, with final maturity in 2019. The principal amount accrues interest at the TJLP, but limited to 6.0% per year, plus 2.50% per year. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The financing agreement is collateralized by part of the billings from the provision of water and sewage services. As of December 31, 2017, the outstanding debt was R\$33.6 million;
- in May 2008, we entered into a R\$174.0 million financing agreement with BNDES. Repayments of the principal amount are being made in 150 successive monthly installments, with final maturity in 2023. The principal amount accrues interest at the TJLP, but limited to 6.0% per year, plus 2.15% per year. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The financing agreement is collateralized by part of the billings from the provision of water and sewage services. As of December 31, 2017, the outstanding debt was R\$61.2 million;

- in March 2010, we entered into a R\$294.3 million financing agreement with BNDES. Repayments of the principal amount are being made in 156 successive monthly installments, with final maturity in 2025. The principal amount accrues interest at the TJLP, but limited to 6.0% per year, plus 1.92% per year. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The financing agreement is collateralized by part of the billings from the provision of water and sewage services. As of December 31, 2017, the outstanding debt was R\$169.9 million;
- in 2011, we entered into financial leases in the total amount of R\$49.6 million with certain contractors for the construction of infrastructure on land we own. During the construction phase, we recognize an intangible assets and the related liability of the lease at fair value. Upon the conclusion of the construction, we began paying the rental of the infrastructure (in 240 installments) and the lease was updated accordingly to the contract. On August 31, 2013, SES Campo Limpo Paulista and Várzea Paulista started operations, and the corresponding amount as of December 31, 2014 was of R\$138,602 million. As of December 31, 2017, the outstanding debt was R\$561.6 million;
- in March 2012, we entered into a R\$180.8 million financing agreement with BNDES. Amortization of the principal amount is being made in up to 156 successive monthly installments, with the final maturity in 2027. The principal amount accrues interest at the TJLP but it is limited to 6.0% per year plus a yearly 1.72%. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services. As of December 31, 2017, the outstanding debt was R\$49.2 million;
- in February 2013, we entered into a R\$1.3 billion financing agreement with BNDES. Amortization of the principal amount is being made in up to 144 successive monthly installments with the final maturity in 2028. The principal amount accrues interest at the TJLP but is limited to 6.0% per year plus a yearly 1.66%. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services. As of December 31, 2017, the outstanding debt was R\$311.2 million;
- in June 2014, we entered into a R\$61.1 million financing agreement with BNDES. Amortization of the principal amount shall be paid in up to 108 successive monthly installments after the grace period of 36 months, with the final maturity in 2026. The principal amount accrues interest at the TJLP but is limited to 6.0% per year plus a yearly 1.76%. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services;
- in June 2015, we entered into a R\$747.4 million financing agreement with BNDES. Amortization of the principal amount shall be paid in up to 204 successive monthly installments after the grace period of 36 months, with the final maturity in 2035. The principal amount accrues interest at the TJLP but is limited to 6.0% per year plus a yearly 2.18%. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services. As of December 31, 2017, the outstanding debt was R\$408.0 million; and
- in October 2015, we entered into a R\$48.3 million financing agreement with Financier of Studies and Projects (*Financiadora de Estudos e Projetos*, or FINEP). Repayments of the principal amount shall be paid in up in 91 successive monthly installments after the grace period of 30 months, with the final maturity in 2025. The principal amount accrues interest at the TJLP but it limited to 6.0% per year plus a yearly 1.5%. If TJLP exceeds 6% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services. As of December 31, 2017, the outstanding debt was R\$10.9 million.

Under the BNDES program, we issued three tranches of debentures in the aggregate amount of R\$826.1 million. In November 2009, we issued our tenth tranche of debentures in the aggregate principal amount of R\$275.4 million. The debentures are divided in three series: the first and third series will mature in November 2020 and the second in December 2020. The debentures of the first and third series, in the aggregate principal amount of R\$77.1 million and R\$115.7 million, respectively, bear interest at 1.92% per year, plus the TJLP. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The debentures of the second series, in the aggregate principal amount of R\$82.6 million, bear interest at the rate of the IPCA index plus 9.53% per year. This issuance was entirely subscribed by BNDES. As of December 31, 2017 the outstanding debt of tenth issuance of debentures is R\$122.7 million. In February 2011, we issued our fourteenth tranche of debentures, the second tranche out of those three, also subscribed exclusively by BNDES. These debentures are divided in three series: the first and third series will mature in February 2022 and the second, in March 2022. The debentures of the first and third series, in the aggregate principal amount of R\$77.1 million and R\$115.7 million, respectively, bear interest at 1.92% per year, plus the TJLP. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The debentures of the second series, in the aggregate principal amount of R\$82.6 million, bear interest at the rate of the IPCA index plus 9.20% per year. As of December 31, 2017 the outstanding debt of fourteenth issuance of debentures is R\$181.9 million. In October 2013, we concluded our eighteenth issuance of debentures, the third tranche out of those three also subscribed exclusively by BNDES. These debentures are divided in three series: the first and third series will mature in October 2024 and the second, in November 2024. The debentures of the first and third series, in the aggregate principal amount of R\$77.1 million and R\$115.7 million, respectively, bear interest at 1.92% per year, plus the TJLP. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The debentures of the second series, in the aggregate principal amount of R\$82.6 million, bear interest at the rate of the IPCA index plus 8.26% per year. In December 2013, BNDES subscribed to the debentures of the first and second series. In December 2014 and July 2015, BNDES subscribed in part to the debentures of the third series and will subscribe to the other debentures of the third series in 2018. We have used the funds raised from the three issuances for investments primarily in the Corporate Program for Water Loss Reduction and on improvements and reforms of the Rio Grande's water treatment plant, including other projects for water supply and sewage collection systems in the São Paulo Northern Coast, Paraíba Valley and Mantiqueira Regions. As of December 31, 2017 the outstanding debt of eighteenth issuance of debentures is R\$227.9 million.

In June 2010, we carried out our twelfth issuance of debentures, totaling R\$500 million, to the FGTS, based on the FGTS's program to finance companies in the sanitation, transport and real estate businesses. The debentures will mature in June 2025 and bear monthly interest based on the TR plus 9.5% per year. The proceeds of this issuance were used to fund a portion of our capital expenditure program in the water supply and sewage system. As of December 31, 2017 the outstanding debt of twelfth issuance of debentures is R\$340.2 million.

In February 2012, we issued our fifteenth issuance of debentures in two series in the aggregate principal amount of R\$771.0 million. The first and second series will mature in February 2017 and 2019, respectively. The debentures of the first series (in the aggregate principal amount of R\$287.3 million) bear interest at a rate of CDI plus 0.99% per year. The second series (in the aggregate principal amount R\$483.7 million) bears interest at a rate of IPCA plus 6.2% per year. The net proceeds were used to repay financial commitments throughout 2012, including the early redemption of our thirteenth debentures issuance. As of December 31, 2017 the outstanding debt of fifteenth issuance of debentures is R\$692.2 million.

In November 2012, we carried out our sixteenth issuance of debentures of R\$500 million, with a maturity date of November 2015 and bearing interest, each quarter with an interest rate of between 0.30% and 0.7% per year plus the CDI rate. The proceeds of this issuance were used to pay our financial commitments for 2012 and 2013.

In January 2013, we carried out our seventeenth issuance of debentures of R\$1.0 billion in three series, the first for R\$424.7 million with maturity date of January 2018 and with an interest rate of 0.75% per year plus the CDI rate, the second for R\$395.2 million with a maturity of January 2020 and with the interest rate of 4.50% per year plus IPCA variation and the third for R\$180.1 million with a maturity date of January 2023 and with an interest rate of 4.75% per year plus IPCA variation. The proceeds of this issuance were used to pay our financial commitments for 2013. As of December 31, 2017 the outstanding debt of seventeenth issuance of debentures is R\$926.3 million.

In June 2014, we carried out our nineteenth issuance of debentures of R\$500 million, with a maturity date of June 2017 and bearing interest, each semester with an interest rate of between 0.80% and 1.08% per year plus the CDI rate. The proceeds of this issuance were used to pay our financial commitments for 2014 and 2015. In March 2016, we made an extraordinary partial amortization of the nineteenth issuance of R\$300 million, and in June 2017, we repaid the remaining amount due under these debentures.

In December 2015, we carried out our twentieth issuance of debentures of R\$500 million, with a maturity date of December 2019 and bearing interest, each semester with an interest rate of 3.80% per year plus the CDI rate. The proceeds of this issuance were used to strengthen our cash position and refinance financial commitments which were set to mature in the first trimester of 2016. As of December 31, 2017 the outstanding debt of twentieth issuance of debentures is R\$496.9 million.

In June 2017, we carried our twenty-first issuance of debentures in two series in the aggregate principal amount of R\$500 million. The first and second series will mature in June 2020 and 2022, respectively. The debentures of the first series (in the aggregate principal amount of R\$150 million) bear interest at a rate of CDI plus 0.60% per year. The debentures of the second series (in the aggregate principal amount of R\$350 million) bear interest at a rate of CDI plus 0.90% per year. The proceeds of this issuance shall be used to strengthen our cash position and refinance financial commitments which mature in 2017. As of December 31, 2017 the outstanding debt of twenty-first issuance of debentures is R\$499.6 million.

In February 2018, we carried our twenty-second issuance of debentures in three series in the aggregate principal amount of R\$750 million. The first, second and third series will mature in February 2021, 2023 and 2025 respectively. The debentures of the first series (in the aggregate principal amount of R\$100 million) bear interest at a rate of CDI plus 0.58% per year, with semi-annual interest payments. The second series (in the aggregate principal amount R\$400 million) bears interest at a rate of CDI plus 0.90% per year, with semi-annual interest payments. The third series (in the aggregate principal amount R\$250 million) bears interest at a rate of IPCA plus 6.00% per year, with annual interest payments. The proceeds from this funding are intended to strengthen our cash position and refinance outstanding financial commitments in 2018.

Part of our *real* denominated indebtedness is indexed to take into account the effects of inflation. This debt provides for inflation based increases to the principal amount, determined by reference to the IPCA.

#### *Financial Covenants*

We are subject to financial covenants under the agreements evidencing or governing our outstanding indebtedness.

#### Foreign currency denominated indebtedness

With respect to our indebtedness denominated in U.S. dollars, including our borrowings from the IADB, we are subject to financial covenants, including limitations on our ability to incur debt. For example:

The financial covenants in our Loan No. 1212 from the IADB require as follows:

- our tariff revenues must be sufficient to cover the operational expenses of our system, including administrative, operating and maintenance expenses, and depreciation;
- our tariff revenues must provide a return on the balance sheet value of our property, plant, and equipment of not less than 7%; and
- during project execution, the balance of our short-term borrowings must not exceed 8.5% of our total equity.

This contract contain an early maturity clause in the event of non-compliance on our part, of any obligation stipulated therein or in other contracts with the bank relating to the financing of the above-mentioned projects.

The financial covenants in our AB Loan Agreements with the IADB (No. 1983AB) require as follows:

- our debt service coverage ratio must be greater than or equal to 2.35:1.00; and
- our ratio of Net Debt (defined as all borrowed money, including debentures and Eurobonds, less interest and financial charges that have been provisioned for the current period) to Adjusted EBITDA (defined as our net income before net financial expenses, income tax and social contribution tax, depreciation and amortization, non-operating income or expenses, and extraordinary items net of income tax and social contribution, as set forth in our consolidated financial statements), each determined on a consolidated basis, must be less than 3.65:1.00.

This contract contains an early maturity clause. In the event of non-compliance with the terms of the contract, the BID can request the anticipated payment of part or all of the loan. The contract also contains cross-default provisions whereby an event of non-compliance on our part relating to any other of our debts with BID or third-parties (in this case, if over US\$25 million) allows BID to request the early payment of the loan.

In a Letter Agreement executed on September 30, 2015, the IADB irrevocably agreed not to exercise its right to accelerate its loans to us if our ratio of Net Debt to Adjusted EBITDA is equal to or exceeds 3.65:1.00 for one fiscal quarter only during the period from September 30, 2015 to October 1, 2016. As a result, the IADB was only able to accelerate its loans to us if we breached this ratio for more than one quarter during that period. This agreement had a cross-default clause. See Note 16 to our financial statements.

The indenture relating to our US\$350.0 million 6.25% notes due 2020 prohibit, subject to some exceptions, the incurrence of additional debt in the event that: (i) the ratio of Adjusted Total Debt to adjusted EBITDA (as defined in the related indentures) is greater than 3.65:1.00; or (ii) the Debt Service Coverage Ratio (as defined in the related indentures) is less than 2.35:1.00. This agreement has a cross-default clause, i.e. the early maturity of any debt in connection with our loans or the loans of any of our subsidiaries in a total principal amount of US\$25.0 million or more (or the corresponding amount in other currencies) shall imply this agreement's early maturity. See Note 16 to our financial statements included in this annual report. In November 2016, the US\$140.0 million 7.5% notes due 2016 were completely amortized.

Any significant devaluation of the *real* will affect the total portion of our debt denominated in foreign currencies when measured in *reais*. As a result, the Adjusted Total or Net Debt in *reais* will be affected, with consequent impact on the ratio between Adjusted Total or Net Debt to adjusted EBITDA.

As of December 31, 2017 and 2016, we had met all the requirements set forth by these loans and financing agreements.

#### Local currency denominated indebtedness

With respect to our outstanding indebtedness denominated in *reais*, we are subject to financial covenants.

The covenant clauses apply to all of SABESP's indebtedness with BNDES, including the 10th, 14th, and 18th issuances of debentures held by BNDES, which totaled R\$1,504.2 million as of December 31, 2016. The only financing agreement which is exempt from the renegotiated financial is contract No. 08.2.0169. See Note 16 (a) (ii) to our financial statements included in this annual report.

In summary, the BNDES financings specify two bands for the ratios of Adjusted Net Debt / Adjusted EBITDA, Adjusted EBITDA / Adjusted Financial Expenses, and Other Onerous Debt / Adjusted EBITDA. The financings also specify a collateral mechanism by which we assign a portion of its tariff payment receivables to BNDES in order to provide a partial guarantee of the amounts due under the financings. Under this mechanism, each month we must ensure that a portion of the tariff payments which we receive are deposited on a daily basis into a blocked collateral account, before being released to a regular movements account later in the day provided that BNDES has not notified the bank that we are in default. If the ratio of Adjusted EBITDA / Adjusted Financial Expenses is equal to or higher than 3.50, the ratio of Adjusted Net Debt / Adjusted EBITDA equal to or lower than 3.00, and the Other Onerous Debt / Adjusted EBITDA equal to or lower than 1.00, the amount that must pass through this blocked collateral account is R\$225.9 million per month. If one of the three aforementioned ratios are not met in any two or more quarters, consecutive or not, within a twelve-month period, yet remain within the following band of ratios: Adjusted EBITDA / Adjusted Financial Expenses lower than 3.50 but equal to or higher than 2.80, Adjusted Net Debt / Adjusted EBITDA equal to or lower than 3.80 but higher than 3.00, and Other Onerous Debt / Adjusted EBITDA equal to or lower than 1.30 but higher than 1.00, the amount that must pass through the blocked collateral account is automatically increased by 20%.

The current covenant clauses are:

A. Maintenance of the following ratios, calculated quarterly and relative to amounts accumulated over the last 12 months at the time of disclosure of reviewed quarterly financial statements or audited annual financial statements:

- Adjusted EBITDA / Adjusted Financial Expenses equal to or higher than 3.50;
- Adjusted Net Debt / Adjusted EBITDA equal to or lower than 3.00; and
- Other Onerous Debt / Adjusted EBITDA equal to or lower than 1.00 (where “Other Onerous Debt” is equal to the sum of (i) social security liabilities and health care plans, (ii) installment payments of tax debt and (iii) installment payments of debt with electricity providers).



B. If any one of the ratios specified in A. above are not met in any two or more quarters, consecutive or not, within a twelve-month period, we shall be deemed to be in non-compliance with the first band ratios and must, as a result, automatically increase the amount passing through the blocked collateral account by 20%, provided that the following second band ratios are met:

- Adjusted EBITDA / Adjusted Financial Expenses lower than 3.50 but equal to or higher than 2.80;
- Adjusted Net Debt / Adjusted EBITDA equal to or lower than 3.80 but higher than 3.00; and
- Other Onerous Debt / Adjusted EBITDA equal to or lower than 1.30 but higher than 1.00.

C. If any one of the second band ratios specified in B. above are not met for any one quarter, or if we are required to but fails to ensure that the increased monthly amount specified in B. above passes through the blocked collateral account, then we shall be deemed to be in non-compliance with its ratio covenants, in which case BNDES may at its discretion:

- require us to provide additional financial guarantees within a deadline specified by BNDES, which may not be less than 30 days;
- suspend the release of funds; and/or
- declare the financings to be immediately due and payable.

As of December 31, 2017, the amount that must pass through the blocked collateral account is R\$225.9 million per month, not including the financial guarantees for financing contract No. 08.2.0169.1.

The financial covenants applicable to financing contract No. 08.2.0169.1 are the following:

- Adjusted EBITDA / Adjusted Net Operational Revenue equal to or higher than 38%;
- Adjusted EBITDA / Adjusted Financial Expenses equal to or higher than 2.35; and
- Adjusted Net Debt / Adjusted EBITDA equal to or lower than 3.20.

BNDES will annually verify the maintenance of the aforementioned ratios for contract 08.2.0169.1 by reviewing our audited annual financial statements, which must be presented to BNDES or published by April 30 of the following year to which the financial statements refer. If we maintain all of the financial covenants for contract 08.2.0169.1, BNDES shall reduce the interest charged in such financing contract from 2.15% to 1.82% per annum. If the financial covenants are maintained, the interest rate is reduced as of June 16 of the same year in which the financial covenants were verified until June 15 of the subsequent year.

The financing agreement established with BNDES in March 2010 is subject to a cross-default clause. For example, the early maturity of any of our debts, the financial contracts and/or amounts of which may compromise the obligations stipulated in the indenture shall cause the early maturity of such agreement.

Our financing agreements with *Caixa Econômica Federal* do not contain material financial covenants. The agreement with *Caixa Econômica Federal* has a cross-default clause. See Note 16 to our financial statements included in this annual report.

With respect to our outstanding debentures, the twelfth issuance requires us to maintain an Adjusted Current Ratio (current assets divided by current liabilities, excluding from current liabilities the current portion of noncurrent debts incurred by us that is recorded in current liabilities) higher than 1.0:1.0 and an EBITDA/Financial Expenses Ratio equal to or higher than 1.5:1.0. The twelfth debenture issuance has an early maturity clause, which is triggered if our credit ratings are downgraded two levels below the “brAA-” Brazil National Scale rating assigned to our debentures by the credit rating agency S&P at the time of their issuance. On January 12, 2018, our credit rating and the one assigned to the twelfth debenture issuance by S&P were both “brAA-”. This issuance has a cross-default clause. See Note 16 to our financial statements included in this annual report.

The tenth, fourteenth and eighteenth issuances follow the covenants set forth with BNDES, as described above, and contain a cross-default clauses. See Note 16 to our financial statements included in this annual report.

The fifteenth, seventeenth, nineteenth and twentieth issuances require us to maintain an EBITDA/paid financial expenses ratio equal to or higher than 1.5:1.0 and an adjusted total debt/EBITDA ratio equal to or lower than 3.65:1.0. These issuances have a cross-default clause. See Note 16 to our financial statements.

The table below shows the more restrictive covenants ratios and our financial covenants ratios as of December 31, 2017.

The twenty-first and twenty-second issuances require us to maintain an EBITDA/paid financial expenses ratio equal to or higher than 1.5:1.0 and an adjusted net debt/EBITDA ratio equal to or lower than 3.50:1.0. These issuances have a cross-default clause. See Note 16 to our financial statements.

	<b>Restrictive Ratios</b>	<b>Ratio as of December 31, 2017</b>
Adjusted EBITDA / Adjusted financial expenses	Equal to or higher than 2.80:1.00	7.55
Adjusted net debt / Adjusted EBITDA	Equal to or lower than 3.80:1.00	1.89
Adjusted total debt / Adjusted EBITDA	Lower than 3.65:1.00	2.27
Other onerous debt <sup>1/</sup> / Adjusted EBITDA	Equal to or lower than 1.30:1.00	0.56
Adjusted current ratio	Higher than 1.0	1.45
EBITDA/Paid financial expenses	Equal to or higher than 2.35:1.00	7.79
Net debt/Adjusted EBITDA	Equal to or lower than 3.50:1.0	1.84

(1) “Other Onerous Debts” correspond to the sum of social security liabilities, health care plan, installment payment of tax debts and installment payment of debts with the electricity supplier.

As of December 31, 2017 and 2016, we had met all the requirements set forth by these loans and financing agreements.

### **Capital Requirements**

We have, and expect to continue having, substantial liquidity and capital resource requirements. These requirements include debt service obligations, capital expenditures to maintain, improve and expand our water and sewage systems, and dividend payments and other distributions to our shareholders, including the State.

### **Capital Expenditures**

Historically, we have funded and plan to continue funding our capital expenditures with funds generated by operations and with long-term financing from international and national multilateral agencies and development banks. We generally include in our capital expenditure program for the following year the amount of investment that was not realized in the previous year. In 2017, we recorded R\$3.4 billion to improve and expand our water and sewage system and to protect our water sources in order to meet the growing demand for water and sewage services in the state of São Paulo. We have budgeted investments in the amount of approximately R\$17.3 billion from 2018 through 2022. See “Item 4.A. History and Development of the Company—Capital Expenditure Program”.

### **Dividend Distributions**

We are required by our bylaws to make dividend distributions, which can be made as payments of interest on shareholders' equity to our shareholders in an amount equal to or higher than 25% of the amounts available for distribution. In addition, our dividend policy, which was approved at the annual shareholders' meeting held on April 27, 2018, establishes that this percentage shall be maintained until the universalization of basic sanitation services in the areas where we operate. We declared dividends of R\$703.9 million, R\$823.5 million and R\$149.9 million in 2017, 2016 and 2015, respectively. See "Item 7.B. Related Party Transactions—Dividends".

**C. Research and Development, Patents and Licenses, Etc.**

Our policy is to invest continually in the modernization of equipment and identify and evaluate the technology needed to improve our provision of basic sanitation services while promoting environmental protection and maintaining our competitiveness and profitability. In 2017, 2016 and 2015, we invested R\$10.7 million, R\$11.9 million and R\$14.7 million, respectively, in research and development.

With respect to our partnership with FAPESP to develop and support research projects involving researchers from graduate schools, the State of São Paulo and our employees, the projects are equally financed by us and FAPESP. Under this partnership, two phases of projects were carried out. In the first phase, 10 projects have been approved and 9 of them have been executed and concluded. They are related to: (i) the development of technology related to the use of membrane filtration in water and sewage treatment, (ii) alternatives for the treatment, use and disposal of sludge from water and sewage treatment plants, (iii) new technologies for the implementation, operation and maintenance of water distribution and sewage collection systems, (iv) new technologies for improvements in unitary operations processes, (v) monitoring water quality; (vi) energy efficiency and (vii) the sanitary economy.

Some of nine projects concluded in the first round have led to several patents and software registrations requests, including:

- “Use of Autonomous Microlaboratories to Monitor Phosphorus in Real Time” – This project consists of the development of a microlaboratory to detect phosphorus in water bodies using a more efficient method than traditional processes;
- “Intensive Monitoring of São Paulo Metropolitan Region Reservoirs, with emphasis on cyanobacteria and its correlation with physical and chemical parameters: the Billings case” – One of the results of this project was the development of a forecasting model to determine the concentration of cyanobacteria in water sources; and
- “Specialized System for the Detection and Diagnosis of Leaks in Urban Water Lines” – This project represents the first phase of the development of a water leakage detection system with less dependence on manual detection by the field operators. The acoustic signals derived from the leak are recorded on a portable GPS device that generates a database to be posteriorly correlated and analyzed.

Some of the research institutions with whom we have partnered on the abovementioned projects are the University of São Paulo (*Universidade de São Paulo - USP*), the Aeronautic Technical Institute (*Instituto Tecnológico de Aeronáutica - ITA*), São Paulo State University (*Universidade Estadual Paulista – UNESP*), Federal University of São Paulo – UNIFESP, and the National Institute of Spacial Research (*Instituto Nacional de Pesquisas Espaciais – INPE*).

In May 2013, we launched the second phase of our agreement with FAPESP. In this second phase, the seven lines of research were defined in greater detail in order to precisely contemplate our needs. In this phase, 37 proposals were submitted, 10 proposals were approved according to the technical-scientific criteria and eight of them had their agreements signed in 2015, as follows:

- Development of a National Correlated Signal Optimized for Locating and Detecting Leaks in Underground SABESP Water Pipes - UNESP;
- Development of an Aerobic Granular Sludge for Simultaneous Removal of Organic Matter, Nitrogen and Phosphorous from Sanitary Sewage – USP;
- Sewage Sludge Composting: Evaluation of the Process, Generated Product and its Costs - UNESP;
- Diagnosis, Management and New Treatment Alternatives – USP;
- Saxitoxins in Water Supply: Production of Analytical Standards, Development of Analytical Methodologies and the Degradation Study – USP;
- Feasibility of the Use of Water Treatment Sludge as Landfill Cover Material and in the Construction of Compacted Soil Landfills - USP;
- Online Analysis of Water Quality – USP; and
- Separation Systems by Membranes for the Public Supply of Water: Hiring Projects Mechanisms and Treatment of Contaminated Underground Water – USP.

In 2015, we entered into a financing agreement with FINEP, for the “Sabesp – Technological Innovations for the Sanitation Sector” plan. This plan is part of the “FINEP Innovates Brazil” program and aims at supporting Brazilian

companies' plans for strategic investment in innovation. This plan must detail a company's targets and goals for the period during which they will receive financing, pursuant to the Federal Government's "Greater Brazil Plan – PBM". This plan consists of four projects, whose costs total approximately R\$60 million, as follows: (i) production system for reused water in urban and industrial uses; (ii) biofiltration units for odor control; (iii) sludge dryer based on solar radiation for sewage treatment plants in the city of Franca, Franca Sewage Treatment Plant; and (iv) plasma gasification system for solid waste from sewage treatment plants in the Barueri Sewage Treatment Plant.

We also entered into an agreement with the Fraunhofer Institute in Germany in 2011 in order to obtain biomethane from the sewage treatment process to be used as fuel for cars. The objective is to mobilize a fleet of 49 cars using biomethane fueled by a sewage treatment process instead of gasoline. This project has been delayed due to a judicial dispute between the supplier of the equipment and the Fraunhofer Institute which has temporarily impeded the importation of equipment donated by the Fraunhofer Institute. In 2016, we received the imported equipment. In 2017, we completed the construction and installation of equipment, and started testing the technology. Full operation is expected to begin in 2018.

In 2016, we signed a technical cooperation agreement with Magni, a representative of the Danish company Liqtech, aiming to test cutting edge ceramic ultra-filtering membranes to treat residual water in our water treatment plants. Tests were completed in 2017.

In 2016, we also formalized a Memorandum of Understanding with the Danish Water Forum (“DWF”), aiming to enhance technological cooperation to create pilot projects that seek to make our treatment plants more energy-efficient and to fight water loss through the creation of “Measure and Control Districts”, areas of the distribution network temporarily or permanently closed to measure the amount of water entering or leaving. As part of this cooperation, in 2017 a workshop was held to present the loss reduction technologies used by Danish companies in the management of water supply networks.

Seeking energy efficiency in our operations, we established a procedure to calculate the oxygen transfer rate in air diffusers dissolved in sewage treatment plants. The project also aims to find the best cleaning period and when these devices would have to be replaced. The tests conducted at our pilot sewage treatment plant were concluded in 2017. In 2018, we expect to conclude the evaluation of operational and quality results as well as the elaboration of technical reports in order to reach a final conclusion regarding the feasibility of replicating this technology in other sewage treatment plants.

In 2017, we signed a Term of Commitment with the Federal University of Minas Gerais (*Universidade Federal de Minas Gerais* – UFMG), through the university’s Department of Sanitary and Environmental Engineering, aiming to continue the project entitled “Evaluation of the potential energy utilization of biogas generated in anaerobic reactors as applied to domestic sewage treatment in Brazil” at the Várzea Paulista Sewage Treatment Plant. Measurements and assessments of biogas production are currently in process.

In 2017, we also signed a Memorandum of Understanding with ino3W Ltd. with the specific purpose of exchanging knowledge and experience aimed at potentially establishing a partnership in the area of technological development. Ino3W Ltd. hosts a platform on which large water and sanitation utility providers in several countries can collaborate to find efficient solutions through partnerships with global innovative technology providers, entrepreneurs and water and sanitation companies.

We also have developed custom made biofilters to reduce the odor from sewage pumping stations and sewage treatment plants. Additionally, we have projects linked to the quality and treatment of water, including projects that focus on particularly hard to remove chemical components, and projects that focus on machinery used to control the water treatment process in our treatment plants.

In our sewage collection and treatment plants, we have projects that seek to automatize operational processes and develop alternative technologies not used or rarely used in Brazil, such as the use of ultraviolet technology in the disinfection of water planned to be re-used and the use of activated charcoal to minimize odors generated by the sewage collection process in cities.

We publish DAE Magazine, our company's quarterly engineering journal which has now totaled over 200 editions since its inauguration. This journal's publication began in 1936 under the title Bulletin of the Water and Sewage Department – RAE (*Boletim da Repartição de Aguas e Esgotos – RAE*). The journal has a specialized staff and is currently accredited by the Qualis / CAPES system under the category “B2.” Through the journal's publication of technical and scientific articles on basic and environmental sanitation, we aim to ensure that improvements in processes, innovations and technological advances aid in the construction of universalized and sustainable sanitation, which in addition to the implementation of infrastructure, generate social-environmental solutions to improve the quality of life and health of the Brazilian population.

#### **D. Trend Information**

Several factors may affect our future results of operations, liquidity and capital resources, including:



- the interests of our controlling shareholder;
- our potential corporate reorganization, as approved by State Law No. 16,525 on September 15, 2017;
- regulations issued by ARSESP regarding several aspects of our business, with respect to our ability to adjust our tariffs and the competency of state and municipalities to manage their sanitation affairs;
- Brazilian economic conditions;
- the effects of extreme weather events;
- the effects of any continuous international financial turmoil that may affect liquidity in the Brazilian capital and lending markets;
- the effects that further changes in the Basic Sanitation Law and its interpretation may have on the basic sanitation industry in Brazil and on us;
- the effects of inflation in our results of operations;
- the effects of fluctuations in the value of the Brazilian real and in interest rates on our net interest income;
- the renewal of our concession agreements;
- the impact on our business of lower water consumption practices adopted by our customers during the water crisis, which may remain in place despite the discontinuation of the measure we adopted to serve the São Paulo metropolitan region during the water crisis;
- investments made, by some sectors, during the water crisis in search of alternative sources of supply, such as the drilling of artesian wells, the reuse of water and the use of rainwater;
- the May 2017 renewal of the concession that regulates the volume of water that may be extracted from the Cantareira System, the main water system we use to serve the São Paulo metropolitan region, based on the volume of water available in the reservoirs divided into five tranches: (i) if the volume of water available is higher than 60% of the reservoirs' capacity, we can draw up to 33m<sup>3</sup>/s; (ii) if the volume of water is between 40% and 60% of the reservoirs' capacity, we can draw up to 31m<sup>3</sup>/s; (iii) if the volume of water is between 30% and 40% of the reservoirs' capacity, we can draw up to 27m<sup>3</sup>/s; (iv) if the volume of water is between 20% and 30% of the reservoirs' capacity, we can draw up to 23m<sup>3</sup>/s; and (v) if the volume of water available is lower than 20% of the reservoirs' capacity, we can draw up to 15.5m<sup>3</sup>/s;
- any measures that we may be required to take to ensure the provision of water to our customers; and
- the formalization of agreements with certain of the municipalities we serve.

Some of these factors are described in more detail under "5.A. Operating and Financial Review and Prospects".

In addition, you should read "3.D. Risk Factors" for a discussion of the risks we face in our business operations, which could affect our business, results of operations or financial condition.

#### **E. Off Balance Sheet Arrangements**

We had no off balance sheet arrangements as of December 31, 2017.

#### F. Tabular Disclosure of Contractual Obligations

Our debt obligations and other contractual obligations as of December 31, 2017 were as follows:

	<b>Less than 1 year</b>	<b>1 3 years</b>	<b>3 5 years</b>	<b>More than 5 years</b>	<b>Total</b>
			(in millions of reais)		
Loans and financing	1,746.8	4,021.8	1,701.9	4,630.5	12,101.0
Estimated interest payments <sup>(1)</sup>	474.9	947.2	510.2	904.1	2,836.4
Accounts payable to suppliers and					
contractors	344.9	-	-	-	344.9
Services payable	408.3	-	-	-	408.3
Program contract commitments	128.8	108.1	16.8	16.0	269.7
Purchase obligations <sup>(2)</sup>	3,239.2	3,273.1	1,412.9	7,186.9	15,112.1
<b>Total</b>	<b>6,342.9</b>	<b>8,350.2</b>	<b>3,641.8</b>	<b>12,737.5</b>	<b>31,072.4</b>

- (1) Estimated interest payments on loans and financing were determined considering the interest rates as of December 31, 2017. However, our loans and financing are subject to variable interest indexation and foreign exchange fluctuations, and these estimated interest payments may differ significantly from payments actually made. The debt agreements have cross-default clauses.
- (2) The purchase obligations are the contractual obligations of investments and expenses.

We believe that we can meet the maturity schedule through a combination of funds generated by operations, the net proceeds of new issuances of debt securities in the Brazilian and international capital markets and additional borrowings from domestic and foreign lenders. Our borrowings are not affected by seasonality. For information concerning the interest rates on our indebtedness outstanding as of December 31, 2017, see Note 16 to our financial statements as of December 31, 2017 and 2016 and for the years ended December 31, 2017, 2016, 2015 included elsewhere in this annual report.

## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

### A. Directors and Senior Management

Under our bylaws and Brazilian Corporate Law, we are managed by our board of directors (Conselho de Administração), which currently consists of ten directors, and a board of executive officers (Diretoria), which currently consists of six executive officers.

As our controlling shareholder, the State has the ability to elect the majority of our board of directors and, therefore, our direction and future operations. Upon the election of a new State governor and any resulting change in the administration of the State, all or some of the members of our board of directors, including our chairman, have historically been replaced by designees of the new administration. Our board of directors may in turn replace some or all of the executive officers. See “Item 3.D. Risk Factors—Risks Relating to Our Control by the State of São Paulo—We are controlled by the State of São Paulo, whose interests may differ from the interests of non-controlling shareholders, including holders of ADSs”.

#### *Board of Directors*

Our bylaws provide for a minimum of seven and a maximum of 11 directors. The members of our board of directors are elected at a general shareholders’ meeting to serve a two-year term. Such terms may be renewed three consecutive times. Pursuant to our bylaws, our employees have the option to elect one member of our board of directors. Currently, our employees have not elected a director. In addition, pursuant to Law No. 6,404/1976 of December 15, 1976, as amended (“Brazilian Corporate Law”), at least one member of the board of directors of mixed capital companies, such as us, must be appointed by the minority shareholders. Finally, according to the Novo Mercado rules and Federal Law No. 13,303/16, at least two, or 25.0%, of the board of directors must be comprised of independent members.

All the current members of our board of directors were elected at the annual shareholders’ meeting held on April 27, 2018, except for Karla Bertocco Trindade who joined our board of directors on May 14, 2018 when she was appointed our Chief Executive Officer. The tenure of all the directors will end upon the election of members for the new term at the annual shareholders’ meeting in 2020. Currently, we have seven members considered independent under the Novo Mercado rules and Federal Law No. 13,303/16.

Our board of directors ordinarily meets once a month or, when necessary for the interests of our company, when called by a majority of the directors or the chairman. Its responsibilities include the establishment of policy and general orientation of our business, and the appointment and supervision of our executive officers.

The following are the names, ages, positions, dates of election and brief biographical descriptions of the current members of our board of directors elected at the shareholders’ meeting on April 27, 2018 and, in the case of Karla Bertocco Trindade, on May 14, 2018:

<b>Director</b>	<b>Age</b>	<b>Position</b>	<b>Date Elected</b>
Mario Engler Pinto Junior	61	Chairman	April 27, 2018
Karla Bertocco Trindade	41	Member	May 14, 2018
Jerônimo Antunes	62	Independent Member*	April 27, 2018
Reinaldo Guerreiro	64	Independent Member*	April 27, 2018

Francisco Vidal Luna	71	Independent Member*	April 27, 2018
Luís Eduardo Alves de Assis	61	Independent Member*	April 27, 2018
Francisco Luiz Sibut Gomide	72	Independent Member*	April 27, 2018
Lucas Navarro Prado	37	Independent Member*	April 27, 2018
Ernesto Rubens Gebcke	74	Independent Member*	April 27, 2018
Rogério Ceron de Oliveira	37	Member	April 27, 2018

\* These members comply with the independence requirements established by the *Novo Mercado* rules.

Mario Engler Pinto Junior. Mr. Pinto has been the Chairman of our board of directors since April 2018. Mr. Pinto holds a law degree and PhD in Commercial Law from the University of São Paulo (Universidade de São Paulo – USP). He is the CEO and a member of the board of directors of the São Paulo Partnership Company (Companhia Paulista de Parcerias - CPP), a member of the State Capital Protection Board (Conselho de Defesa dos Capitais do Estado - CODEC), chief advisor on public and corporate finance to the Treasury Department, an arbitrator for the B3 Arbitration Chamber, a member of the Advisory Chamber for the Governance Market for State-Owned Companies (Mercado de Governança de Estatais) and a member of the Fiscal Council for the Luso-Brazilian Bank (Banco Luso-Brasileiro). He is also a professor at the bachelor's and master's levels and for a specialization course at the Getúlio Vargas Foundation (Fundação Getúlio Vargas – FGV), where he also conducts legal research regarding contractual and corporate arrangements in the public and private sector and serves as coordinator of the professional master's degree program. He has been an active lawyer since 1979 and served as a São Paulo State Attorney from 1984 to 2014. He was also a member of the Energy Council for the Regulatory Agency of Sanitation and Energy for the State of São Paulo (Conselho de Orientação de Energia da Agência Reguladora de Saneamento e Energia do Estado de São Paulo) from 2008 to 2010, a member of our board of directors from 2006 to 2011, a member of our audit committee from 2006 to 2009, a member of the board of directors for the Brazilian Institute of Corporate Governance (Instituto Brasileiro de Governança Corporativa – IBGC) from 2004 to 2006, Deputy Attorney General for the State of São Paulo from 2000 to 2003 and a member of the board of directors for the airline Viação Aérea São Paulo from 2000 to 2001.

*Karla Bertocco Trindade.* Mrs. Trindade has been our Chief Executive Officer and a member of our board of directors since May 2018. She holds a Bachelor's degree in Public Administration from the Getúlio Vargas Foundation (Fundação Getúlio Vargas - FGV), a Bachelor's degree in Law from the Pontifical University of São Paulo (Pontifícia Universidade Católica de São Paulo – PUC-SP) and a post-graduate degree in Administrative Law from FGV. She was Undersecretary of Partnerships and Innovation at the Secretariat of the São Paulo State Government, responsible for coordinating different public-private partnerships and concession projects in the State of São Paulo between 2015 and 2018, Director General of the State of São Paulo Regulatory Agency for Delegated Transportation Public Services (Agência Reguladora de Serviços Públicos Delegados de Transporte do Estado de São Paulo - ARTESP) between 2011 and 2015, and Director of Institutional Relations of the State of São Paulo Regulatory Agency for Sanitation and Energy (Agência Reguladora de Saneamento e Energia do Estado de São Paulo - ARSESP) between 2008 and 2010. She also worked as Advisor to the President of our company between 2003 and 2006.

*Jerônimo Antunes.* Mr. Antunes has been an independent member of our board of directors and Coordinator of the Audit Committee since April 2008. He holds a Bachelor's degree in Business Administration and Accounting and both a Masters' degrees and a doctorate in Controllershship and Accounting from the Business, Economics and Accounting School at the University of São Paulo (Universidade de São Paulo - USP). He has been a professor of several MBA courses at the Foundation Institute of Accounting, Actuary and Financial Research (Fundação Instituto de Pesquisas Contábeis, Atuariais e Financeiras - FIPECAFI) and at the Foundation Institute of Administration (Fundação Instituto de Administração - FIA), among other institutions. Mr. Antunes has acted as an independent auditor from 1977 to 2005 and as an expert and specialist in accounting examinations since 2005. He was a member of the board of directors and a member of Finance, Risks, and Contingencies committee of Paranapanema S.A. from October 2016 to August 2017 and he has been a member of the audit committee of Paranapanema S.A. since November 2017. He has been member of the audit committee of Desenvolve SP since April 2013 and was the president of its audit committee from April 2013 to February 2017. Since July 2015, he has been an independent member of the board of directors, a member of the audit committee (acting as president since September 2016) and a member of compensation and succession committee of Petróleo Brasileiro S.A. - Petrobras. He has been an independent member of the board of directors and the President of the audit committee of Petrobras Distribuidora S.A. since August 2016. Mr. Antunes has also been a member of the board of trustees of FIPECAFI since April 2017, and an alternate member of the fiscal council of *Companhia Brasileira de Distribuição* since April 2017. He is a member of IBGC and was an executive officer of the Institute of Accounting, Actuary and Financial Research (*Instituto de Pesquisas Contábeis, Atuariais e Financeiras- IPECAFI*), the Brazilian Institute of Independent Auditors (*Instituto Brasileiro de Auditores Independentes – IBRACON*) and the National Association of Executives in Finance, Administration and Accounting (*Associação Nacional de Executivos de Finanças, Administração e Contabilidade– ANEFAC*).

*Reinaldo Guerreiro.* Mr. Guerreiro has been an independent member of our board of directors since January 2007 and a member of our Audit Committee from January 2007 to May 2017. He holds a doctorate in Accounting and Controllershship, a Master's degree in Accounting and Controllershship and a Bachelor's degree in Accounting Sciences, all of them from the Business, Economics and Accounting School at the University of São Paulo (*Universidade de São Paulo - USP*). Currently, he is a professor and Deputy Head of the Accounting Department at the Business, Economics and Accounting School at USP. He has authored books in management accounting and has published various scientific articles in domestic and international magazines. He is a specialized consultant in financial management. Mr. Guerreiro has worked on various projects in the areas of financial management, costs, budget and IT in a variety of companies, such as Banco do Brasil, *Caixa Econômica Federal*, Previ and for the São Paulo Government - GESP.

*Francisco Vidal Luna.* Mr. Luna has been an independent member of our board of directors since April 2013 and a member of our Audit Committee from April 2013 to September 2016. He has a doctorate in Economics from the

Business, Economics and Accounting School at the University of São Paulo (*Universidade de São Paulo - USP*) and is a retired professor of the same university. In the public sector, he has served as the Secretary of Planning for the state and city of São Paulo. He has also worked at the Treasury Department for the State of São Paulo and the Federal Planning Bureau, among other roles. Within the private sector, Mr. Luna was Chairman and President of Banco Inter American Express S.A. At the governmental level, he served as a member of the advisory board of the Superintendency for the Development of the Northeast (*Superintendência de Desenvolvimento do Nordeste – Sudene*), a member of the board of directors of BNDES; superintendent of the Planning Institute of the Federal Planning Bureau, Special Secretary for Economic Affairs of the Federal Planning Bureau. At the state level, Mr. Luna has also been the Chairman of the Advisory Board for the division of Economic Affairs of the Secretariat of Finance of the State of São Paulo and Executive Secretary of the Board of Financial Coordination of São Paulo. Currently, Mr. Luna is a member of the board of directors and the audit committee of Develop São Paulo (*Desenvolve SP*), a member of the board of directors and the audit committee of Gafisa S.A., a member of the board of directors of *Tenda S.A.*, Chairman of the board of directors of IDBRASIL and the Afro-Brazilian Museum, a member of the board of trustees of the Father Anchieta Foundation (*Fundação Padre Anchieta*) and an advisory board member of the Foundation of Medical Faculty (*Fundação Faculdade de Medicina – FFM*).

*Luís Eduardo Alves de Assis.* Mr. Assis has been an independent member of our Board of Directors since April 2014 and a member of our Audit Committee since September 30, 2016. He holds a degree in Economics from the University of São Paulo (*Universidade de São Paulo - USP*), a Master's degree from the State University of Campinas (*Universidade Estadual de Campinas – UNICAMP*) and an MBA from *Scuola Superiore Enrico Mattei* in Milan, Italy. He was director of Monetary Policy of the Central Bank of Brazil and a professor in the Department of Economics at the Pontifical University of São Paulo (*Pontifícia Universidade Católica de São Paulo - PUC-SP*) and at the Getulio Vargas Foundation (*Fundação Getulio Vargas - FGV-SP*). He has developed his long career in the financial market, having held the positions of Chief Economist and Investment Director at Citibank, Chief Executive Officer at HSBC Investment Bank Brasil, Chief Executive Officer at HSBC Asset Management, Chief Operating Officer at HSBC Bank Brasil, Senior Strategic Planning Executive at the HSBC Group in London and Local Director for Latin America at HSBC. Currently, he serves as the President of Fator Seguradora and as vice-president of the Fernand Braudel Institute of World Economics council. He also writes an opinion column for the newspaper *O Estado de São Paulo*.

*Francisco Luiz Sibut Gomide* Mr. Gomide has been an independent member of our board of directors since April 2017 and was a member of our Audit Committee from May 2017 to August 2017. He holds a Bachelor's degree in Civil Engineering and Economic Sciences from the Federal University of Paraná (*Universidade Federal do Paraná*) and a PhD in Hydrology and Water Resource from the Colorado State University. He was Minister of Mines and Energy in 2002, President of ESCELSA – Espírito Santo Centrais Elétricas S.A. between 1995 and 2001, President of the Energy Company of Mato Grosso do Sul between 1997 and 2001, General Manager of Itaipu Binacional between 1993 and 1995. Mr. Gomide was also a professor at the Federal University of Paraná (*Universidade Federal do Paraná*) from 1970 to 1995 and the President and Chief Financial Officer of the Energy Company of Paraná (*Companhia Paranaense de Energia – Copel*) between 1986 and 1993 and from 1983 to 1985, respectively. He was also a hydraulic engineer at the Energy Company of Paraná between 1969 and 1982.

*Lucas Navarro Prado.* Mr. Prado has been an independent member of our board of directors and a member of our Audit Committee since August 2017. He holds a law degree from the University of São Paulo (*Universidade de São Paulo - USP*) and a master's degree in Corporate Finance and Investment Banking from the University of São Paulo's Business Institute Foundation (FIA-USP). From 2005 to 2007, he served as the advisor to the public-private partnership division of the Planning, Budget and Management Ministry of Brazil. Mr. Prado served as an advisor to SABESP's CEO between 2007 and 2009 and as the head of SABESP's legal department between 2009 and 2011.

*Ernesto Rubens Gelbcke.* Mr. Gelbcke has been an independent member of our board of directors since April 2018. Mr. Gelbcke has a Bachelor's degree and a Master's degree in accounting sciences, both from the School of Economics, Administration and Accounting of the University of São Paulo (Faculdade de Economia, Administração e Contabilidade da Universidade de São Paulo – FEA USP). He worked at Arthur Andersen (various positions, including São Paulo audit coordinator and member of the Brazil technical policies committee) from 1965 to 1976, Directa Auditores (founder and CEO) from 1977 to 2014, Grant Thornton Brasil (chairman of the board of directors) from 2014 to 2015, Gelbcke Consultores (founder and consultant) since 2001, and GHG Contadores (founder) since 2017. He was one of the twelve elected members of the Accounting Pronouncements Committee, representing the Foundation Institute of Accounting, Actuary and Financial Research (Fundação Instituto de Pesquisas Contábeis, Atuariais e Financeiras – FIPECAFI) from its creation in 2006 until 2016. He was also a professor at FEA USP from 1971 to 2003, professor and coordinator of the audit specialization course at the Central Bank with the Foundation Institute for Accounting, Actuarial and Financial Research (Fundação Instituto de Pesquisas Contábeis, Atuariais e Financeiras – FIPECAFI) from 1978 to 1980, among others. He has authored and co-authored various articles, technical opinions and books, such as “Accounting Manual for Stock Companies” (Manual de Contabilidade das Sociedades por Ações), “Manual for Corporate Accounting” (Manual de Contabilidade Societária), and “Intermediate Accounting” (Contabilidade Intermediária). He was a member of the fiscal committee and of the audit committee of AMBEV S.A. from 2007 to 2009, a member of the Board of Directors of the Brazilian Institute of Independent



Accountants (Instituto dos Auditores Independentes do Brasil – IBRACON) from 2015 to 2017, and a member of the audit committee of AES Eletropaulo in 2017, among others. Since 2017, he has been a member of the fiscal council of FIPECAFI. This term expires in 2019.

*Rogério Ceron de Oliveira.* Mr. Oliveira has been a member of our board of directors since May 2018. Mr. Oliveira holds a Bachelor’s degree and a Master’s degree in economics from the State University of Campinas (Universidade Estadual de Campinas – UNICAMP) from 2005 to 2012, and is completing a doctorate in public administration at the Getúlio Vargas Foundation (Fundação Getúlio Vargas – FGV), with experience in public finance. Since 2017, he is the Deputy Secretary of the Treasury of the State of São Paulo. He served in the São Paulo Municipal Government as Finance Secretary between 2015 and 2016, Deputy Secretary of Finance in 2015, Deputy Secretary of Treasury from 2001 to 2014 and Chief and Advisor of Economics for the Finance Department between 2007 and 2010. He also worked at the Accounting Court of the State of São Paulo in 2006 and worked as a researcher at CPqD Telecom & IT Solutions between 2001 and 2005. He was and is a member of the boards of directors and of the fiscal committees of companies such as the São Paulo Company for the Development and Mobilization of Assets (Cia. São Paulo de Desenvolvimento e Mobilização de Ativos – SPDA), SP Negócios and the Paulista Company of Securitization (Companhia Paulistana de Securitização – SPSEC). He was also a member of the fiscal council of the São Paulo Metro Company (Companhia Metropolitana de São Paulo – Metro).

### ***Board of Executive Officers***

Our board of executive officers is composed of six executive officers appointed by our board of directors for a two year term. Such terms may be renewed three consecutive times. Our executive officers are responsible for all matters concerning our day to day management and operations. Members of our board of executive officers have individual responsibilities established by our board of directors and our bylaws.

The following are the names, ages, positions, dates of election and brief biographical descriptions of our board of executive officers:

<b>Executive Officer</b>	<b>Age</b>	<b>Position</b>	<b>Date Elected</b>
Karla Bertocco Trindade	41	Chief Executive Officer	May 14, 2018
Manuelito Pereira Magalhães Junior	50	Corporate Management Officer	June 22, 2017
Rui de Britto Álvares Affonso	60	Chief Financial Officer and Investor Relations Officer	June 22, 2017
Paulo Massato Yoshimoto	65	Metropolitan Region Officer	June 22, 2017
Luiz Paulo de Almeida Neto	62	Regional Systems Officer	June 22, 2017
Edison Airoidi	61	Technology, Enterprises and Environment Officer	June 22, 2017

*Karla Bertocco Trindade.* See above, “—Board of Directors”.

*Manuelito Pereira Magalhães Júnior.* Mr. Magalhães has been our Corporate Management Officer since February 2011. He holds a degree in Economic Sciences from the State University of Campinas (*Universidade Estadual de Campinas – UNICAMP*). Mr. Magalhães was a member of our board of directors from January 2007 to February 2011. From 2009 to 2011 he was the Chief Executive Officer of *Empresa Paulista de Planejamento Metropolitano – EMPLASA*. From 2006 to 2009 he was the Secretary of Planning of the Municipality of São Paulo and from 2005 to 2006 he was the Deputy Secretary of the Planning Secretariat. From 2003 and 2004 he was Ombudsman of the National Supplementary Health Agency. From 1998 to 2002, he was the special advisor of the Ministry of Health. He was also a parliamentary advisor in the Federal Senate from 1997 to 1998.



*Rui de Britto Álvares Affonso.* Mr. Affonso has been our Chief Financial Officer and Investor Relations Officer since July 2003. Mr. Affonso holds a PhD and a Master's degree in Economics from the State University of Campinas (*Universidade Estadual de Campinas – UNICAMP*), and a degree in Economics from the University of São Paulo (*Universidade de São Paulo - USP*). He has been a professor at UNICAMP since 1986, a professor at the Business, Economics and Accounting School of USP from 1983 to 1989, and a Director of Public Economy at the Foundation of Administrative Development (*Fundação do Desenvolvimento Administrativo*) from 1994 to 2003. He also represented Brazil on the board of directors of the Forum of Federations, a non governmental entity located in Canada, from 2000 to 2006. Mr. Affonso has also held several positions in state government.

*Paulo Massato Yoshimoto.* Mr. Yoshimoto has been our Metropolitan Region Officer since February 2004. He holds a degree in Civil Engineering from the Lins School of Engineering (*Escola de Engenharia de Lins*). Mr. Yoshimoto joined us in 1983, and has held the positions of executive assistant to the operations office and head of the water production and maintenance and metropolitan planning departments. Mr. Yoshimoto has also held the position of senior planning professional at *Empresa Metropolitana de Planejamento* from 1975 to 1983.

*Luiz Paulo de Almeida Neto.* Mr. Almeida Neto has been our Regional Systems officer since January 2011. He holds a degree in Civil Engineering from the Polytechnic School at the University of São Paulo (*Universidade de São Paulo - USP*), a degree in Business Administration from the Votuporanga Educational Foundation (*Fundação Educacional Votuporanga/SP*) and a post graduate degree in Sanitary Engineering from the School of Public Health at USP. Mr. Almeida joined us in 1979 and has worked with us as head of the Baixo Tietê Business Unit responsible for the management of areas located in the hydrographic basins of Baixo Tietê, Tietê Batalha, São José dos Dourados and Turvo Grande. Mr. Almeida Neto has authored several articles.

*Edison Airoidi.* Mr Airoidi has been our Technology, Enterprises and Environment Officer since June 2015. He holds a degree in Mechanical Engineering from the Polytechnic School at the University of São Paulo (*Universidade de São Paulo - USP*) and a Master's degree in Business Administration from the Foundation Institute of Administration (*Fundação Instituto de Administração - FIA*). Mr. Airoidi joined us in 1981 and has worked with us as the Head of the Northern Region business unit, the Water Production business unit and the Technical and Integrated Planning Unit.

## **B. Compensation**

Pursuant to Brazilian Corporate Law, our shareholders are responsible for establishing the aggregate amount of compensation we pay to the members of our board of directors, members of our fiscal committee and our executive officers. According to Instruction No. 480 issued by CVM, we have to periodically disclose certain information on the aggregate compensation such as averages and fringe benefits.

In 2017, 2016 and 2015, the aggregate compensation, including benefits in kind granted that we paid to members of our board of directors, board of executive officers and fiscal committee for services in all capacities were R\$4.4 million, R\$4.4 million and R\$4.6 million, respectively. At our annual shareholders' meeting held on April 27, 2018, our shareholders approved R\$4.7 million in aggregate compensation payable to members of our board of directors, members of our fiscal committee and our executive officers in 2018.

The tables below sets forth the breakdown of the total compensation received by our directors and members of our board of executive officers and fiscal committee and other data related to their compensation for the periods indicated:

	<b>Year ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>

*(in thousands of R\$, except where indicated otherwise)*

<b>Total compensation per administrative body</b>			
Board of directors	848	923	1,139
Board of executive officers	3,208	3,184	3,135
Fiscal committee	313	299	324
<b>Total amount of compensation</b>	<b>4,369</b>	<b>4,406</b>	<b>4,598</b>
<b>Number of members (in individuals)</b>			
Board of directors	7	8	10
Board of executive officers	6	6	6
Fiscal committee	5	5	5
<b>Fixed annual compensation</b>			
Salary			
Board of directors	659	710	878
Board of executive officers	1,856	1,877	1,781
Fiscal committee	247	243	252
Direct and indirect benefits			
Board of directors	189	213	262
Board of executive officers	796	812	833
Fiscal committee	66	56	72
<b>Variable compensation</b>			
Bonus			
Board of directors	-	-	-
Board of executive officers	556	494	521
Fiscal committee	-	-	-
<b>Maximum amount of compensation</b>			
Board of directors	156	157	157
Board of executive officers	691	618	581
Fiscal committee	62	61	66
<b>Minimum amount of compensation</b>			
Board of directors	96	96	96
Board of executive officers	439	420	494
Fiscal committee	62	51	64
<b>Average amount of compensation</b>			
Board of directors	121	114	114
Board of executive officers	535	531	489
Fiscal committee	62	61	60

### ***Profit Sharing and Pension Plans***

We have established a pension and benefit fund (*Fundação SABESP de Seguridade Social*), or SABESPREV, to provide our employees with retirement and pension benefits. This pension plan provides benefit payments to former employees and their families. Both we and our employees make contributions to the pension plan under SABESPREV, which we called as plan G1. Our total contributions to the pension plan totaled R\$48.7 million, R\$24.3 million and R\$23.7 million in 2017, 2016 and 2015, respectively. In addition to the pension plan under SABESPREV, we are also required to pay supplemental pension payments relating to the employment contract of certain employees prior to the creation of SABESPREV, which we called as plan G0. Based on independent actuarial reports, as of December 31, 2017, our obligation under these both plans (G0 and G1) totaled R\$2,932.3 million. For further information on our pension plans see Note 20 to our financial statements included in this annual report.

Beginning in 2008, payments under the profit sharing plan were based both on general goals that evaluate us as a whole and on other goals that evaluate the performance of our different business units. Payments are proportionally reduced annually if the goals are not completely achieved.

We recorded profit sharing expenses of R\$94.4 million, R\$83.7 million and R\$76.6 million in 2017, 2016 and 2015, respectively. We do not have a stock option plan for our employees.

### **C. Board Practices**

The members of our board of directors are elected at an annual shareholders' meeting to serve a two year term. Such term may be renewed three consecutive times. Our next annual shareholders' meeting will be held on April 27, 2018. Our board of directors ordinarily meets once a month or when called by a majority of the directors or the chairman. See "Item 6.A. Directors and Senior Management—Board of Directors".

Our board of executive officers is composed of six executive officers appointed by our board of directors for a two year term. Such term may be renewed three consecutive times. Although our bylaws provide that the meetings of our board of executive officers shall be held at least twice a month, meetings are held on a weekly basis. See "Item 6.A. Directors and Senior Management—Board of Executive Officers".

None of our directors and/or executive officers is a party to an employment contract providing for benefits upon termination of employment. Those directors and officers who are also our employees will remain as our employees after their tenure as directors and/or officers, in this case, maintaining all benefits granted to our employees.

### ***Fiscal Committee (Conselho Fiscal)***

Our fiscal committee, which is established on a permanent basis, consists of a minimum of three and a maximum of five members and generally meets once a month. Our fiscal committee currently consists of four members and four alternates. Although each member must have his or her respective alternate, we currently only have three alternates due to the resignation of one of the alternates immediately following election. All of the current members of our fiscal committee were elected in the shareholders' meeting held on April 27, 2018. Their tenure will end on April 2019. The primary responsibility of the fiscal committee, which is independent from management and from the external auditors appointed by our board of directors, is to review our financial statements and report on them to our shareholders.

The following are the names, ages, position, date of election and brief biographical descriptions of the current and alternate members of our fiscal committee:

<b>Fiscal Committee Members</b>	<b>Age</b>	<b>Position</b>	<b>Date Elected</b>
Humberto Macedo Puccinelli	60	Member	April 27, 2018
Pablo Andres Fernandez Uhart	44	Member	April 27, 2018
Rui Brasil Assis	63	Member	April 27, 2018
Alexandre Pedercini Issa	36	Member	April 27, 2018
Gustavo Carvalho Tapia Lira	39	Alternate	April 27, 2018
César Aparecido Martins Louvison	57	Alternate	April 27, 2018
Leticia Pedercini Issa Maia	37	Alternate	April 27, 2018

*Humberto Macedo Puccinelli.* Mr. Puccinelli has been a member of our fiscal committee since April 2011. Mr. Puccinelli holds a degree in Economics from the Pontifical University of São Paulo (*Pontifícia Universidade Católica de São Paulo - PUC-SP*). He worked at the Economy and Planning Secretariat State of São Paulo (*Secretaria de Planejamento e Gestão do Estado de São Paulo*) from 1985 to 1995, at the Health State Department as Assistant Secretary from 1995 to 1996, at the State Treasury from 1996 to 2002, and at the Economy and Planning Secretariat State of São Paulo as Assistant Secretary in 2003. He has been the Technical Assistant of the State Treasury since January 2004.

*Pablo Andres Fernandez Uhart.* Mr. Uhart has been a member of our fiscal committee since April 2017. He holds a Bachelor's degree in Public Administration from the Getulio Vargas Foundation (*Fundação Getúlio Vargas – FGV - SP*) and an MBA from the Pontifical Catholic University of Rio de Janeiro (*Pontifícia Universidade Católica do Rio de Janeiro – PUC - RJ*). He also was an advisor to the São Paulo State Secretary (*Secretaria da Fazenda do Estado de São Paulo – FESP*) and has more than twenty years of experience in finance, having held the positions of Corporate Controller, Regional Head (Latin America) of Treasury Center and Corporate Finance, and Advisor & Risk Manager at Nestlé from 1995 to 2013.

*Rui Brasil Assis.* Mr. Assis has been a member of our fiscal committee since April 2014. He holds a degree in Civil Engineering from Escola de Engenharia de Lins. In the public sector, he worked for Lins City Hall from 1980 to

1983, the Water and Electricity Department from 1983 to 1999, the Water Resources, Sanitation and Construction Secretariat from 1999 to 2003, the Energy, Water Resources and Sanitation Secretariat from 2003 to 2007, the Energy Secretariat from 2007 to 2010 and the Sanitation and Water Resources Secretariat since 2011. Mr. Assis has been a member of the fiscal committee of the Foundation Hydraulic Technology Center (*Fundação Centro Tecnológico de Hidráulica*) since 2014. He has also served as a member of the deliberative council of the Foundation Agency of Alto Tietê Water Basis (*Fundação Agência de Bacia Hidrográfica do Alto Tietê*) from 2006 to 2014 and since 2017. Mr. Assis was a member of the fiscal committee of EMAE from 2007 to 2011, the board of directors of the Association for Water Management of the Paraíba do Sul River Basin (*AGEVAP*) from 2003 to 2006 and the board of directors of the *Companhia Ambiental do Estado de São Paulo - CETESB* from 1999 to 2007.

*Alexandre Pedercini Issa.* Mr. Padercini has been a member of our fiscal committee since April 2017. He holds a Bachelor's degree in Administration from Milton Campos College (*Faculdade Milton Campos*) and an MBA in Strategic Business Management from the Foundation for Education and Culture of Minas Gerais (*Fundação Mineira de Educação e Cultura – FUMEC*). He was a member of the Board of Directors of the Sanitation Company of Minas Gerais State (*Companhia de Saneamento de Minas Gerais – COPASA*) from 2011 to 2016, a member of the fiscal committee of the Telecommunications provider that is part of the Minas Gerais Energy Company Group (*Companhia Energética de Minas Gerais – CEMIG*) between 2013 and 2015. Additionally, he is also the founder and administrator of the investment club Letalex.

Gustavo Carvalho Tapia Lira. Mr. Tapia has been a member of our fiscal committee since April 2018. He holds a Bachelor's degree in Administration and a Master's degree in Political Economics, both from the Pontifical University of São Paulo (Pontifícia Universidade Católica de São Paulo – PUC-SP). Since 2013, he has been the expert advisor of the Management and Planning Secretariat's Office (Gabinete da Secretaria de Planejamento e Gestão), where he also served as an economic advisor public executive from 2009 to 2013. He also worked as an examiner for the Fundação Procon-SP, from 2005 to 2008. He was a member of the fiscal committee of the Paulista Company of Events and Tourism (*Companhia Paulista de Eventos e Turismo – CPETUR*) and is currently a member of the fiscal committee of the São Paulo Retirement Plan (São Paulo Previdência – SPPREV).



*César Aparecido Martins Louvison.* Mr. Louvison has been a member of our fiscal committee since April 2017. He holds a Bachelor's degree in Law from the University of Marília (*Universidade de Marília*) and was a professor in several universities and secondary schools (1981-2006). He is currently the Technical Director III of Hydrological Resources Department and was previously a Public Executive at the Secretariat for Sanitation and Water Resources (*Secretaria de Saneamento e Recursos Hídricos do Estado de São Paulo*) between 2013 and 2017. He has also been an administrative director of the Barueri Campus of the Pontifical Catholic University of São Paulo (*Pontifícia Universidade Católica de São Paulo – PUC - SP*) between 2010 and 2011, an Administrative Officer of the Office for the Development of Sanitary Education and Mass Immunization (*Fomento de Educação Sanitária e Imunização em Massa – FESIMA*) between 2000 and 2007, Planning and Control Technical Assistant II of the Justice and Citizenship Defense Secretariat's Office of the State of São Paulo (*Secretaria de Estado da Justiça e Defesa da Cidadania de São Paulo*) between 1998 and 1999, and director of the Brazilian detention center for the youth (*Fundação do Bem-Estar do Menor – FEBEM-SP*) from 1996 to 1998.

*Leticia Pedercini Issa Maia.* Ms. Pedercini has been a member of our fiscal committee since April 2017. She holds a Bachelor's degree in Administration from the Administrative School of Minas Gerais (*FEAD Minas - Centro de Gestão Empreendedora*). She is the founder and manager of Hydrocenter Válvulas Tubos e Conexões Ltda since 2004 and the Chief Financial Officer of GPI Distribuidora since 2012. She has also been the Vice-President of the Fiscal Council of the Sanitation Company of Minas Gerais State (*Companhia de Saneamento de Minas Gerais – COPASA*) from 2015 to 2016, the President of the Fiscal Council of the Sanitation Company of Minas Gerais State (*Companhia de Saneamento de Minas Gerais – COPASA*) from 2014 to 2015 and a member of the Fiscal Committee of the Sanitation Company of Minas Gerais State (*Companhia de Saneamento de Minas Gerais – COPASA*) from 2011 to 2014. Prior to that, she was a portfolio manager at Clube de Investimentos Letalex from 2007 to 2008 and the CFO of Grupo Dismetel from 1999 to 2004.

### ***Audit Committee***

Our bylaws provide for an audit committee to be comprised of three board members, who will cumulatively comply with the requirements of (i) independence, (ii) technical expertise, and (iii) identifying and complying with applicable exemptions in accordance with the United States Securities and Exchange Commission, or the SEC, and New York Stock Exchange, or NYSE, rules. Our Board of Directors determined that Jerônimo Antunes qualifies as a financial expert under the SEC rules. The members are appointed by the board of directors and pursuant to our bylaws, the members of our audit committee may be appointed simultaneously to their election to the board of directors or by a subsequent resolution.

The audit committee is mainly responsible for assisting and advising the board of directors in its responsibilities to ensure the quality, transparency and integrity of our published financial information and financial statements. The audit committee is also responsible for supervising all matters relating to the Code of Ethics and Conduct, accounting, internal controls, the internal and independent audit functions, compliance, risk management and internal policies, such as the related parties transaction policy. The audit committee and its members have no decision making powers or executive functions.

The minimum availability required from each member of the audit committee is thirty hours per month. Under our bylaws, the members shall exercise their roles for the same period as their corresponding term of office, or until otherwise resolved by the general shareholders' meeting or by resolution of the board of directors. In the event that an audit committee member resigns or is removed from office after exercising any portion of his or her term, such member may only rejoin the audit committee at least three years from the end of such member's term. All of our audit committee members are independent.

The following are the names, positions and dates of election of the members of our audit committee:

<b>Director</b>	<b>Position</b>	<b>Date Elected</b>
Jerônimo Antunes	Coordinator and Financial Expert	May 12, 2016
Lucas Navarro Prado	Member	August 24, 2017
Luís Eduardo Alves de Assis	Member	September 30, 2016

***Regulatory Affairs Committee***

In April 2011, we created a regulatory affairs committee, which was comprised of our Chief Executive Officer, Chief Financial Officer and Investor Relations Officer, Metropolitan Officer, and Regional System Officer. The regulatory affairs committee was responsible for defining our regulatory directives, strategies and guidelines and coordinating our regulatory affairs department, under the directives of our executive board.

In our annual shareholders' meeting, held on April 27, 2018, our bylaws were amended and this committee was terminated. Regulatory affairs matters are currently handled by our executive officers.

***Eligibility and Advisory Committee***

In accordance with Federal Law No. 13,303/16, and pursuant to our bylaws, as approved at the extraordinary shareholders' meeting held on April 27, 2018, we will create an Eligibility and Advisory Committee, responsible for supervising the process for the appointment and evaluation of members of our board of directors, executive board and fiscal council.

This committee will be composed of up to three members, elected by a general shareholders' meeting. Members must have at least three years' professional experience in public administration, or three years' experience in the private sector in an area in which, or related to which, we operate.

Members of the Eligibility and Advisory Committee may attend board of directors' meetings where matters related to this committee are discussed and will have the right to speak, but not to vote, in accordance with our bylaws.

This committee will be also responsible for providing methodological and procedural support to the board of directors to evaluate the performance of officers and other members of statutory committees.

We expect that a written charter addressing the committee's purpose and detailing its required responsibilities will be approved by the board of directors.

**D. Employees**

As of December 31, 2017, we had 13,672 full time employees. On December 31, 2017, we had 910 interns and 540 apprentices (*aprendizes*), as defined by Federal Law No. 10,097/2000, dated December 19, 2000, as amended.

The following table sets forth the number of our full time employees by main category of activity and geographic location as of the dates indicated:

	<b>As of December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
<b>Number of employees by category of activity:</b>			
Projects and operations	9,176	9,456	9,489
Administration	2,147	2,220	2,211
Finance	387	424	440
Marketing	1,962	2,037	2,083
<b>Number of employees by corporate division:</b>			
Head office	1,342	1,389	1,377
São Paulo metropolitan region	6,353	6,634	6,612
Regional Systems	5,977	6,114	6,234
<b>Total number of employees</b>	<b>13,672</b>	<b>14,137</b>	<b>14,223</b>

The average tenure of our employees is approximately 19.5 years. We also outsource certain services such as maintenance, delivery of water and sewage bills, meter reading, catering and security. We believe that our relations with our employees are generally satisfactory.

Approximately 70% of all our employees are members of unions. The five main unions that represent our employees are (i) the Union of Workers in Water, Sewage and Environment of the State of São Paulo – SINTAEMA; (ii) workers union of Santos Urban Industries, Baixada Santista region, South Coast and Vale Ribeira – SINTIUS; (iii) the Union of Engineers of the State of São Paulo – SEESP; (iv) the Union of Attorneys of the State of São Paulo – SASP; and (v) the Union of Industrial Technicians of the State of São Paulo – SINTEC.

The collective bargaining agreement signed in 2014 resulted in: (i) a salary increase of 5.2% (which corresponds to the inflation adjustment for the period); (ii) the establishment of an employment guarantee for 98% of our employees; (iii) an increase of 8% in meal vouchers; (iv) an increase of 5.2% in food allowance; and (v) the termination of Regional Salary for which Sabesp adopted separate pay scales for Region 1 – São Paulo metropolitan region, Vale do Paraíba, Baixada Santista, Capivari/Jundiá and Litoral Norte – and Region 2 – other interior and coast cities. Region 2 employees received salaries at a ratio of 80% of the salaries of Region 1 employees. As a result of the collective agreement of 2014, equalization in salaries was conceded for the two regions in two stages: first, on May 1, 2014 with a salary increase from 80% to 90% and second, on May 1, 2015, from 90% to 100%.

The collective bargaining agreement signed in 2015 resulted in: (i) a salary increase of 8.29% (which corresponds to the inflation adjustment for the period plus a 1.01% real adjustment); (ii) the readjustment of 10% in the values of the meal vouchers and monthly food stipend; (iii) a readjustment of 8.29% for the remaining benefits; (iv) maintenance of the clause that guarantees the employment of 98% of our employees according to the 2014/2015 collective bargaining agreement; and (v) maintenance, in an exceptional character, of the Christmas food stipend.

The collective bargaining agreement signed in 2016 resulted in: (i) a salary increase of 10.03% (which corresponds to the inflation adjustment for the period); (ii) a 10.03% increase in meal vouchers, food stipends and nursery stipends; (iii) maintenance of the clause from the 2014/2015 collective bargaining agreement which guarantees the employment of 98% of our employees; (iv) and maintenance of the Christmas food stipend.

The collective bargaining agreement signed in 2017 resulted in: (i) a salary increase of 3.7% (which corresponds to the inflation adjustment for the period); (ii) a 7.1% increase in meal vouchers; (iii) a 36.1% increase in food assistance; (iv) a 8.39% increase in nursery stipends; (v) maintenance of the clause from the 2016/2017 collective bargaining agreement which guarantees the employment of 98% of our employees; and (vi) maintenance of the Christmas food stipend on an exceptional basis.

We experienced a two day strike in 2013, which did not interrupt the essential services that we provide. In 2017, 2016, 2015 and 2014 there were no strikes. Under Brazilian law, our non administrative employees are considered “essential employees” and, therefore, are limited in their right to strike.

## E. Share Ownership

As of May 24, 2018, none of our directors and executive officers owned any of our common shares. See “Item 7.A. Major Shareholder” for more information.

## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

### A. Major Shareholder

On April 22, 2013 our shareholders approved a stock split, following which each common share represented three new common shares. Since then, our outstanding capital stock consists of 683,509,869 common shares, without par value. Under state laws, the State is required to own at least one half plus one of our outstanding common shares. All of our shareholders, including the State, have the same voting rights.

The following table sets forth ownership information for each of our shareholders that beneficially owned 5.0% or more of our common shares and for our officers and directors, individually and as a group, as of April 2, 2018:

	Common shares	
	Shares	%
State of São Paulo	343,528,563	50.3%
Directors and executive officers of Sabesp	-	-
Lazard Asset Management	34,596,179	5.1%
Others	305,385,127	44.6%
<b>Total<sup>(1)</sup></b>	<b>683,509,869</b>	<b>100.0%</b>

(1) As of May 24, 2018, 49.7% of our outstanding common shares were held by 5,962 registered shareholders in Brazil.

As of April 2, 2018, 19.4% of our outstanding common shares were held in the United States, in the form of ADSs. According to the ADS depository’s records, which contain information regarding the ownership of our ADSs, there were, on March 31, 2018, 31 record holders of ADSs in the United States.

On May 12, 2017, we announced that the State of São Paulo’s Privatization Program Board, established by State Law No. 9,361/1996, dated as of July 5, 1996, resolved to take the following measures:

- (i) to proceed with studies aiming to provide alternatives to our current capitalization model;
- (ii) the hiring of the International Finance Corporation, a member institution of the World Bank Group; and
- (iii) the conclusion of an agreement between us and the São Paulo State Government, through the Secretariat of Sanitation and Water Resources and the Secretariat of Finance, to delineate the scope of the

International Finance Corporation's hiring and to govern the relationship between the contracting parties, including the proportional reimbursement of expenses.

The proposed capitalization plan provides for the creation of a new parent company to which the State of São Paulo would transfer all of its ownership interest in us, thus maintaining direct control over our operations through this new parent company. In the process, institutional investors may be invited to participate in the new company's capital, but the State of São Paulo will in any case retain sufficient shareholding interest to exercise corporate control, as required by law

In September 2017, the State of São Paulo obtained approval for State Law No. 16,525/2017, which authorizes the State of São Paulo to set up a controlling company to hold all of the shares that the State of São Paulo holds in our company. Once formed, this controlling company will control our company, pursuant to the provisions of Art. 116 of the Brazilian Corporate Law. State Law No. 16,525/2017 allows other minority shareholders, including private companies and state companies, to hold shares of the controlling company, provided that the State of São Paulo holds the majority of the common shares of the controlling company. On March 9, 2018, the State of São Paulo received a letter from a group of investors expressing interest in acquiring shares of the controlling company. This letter is being assessed by the State Privatization Program's Board (*Conselho Diretor do Programa Estadual de Desestatização - CDPED*), which has authority over our corporate reorganization, including the formation of the controlling company. The transaction proposed in the letter relates only to shares of the controlling company level and therefore would not affect the corporate control of our company, which will remain held by the State of São Paulo. The identity of the investors and the content of the letter remain confidential in accordance with the rules applicable to the administrative procedure established by CDPED for the purposes of operation.

## **B. Related Party Transactions**

### ***Transactions with the State of São Paulo***

We have entered into extensive transactions with the State, which is our controlling shareholder, and we expect to continue to do so. The State is our largest customer. It owns some of the facilities that we use in our business, it is one of the governmental entities that regulate our business, and it has assisted us in obtaining financing on favorable terms.

Many of our transactions with the State reflect policies of the State that depend on decisions of elected officials or public servants, and are accordingly subject to change. Among the practices that could change are those described below concerning the provision of State guarantees, and the terms on which we use State owned reservoirs.

### ***Rendering Services***

We provide water and sewage services to the federal government, state and municipal governments and government entities in the ordinary course of our business. Gross revenue from sales to the State, including State entities, totaled R\$463.0 million in 2017, R\$445.7 million in 2016 and R\$357.5 million in 2015. Our accounts receivable from the State for sanitation services totaled R\$106.0 million and R\$77.4 million, as of December 31, 2017 and 2016, respectively. In addition, as required by law, we invest our cash and cash equivalents with government financial institutions.

### ***Payment of Pensions***

Pursuant to a law enacted by the State, certain former employees of some State owned companies that provided services to us in the past and later merged to form our Company acquired a legal right to receive supplemental pension benefit payments. These rights are referred to as “Plan G0”. These amounts are paid by us, on behalf of the State, and are claimed by us as reimbursements from the State, as primary obligor. In 2017, 2016 and 2015, we made payments to former employees of R\$179.5 million, R\$178.7 million and R\$158.9 million, respectively, in respect of Plan G0. The State made reimbursements in 2017, 2016 and 2015 in the amounts of R\$192.9 million, R\$139.5 million and R\$121.7 million, respectively.

### ***Agreements with the State***

In September 1997, we and the State entered into a memorandum of understanding providing that we would, in effect, apply dividends we declared that were otherwise payable to the State to offset accounts receivable in connection with the provision of water and sewage services to the State and its controlled entities.

On December 11, 2001, we entered into an agreement with the State and the DAEE. Pursuant to this agreement, the State acknowledged and agreed, subject to an audit by a State appointed auditor, to pay us amounts it owed to us in respect of:

- water and sewage services we provided to governmental agencies, State owned autonomous entities and foundations through December 1, 2001, and that was not offset in accordance with the September 1997 memorandum of understanding, in the total amount of R\$358.2 million. This amount was renegotiated and included in the second amendment to this agreement discussed below; and
- supplemental retirement and pension benefits we paid from March 1986 to November 2001 on behalf of the State to former employees of the State owned companies which merged to form our Company; as we did not reach an

agreement regarding these amounts, a joint inquiry has commenced in order to ensure agreement between us and the State, in the total amount of R\$320.6 million. This amount was renegotiated and included in the third amendment to this agreement discussed below.



The agreement provided that the DAEE would transfer to us ownership of the Taiaçupeba, Jundiaí, Biritiba, Paraitinga and Ponte Nova reservoirs (herein after referred to as “the reservoirs”), which form the Alto Tietê system, and that the fair value of these assets would reduce the amounts owed to us by the State.

Under the December 2001 agreement, in 2002, a State owned construction company (*Companhia Paulista de Obras e Serviços*), or the CPOS, on behalf of the State, and an independent appraisal firm (*Engenharia de Avaliações*), or the ENGEVAL, on our behalf, presented their valuation reports relating to the reservoirs. Under the agreement, the arithmetic average of these appraisals is deemed the fair value of the reservoirs. The appraisals contained in these reports were in the amounts of R\$335.8 million and R\$341.2 million, respectively. Because we had already made investments in these reservoirs by then, the arithmetic average of the appraisals submitted to our board of directors by August 2002, R\$300.9 million, was net of a percentage corresponding to these investments. Our board of directors approved the valuation reports. This amount was updated until September 2008 according to IPCA index and amounted to R\$696.3 million.

Under the December 2001 agreement, for amounts due in excess of the fair value of the reservoirs, the State is to make payments in 114 consecutive monthly installments. The nominal amount owed by the State would not be indexed to inflation or earn interest if there was a delay in concluding the appraisal of fair value. The installments will be indexed on a monthly basis by the IGP M index, plus 6.0% per year, starting on the date the first installment becomes due.

On October 29, 2003, the Public Prosecution Office of the State of São Paulo (*Ministério Público do Estado de São Paulo*), on behalf of the people of the State, brought a civil public action in a Trial Court of the State of São Paulo (*12 Vara da Fazenda Pública do Estado de São Paulo*) alleging that a transfer to us of ownership of the Alto Tietê system reservoirs from the DAEE would be illegal. An injunction against the transfer of ownership of such reservoirs was granted but was later reversed. However, in October 2004, the court of first instance handed down its judgment on the civil public action and declared the agreement between us, DAEE and State of São Paulo null and void. This decision was suspended by us, and the State treasury and DAEE appealed the decision. On August 23, 2010, the appeal was denied. We have petitioned for clarification of the appeal court’s decision and will seek to take the case to the Supreme Court. The effects of the appeal court’s decision will be suspended until the end of the legal process. We have assessed that it is not probable that we will ultimately prevail in our appeal, which would prohibit the transfer of the reservoirs in payment of the accounts receivable due from the State.

The December 2001 agreement also provided that the legal advisors of the State would carry out specific analyses, which have commenced, to ensure agreement among the parties as to the methodology employed in determining the amount of reimbursement for pension benefits owed to us by the State. The commencement of payments with respect to pension amounts owed to us by the State has been postponed until these analyses are completed, the appraisal report is approved and the credit assignments relating to the transfer of the reservoirs are formalized. As discussed above, the transfer of these reservoirs is currently being disputed and we are not certain whether the transfer will be legally permitted. Under the December 2001 agreement, the first payment was to be made in July 2002.

On March 22, 2004, we and the State entered into a first amendment to the December 2001 agreement. Under this amendment, the State acknowledged that it owed R\$581.8 million to us relating to unpaid accounts receivable from the State until February 29, 2004, and we acknowledged that we owed an aggregate amount of R\$518.7 million to the State as dividends, in the form of interest on shareholders’ equity. Accordingly, we and the State agreed to offset each other’s credit up to the limit of R\$404.9 million, which was an amount adjusted up to February 2004. The outstanding balance of R\$176.9 million (as of February 29, 2004) of the State’s consolidated debt would be paid in consecutive monthly installments from May 2005 until April 2009. These installments would be indexed according to the IPCA index, plus an interest rate of 0.5% per month. Upon the execution of the first amendment, part of the debt that the State owed to us for the use of water and sewage services through February 2004 was offset by the debt that we owed

to the State as dividends, in the form of interest on shareholders' equity. The outstanding balance of R\$113.8 million as dividends in the form of interest on shareholders' equity that we owed to the State was netted against accounts overdue after February 2004. The first amendment did not amend the provisions of the December 2001 agreement regarding the supplemental retirement and pension benefits we paid from March 1986 to November 2001 on behalf of the State to former employees of the State owned companies.

On December 28, 2007, we and the State entered into a second amendment to the December 2001 agreement, pursuant to which the State agreed to pay (i) the outstanding balance under the first amendment, in the amount of R\$133.7 million (as of November 30, 2007), in 60 consecutive monthly installments, beginning on January 2, 2008, and (ii) the amount of R\$236.1 million relating to part of the accounts overdue and unpaid from March 2004 through October 2007 regarding the provision of water supply and sewage collection services. As part of this amendment, we agreed to pay during the period from January through March 2008 the outstanding balance of dividends in the amount of R\$400.8 million, in the form of interest on shareholders' equity, due from March 2004 through December 2006. We paid these amounts as agreed. Under the second amendment, dividends payable by us are no longer required to be applied to offset accounts receivable from the State, and as a result, we are currently unable to determine the amount, if any, of the declared dividends that the State will apply to current and future accounts receivable owed to us by the State or its entities. In addition, pursuant to the second amendment, we and the State agreed on complying with certain mutual obligations relating (i) to the improvement of payment processes and budget management procedures; (ii) the rationalization of the use of water and the volume of water and sewage bills under the responsibility of the State; (iii) the recording of government entities with accounts overdue in a delinquency system or reference file; and (iv) the possibility of interrupting water supply to these entities in case of non payment of water and sewage bills. Finally, this second amendment did not amend the provisions of the December 2001 agreement regarding the supplemental retirement and pension benefits we paid from March 1986 through November 2001 on behalf of the State to former employees of the State owned companies that merged to form our Company.

In 2007, we received payment installments from the State in the amount of R\$326.0 million. As of December 31, 2007, our dividends payable to the State, due from 2004 through 2007, were in the amount of R\$552.0 million. We are currently unable to determine the amount, if any, of the declared dividends that the State will apply to current and future accounts receivable owed to us by the State or its entities. The second amendment no longer requires that dividends be applied to offset accounts receivable from the State.

On March 26, 2008, we entered into a commitment agreement (*termo de compromisso*) with the State with the purpose of finding an alternate solution to the deadlock related to the amount owed by the State to us in connection with the supplemental retirement and pension benefits we paid from March 1986 to November 2001 on behalf of the State to former employees of the State owned companies which merged to form our Company. In this agreement, we and State committed to hiring specialized companies to carry out new valuations of the amounts owed to us by the State and of the reservoirs. An independent consulting firm, FIPECAFI, has been retained to resolve the disagreement and validate the amount we paid from March 1986 through November 2001 on behalf of the State to former employees of the State owned companies that merged to form our Company, which the State has not yet agreed to reimburse us hereinafter referred to as the “Disputed Reimbursement Amount”. In addition, FIPECAFI performed, together with another independent consulting firm, a new evaluation of the reservoirs that might be transferred to us as amortization of the reimbursement payable by the State to us.

On November 17, 2008, we, the State and DAEE entered into a third amendment to the December 2001 agreement, pursuant to which the State recognized a debt balance payable to us totaling R\$915.3 million, hereinafter referred to as the “Undisputed Reimbursement Amount,” as adjusted based on the IPCA. We accepted on a provisional basis the reservoirs as part of the payment of the Undisputed Reimbursement Amount and offered to the State a provisional settlement, recognizing a credit totaling R\$696.3 million, corresponding to the value of the reservoirs located in the Alto Tietê region. We and the State have agreed that the final offset will only be recorded when the effective transfer of the reservoirs is recorded at the Real Estate Registry. The outstanding balance of Undisputed Reimbursement Amount, amounting to R\$219.0 million, is being paid by the State in 114 consecutive monthly installments, as adjusted by the annual IPCA variation, plus interest accruing at the annual rate of 6.0%. The first installment was paid in November 2008.

On March 18, 2015, we, the State and DAEE, with the intervention of the Department of Sanitation and Water Resources, executed a term of agreement, in the amount of R\$1,012.3 million, of which R\$696.3 million refers to the principal amount and R\$316.0 million refers to the monetary adjustment of the principal through February 2015.

The principal amount is payable in 180 installments, as follows:

- The first 24 installments were settled by an immediate transfer of 2,221,000 preferred shares issued by the São Paulo Company of Electric Power Transmission (Companhia de Transmissão de Energia Elétrica Paulista - CTEEP), totaling R\$87.2 million, based on the share closing price as of March 17, 2015. As of April 20, 2016, the Company sold these shares for R\$111.1 million; and
- The amount of R\$609.1 million, payable in 156 monthly installments, was adjusted by IPCA until the initial payment date on April 5, 2017, after which installments are adjusted by IPCA plus simple interest of 0.5% per month.



Given that the lawsuit regarding the transfer of the reservoirs is pending final and unappealable court decision, the agreement also provides for the following:

- If transfer is possible and the reservoirs are effectively transferred to us and registered at the authority's office, we will reimburse to the State the amounts paid in replacement of the reservoirs (principal amount) in 60 monthly installments adjusted by IPCA until the payment date of each installment; and
- If the transfer of the reservoirs is not possible, the State will pay us, in addition to the principal amount, the inflation adjustment credit in the amount of R\$316.0 million in 60 installments, following payment of the principal amount. The amount will be adjusted based on IPCA at the start date of payments and, as of that date, IPCA will be incurred plus 0.5% simple interest rate/month over the amount of each installment.

In addition to the Undisputed Reimbursement Amount, there is an outstanding balance relating to the Disputed Reimbursement Amount. As of December 31, 2017, the Disputed Reimbursement Amount amounted to R\$1,021.7 million, but due to the uncertainty regarding the recovery of the amount our management decided not to recognize the reimbursements. See Note 10 to our financial statements included in this annual report regarding the Disputed Reimbursement Amount. We and the State have agreed that the dispute relating to the Disputed Reimbursement Amount will not prevent us from carrying out the commitments made in the December 2001 agreement.

In addition, the third amendment to the December 2001 agreement provides for the regularization of the monthly flow of benefits. While we are liable for the monthly flow of benefits to the former employees of the state owned companies that merged to form our Company, the State shall reimburse us based on criteria identical to those applied when determining the Undisputed Reimbursement Amount. Should there be no preventive court decision, the State will assume the flow of monthly payment of benefits portion deemed as undisputed.

Finally, the third amendment to the December 2001 agreement established that the Public Attorney's Office of the State of São Paulo, or the Public Attorney's Office, would issue a revised interpretation of the calculation and eligibility criteria applicable to the Disputed Reimbursement Amount. At that time, we believed that the Public Attorney's Office would issue a revised interpretation which would have helped us bring the negotiations with the State to a conclusion. However, contrary to our expectations, the Public Attorney's Office interpretation of the calculation and eligibility criteria applicable to the Disputed Reimbursement Amount refuted the reimbursement of the largest portion of this amount. As of December 31, 2017, we had made a provision of R\$2,543.9 million in our pension obligations accounts in respect of the pension benefit obligation of Plan G0.

Even though the negotiations with the State are still progressing, we cannot assure you that we will recover the receivables related to the Disputed Reimbursement Amount.

We will not waive the receivables from the State to which we consider ourselves to be legally entitled. Accordingly, we will take all possible actions to resolve the issue at all administrative and court levels. Should this conflict persist, we will take all the necessary actions to protect our interests. On March 24, 2010, we sent to the controlling shareholder the official letter approved by our executive committee, proposing that the matter be discussed at the B3 Arbitration Chamber. In June 2010, we sent a settlement proposal to the Secretary of Treasury, which was denied, and on November 9, 2010, we filed a civil lawsuit against the State of São Paulo seeking full reimbursement of the amounts paid as benefits granted by Law No. 4,819/1958. Regardless of the civil lawsuit, we will continue to actively seek a settlement with the State government.

***Agreement with the State and the city of São Paulo***

On June 23, 2010 the State and the city of São Paulo executed an agreement in the form of a *convênio*, to which we and ARSESP consented, under which they agreed to manage the planning and investment for the basic sanitation system of the city of São Paulo on a joint basis. The principal terms of this *convênio* were as follows:

- the State and the city of São Paulo would execute a separate agreement with us, granting us exclusive rights to provide water and sewage services in the city of São Paulo;
- ARSESP would regulate and oversee our activities regarding water and sewage services in the city of São Paulo, including tariffs;
- a management committee (*Comitê Gestor*), consisting of six members appointed for two-year terms, with the State and the city of São Paulo given the right to appoint three members each, would be responsible for planning water and sewage services for the city and for reviewing our investment plans; and

- we may participate in management committee meetings but may not vote.

In application of the *convênio*, we executed a separate contract with the State and the city of São Paulo, also dated June 23, 2010, to regulate the provision of these services for the following 30 years. The principal terms of this contract are as follows:

- The total investment stated in the contract must be equal to 13% of gross revenues from the provision of services to the city of São Paulo, net of the taxes on revenues.
- We must transfer 7.5% of the gross revenues obtained from providing sanitation services in the municipality of São Paulo and subtract (i) COFINS and PASEP taxes, and (ii) unpaid bills of publicly owned properties in the city of São Paulo, to the Municipal Fund for Environmental Sanitation and Infrastructure (*Fundo Municipal de Saneamento Ambiental e Infraestrutura*), established by Municipal Law No. 14,934/2009. In April 2013, ARSESP postponed the application of such municipal charges based on a request from the São Paulo State Government to analyze, among other things, methods to reduce the impact on consumers. In May 2014 ARSESP maintained the suspension of Resolution 407/2013 until the results are obtained in the revision of the contract signed between us, the city and the State of São Paulo, thereby delaying the authorization to pass the charge through to consumers on the service bill.
- Our investment plan must be compatible with the sanitation plans of the State, the city of São Paulo and, if necessary, the Metropolitan region.
- ARSESP will ensure that the tariffs will adequately compensate us for the services we provide and that tariffs may be adjusted in order to restore the original balance between each party's obligations and economic gain (*equilíbrio econômico financeiro*).

We currently have an investment plan in place that reflects our obligations under the *convênio* and addresses their compatibility with the sanitation plans of the State, the city of São Paulo and, if necessary, the São Paulo metropolitan region. The investment plan is not irrevocable and is reviewed every four years by our management committee. We draft a detailed work plan every two years, particularly with respect to the investments to be executed in the subsequent period. In December 2016, we concluded the first four-year revision of our contract with the city of São Paulo, which altered our service quality, investment and investment tracking targets. However, the issue of the 7.5% charge was not discussed.

In January 2018, the second step of our Second Ordinary Tariff Revision was initiated. In this review, the possibility of including the average tariff in the portion related to transfers to municipal funds, as is the case with the 7.5% that we transfer to the São Paulo Municipal Fund for Environmental Sanitation and Infrastructure, was discussed.

On May 9, 2018 ARSESP announced the final results of the Second Ordinary Tariff Revision, recognizing the regulatory limit of 4% of each municipality's direct operating revenue in the tariff calculation. As a result, 1.84% was declared the tariff for the Municipality of São Paulo, corresponding to the 4% regulatory limit.

On May 24, 2018, as a result of the final result of the Second Ordinary Tariff Revision, we filed a reconsideration request as well as a clarification and revision request with ARSESP. As part of the clarification and revision request, we requested that ARSESP provide a revision of the calculation of the financial component related to municipal funds. For more information, see "Item 4.B. Business Overview—Tariffs—Second Ordinary Tariff Revision (2017-2020)."

### ***Dividends***

We regularly pay dividends to our shareholders, including the State of São Paulo. In the past, we have withheld part of the dividends to which the State was entitled in order to offset it against our pending receivables from the State.

In accordance with our agreements with the State, we do not anticipate that we will withhold dividends to which the State was entitled in order to offset it against our pending receivables from the State in the near future.

### ***Government Guarantees of Financing***

In some situations, the federal government, the State or government agencies guarantee our performance under debt and project related agreements.

Furthermore, the federal government has guaranteed, and the State has provided a counter guarantee, in respect of the financial agreements we entered into with the IADB (i) in 1992 and 2000 for the total original aggregate amount of US\$600.0 million related to the financing of the first and second phases of the Tietê River recovery project to reduce pollution; and (ii) in 2010 for the aggregate amount of US\$600 million related to the financing of the third phase of the Tietê River project. The federal government has also guaranteed and the State of São Paulo has provided a counter guarantee, in respect of the financial agreement we entered with the IBRD in the amount of US\$100 million for the Water Source Program (*Programa Mananciais*).



We also entered into credit agreements with JICA, which were guaranteed by the federal government, with counter guarantee from the State of São Paulo, for the financing of (i) the Clean Wave Program for the Baixada Santista metropolitan region, on August 6, 2004, for an aggregate principal amount of ¥21,320 million; (ii) the second phase of the Clean Wave Program, in February 2011, for an aggregate principal amount of ¥19,169 million; (iii) the environmental improvement program in the basin of the Billings dam, in October 2010, for an aggregate principal amount of ¥6,208 million; and (iv) the Corporate Program for Water Loss Reduction, in February 2012, for an aggregate principal amount of ¥33,584 million.

For more information on the aforementioned loans, see “Item 5.B. Liquidity and Capital Resources—Indebtedness Financing”.

### *Use of Reservoirs*

We draw water for use in the São Paulo metropolitan area from the Guarapiranga and Billings reservoirs. We do not pay any fees for the use of these reservoirs, although we are responsible for maintaining them and funding their operating costs. The State incurs no operating costs on our behalf.

EMAE, a company that is also controlled by the State of São Paulo, has a concession to produce hydroelectric energy using water from the same reservoirs. EMAE commenced various lawsuits against us in the past seeking compensation for the water we draw from these reservoirs. Those lawsuits have now been settled by way of an agreement between EMAE and our company.

The settlement agreement settled the compensation arrangements between EMAE and our company regarding compensation for our capture and use of the water on the one hand, as well as apportionment of the maintenance, operation and monitoring costs for the reservoirs on the other hand. It requires us to pay the following amounts to EMAE:

- R\$46.3 million, plus inflation adjustments indexed to the IPCA index, payable in five annual installments from April 2017 through April 2022, plus
- R\$6.6 million, plus inflation adjustments indexed to the IPCA index, payable in 25 annual installments from October 2017 through October 2042.

If we fail to pay any installment to EMAE when due, all remaining amounts to be paid under the agreement will become immediately due and payable.

On April 11, 2016, we were also named in a separate lawsuit commenced by minority shareholders of EMAE against the State of São Paulo, as controlling shareholder of EMAE. The minority shareholders are seeking an order to require the State to stop us from drawing water from the reservoirs without paying compensation to EMAE, and to allow EMAE to pump water from the reservoirs for its hydroelectric facility. The plaintiffs allege that the State, in its capacity as controlling shareholder of EMAE, has acted unduly to EMAE’s detriment and in favor of our company. The settlement agreement between EMAE and us will not necessarily put an end to this separate lawsuit.

In addition, on August 7, 2017 we were named in a new lawsuit against us, EMAE and ANEEL, brought by Alvaro Luiz de Lima de Alvares Otero, another minority shareholder of EMAE, requesting the annulment of ANEEL’s order approving the settlement agreement mentioned above, as well as the condemnation of SABESP for indemnifying EMAE for damages suffered by EMAE. The plaintiff alleges that the order is illegal and harmful, jeopardizing the operational viability of the Henry Borden hydroelectric power plant, as well as the energy security of the State of São Paulo, the Southeast region of Brazil and Brazil as a whole. The judge dismissed this lawsuit without judgment on the

merits, but this decision remains subject to appeal.

If one of the ongoing lawsuits by minority shareholders of EMAE requires the State to make a different decision regarding water use, our ability to draw water from the Guarapiranga and Billings reservoirs may be compromised. If we were no longer able to draw water from these reservoirs, we would have to transport water from locations farther away, which would increase our water transportation costs and may affect our ability to provide adequate service in the region.

### ***Agreements with Lower Tariffs***

We have entered into agreements with public entities, including State entities and municipalities, which manage approximately 8,914 properties. Under these agreements, these public entities pay a different tariff which is approximately 25.0% lower than the tariff that applies for the public entities that have not entered into these agreements, provided such entities implement our Program for Rational Use of Water (*Programa de Uso Racional da Água – PURA*), which has a fixed target for reduction or maintenance of water consumption, according to technical evaluations carried out by us. These agreements are valid for a 12 month term with automatic renewal for equal periods. Pursuant to the terms of these agreements, if these entities fail to make any payment on a timely basis to us, we have the right to cancel the agreement, thereby revoking the 25.0% tariff reduction.

### ***Personnel Assignment Agreement among Entities Related to the State Government***

We have personnel assignment agreements with entities related to the State Government, under which the expenses are fully passed on and monetarily reimbursed. The expenses related to personnel assigned by us to other state government entities in 2017, 2016 and 2015 amounted to R\$9.9 million, R\$10.4 million, R\$10.5 million, respectively.

There were no expenses related to personnel assigned by other entities to us in 2017. The expenses related to personnel assigned by other entities to us totaled R\$0.01 million in 2016 and R\$0.3 million in 2015.

### ***Services Obtained from State Government Entities***

As of December 31, 2017 and 2016, we had an outstanding amount payable of R\$1.4 million and R\$1.9 million, respectively, for services rendered by São Paulo State government entities, including the supply of electric power by the Energy Company of São Paulo (*Companhia Energética de São Paulo –CESP*).

### ***Non operating Assets***

We lend land, free of charge, to DAEE. Such non operating assets totaled R\$1.0 million as of December 31, 2017 and 2016.

### ***Transactions with SABESPREV Pension Fund***

SABESPREV is a pension fund we established to provide our employees with retirement and pension benefits. The assets of SABESPREV are independently held, but we nominate 50.0% of SABESPREV's board of directors, including the chairman of the board, who has the deciding vote pursuant to the applicable legislation. Both we and our employees make contributions to SABESPREV pension plans. We contributed R\$19.2 million, R\$10.8 million and R\$9.5 million in 2017, 2016 and 2015, respectively. On May 29, 2001, a federal law was enacted which, among other provisions, limits the amount mixed capital companies, like us, may contribute to their pension plans. Specifically, the ordinary contributions made by us to our pension plans may not exceed the contributions made by the beneficiaries of these plans.

Our original pension plan (the Defined Benefit Plan) has an actuarial deficit. We have commenced studies to manage this deficit and have also created a new, Defined Contribution Plan (SABESPREV Mais). Our new plan was approved by Previc in June 2010, after which our old plan stopped accepting new members. Contributions to the new plan are also shared between plan members and Sabesp, and benefits are established based on the balance of the individual member's account when payment on his or her benefit begins. This balance consists of contributions and profitability obtained when applying resources. We intended to have members of the old plan migrate their reserves to the new plan. This migration was interrupted by a judicial order as a result of proceedings brought by representative entities for our employees and ex employees. In October 2010, the judge presiding over the case pronounced in an interim decision that people and reserves were not allowed to migrate between the plans until a further decision was made. This decision also prevents the plan from charging contributions to account for the deficit for those who remained covered by the original plan. In September 2012, the judge presiding over the case ordered a financial expert inspection and in early 2013 a financial expert was appointed to the case. The results of this inspection were unfavorable to the representative entities for our employees and ex employees and in 2016 the proceeding was dismissed, revoking the interim decision made in October 2010.

In 2016, participants were again offered the ability to migrate according to the rules established by the regulatory authority. The Retiree and Pensioner Association filed a judicial proceeding questioning the amounts that were transferred from the benefits plan to the individual accounts of the participants who migrated to the Defined

Contribution Plan. On March 14, 2018, the judge presiding over the case held that the adjustment of the Defined Benefit Plan's actuarial deficit was permitted and terminated the lawsuit related to the migration process of members from the Defined Benefit Plan to the Defined Contribution Plan.

*Compensation of Management*

The compensation paid by us to the members of our board of directors, board of executive officers and fiscal committee amounted to R\$3.8 million, R\$3.9 million and R\$4.1 million in 2017, 2016 and 2015, respectively, and it refers to salaries and other short term benefits management. An additional R\$0.6 million, R\$0.5 million and R\$0.5 million related to the bonus program was accrued to executive officers in 2017, 2016 and 2015.

For further information on management compensation, see “Item 6.B. Directors and Senior Management—Compensation”.

### ***Loan agreement through credit facility***

We hold interests in some companies. Although we do not hold the majority of shares in any of the companies in which we hold interests, we are party to shareholders’ agreements which provide for the power of veto with regard to certain management proposals and decisions. Due our significant influence on these companies by way of shareholders’ agreements, for accounting purposes, these companies are accounted for by applying the equity method of accounting.

We entered into loan agreements with the special purpose enterprises Aquapolo Ambiental S.A. on March 30, 2012 and Attend Ambiental S.A. on May 9, 2014 under which we made loans to finance their respective operations, until their loans due to banks are cleared.

The table below summarizes the terms of those agreements at December 31, 2017:

<b>Companies</b>	<b>Principal disbursed</b>	<b>Interest balance</b>	<b>Total</b>	<b>Interest rate</b>	<b>Maturity</b>
Attend Ambiental S.A.	5,400	3,877	9,277	SELIC + 3.5% p.a. CDI +	(1)
Aquapolo Ambiental S.A.	5,629	5,209	10,838	1.2% p.a. CDI +	(2)
Aquapolo Ambiental S.A.	<u>19,000</u>	<u>11,502</u>	<u>30,502</u>	1.2% p.a.	(3)
<b>Total</b>	<b><u>30,029</u></b>	<b><u>20,588</u></b>	<b><u>50,617</u></b>	-	-

(1) The loan agreement with Attend Ambiental S.A. had a renewable term of 180 days, starting from the date the funds were made available to the borrower. The credit facility became overdue on May 11, 2015 and is subject to default interest, including monetary correction based on the General Market Price Index (*Índice Geral de Preços do Mercado*, or IGP-M), a 2% penalty fee and interest on arrears of 1% per month. This contract is currently being renegotiated among the parties.

(2) The R\$5.7 million loan agreement originally expired on April 30, 2016. As of February 10, 2016, an amendment to the agreement changed the payment schedule for four annual installments, the first of which matures on December 30, 2018 and the last of which matures on December 30, 2021.

(3) The loan agreement totaling R\$19 million originally matured on April 30, 2015, but was extended to October 30, 2015, and on November 25, 2015 a new amendment changed the payment schedule for three annual installments,

the first of which matures on December 30, 2021 and the last of which matures on December 30, 2023.

The amount disbursed is recognized as assets, under “Other receivables,” in the amount of R\$1.8 million in current assets and the amount of R\$48.8 million in noncurrent assets. As of December 31, 2017, the total principal and interest due under these loan agreements is R\$50.6 million. The nonpayments reduced our financial income by R\$5.0 million in 2017.

***Pró-Conexão***

In 2012, the State of São Paulo approved a project to subsidize connections to the sewage system for low income families. Initially intended to last eight years, the project involves capital expenditures of up to R\$349.5 million of which 80% will be provided by the State government and 20% by us. In this period we expect that this program will create 192,000 new sewage connections benefiting approximately 800,000 people.

As of December 2017, we had completed approximately 23.5 thousand sewage connections under the *Pró-Conexão* program.

**C. Interests of Experts and Counsel**

Not applicable.

## **ITEM 8. FINANCIAL INFORMATION**

### **A. Financial Statements and Other Financial Information**

See “Item 18. Financial Statements”.

#### **Legal Proceedings**

We are currently subject to numerous legal proceedings relating to civil, tax, labor, corporate and environmental issues arising in the normal course of our business. Several individual disputes account for a significant part of the total amount of claims against us. Our material legal proceedings are described in Note 19 to our financial statements included in this annual report, and that description is incorporated by reference under this Item.

#### ***Civil Public Actions Related to Environmental Matters***

We are subject to administrative and judicial proceedings, including proceedings initiated by the *Companhia Ambiental do Estado de Sao Paulo* (CETESB), the Office of the Public Prosecutor of the State of São Paulo and non-governmental organizations. These proceedings result from alleged environmental damage and relief sought against us includes: (i) cessation of the release of raw sewage into certain local bodies of water; (ii) remedies, in some cases, for environmental damages that have not yet been specified and evaluated by the court’s technical experts; (iii) requirements to install and operate sewage treatment facilities in locations referred to in the civil public actions; and (iv) imposition of a limit on water extracted from the water springs most affected by the water crisis. In certain cases, we are subject to daily fines for non compliance. In our response to these lawsuits, we note that the installation and operation of sewage treatment facilities in locations referred to in the civil public actions is included in our investment plan. There have already been unfavorable judicial decisions against us and their effects may include: (i) investment in works or services not considered by our long term investment plan; (ii) early execution of works or services that were considered for execution in future years in our long term investment plan; (iii) payments related to environmental indemnification; and (iv) a negative impact on our image in national and international markets and in public bodies.

Although we are not able to predict the final outcome of these lawsuits, we believe that the outcome, if unfavorable to us, may have a material adverse effect on us. We recognize provisions for classify certain of these proceedings as defined in Note 3.15 to our financial statements included in this annual report. As of December 31, 2017 we have provisions totaling R\$160.4 million for the matters stated in Note 19 to our financial statements included in this annual report.

#### **Other Legal Proceedings**

The Civil Entity Coordination Committee of Piracicaba on December 30, 2003 filed a civil public action against us, the National Water Agency and the State of São Paulo Treasury Department seeking, among other claims for relief: (i) the termination of use of 31 m<sup>3</sup>/s of water from one of the municipality’s reservoirs; (ii) the creation of a schedule to regulate water use and withdrawal from the Piracicaba river basin by the Cantareira system to eliminate possible damage to populations downstream; and (iii) the development of an environmental impact study on the Cantareira system evaluating the impact of water use and withdrawal on the various basins that constitute the system. In August 2012, this civil public action was decided favorably for us in two lower courts, and the plaintiff’s appeal to a higher court seeking special and extraordinary recourse was denied based on inadmissibility. We are currently awaiting a court decision on the action brought by the plaintiff against the decisions of inadmissibility cited. The amount involved in this proceeding as of December 31, 2017 is R\$24.9 billion. We have assessed that we do not have a current obligation as a result of a past event, and accordingly have not made any provisions.

The Public Prosecutor's Office of the State of São Paulo on November 30, 2012 filed a civil public action against us seeking: (i) the nullification of the contract we entered with the Municipality of São Paulo on June 23, 2010 regarding the service of water supply and sewage services; (ii) our exclusion from the B3's Corporate Sustainability Index; and (iii) sewage treatment coverage of the entire Municipality of São Paulo by 2018. The plaintiff's request for an injunction was denied, and the courts maintained this decision after we presented our defense. On November 18, 2014, the case was dismissed in the first instance, and the plaintiff then appealed this dismissal. We are currently waiting the court's ruling on the appeal. The amount involved in these proceedings is R\$15.9 billion as of December 31, 2017. We have assessed that we do not have a current obligation as a result of a past event, and accordingly have not made any provisions.

## **Dividends and Dividend Policy**

### *Amounts Available for Distribution*



At each annual shareholders' meeting, the board of directors is required to recommend the allocation of net profits for the preceding fiscal year. For purposes of Brazilian Corporate Law, net profits are defined as net income after income tax and social contribution tax for such fiscal year, net of any accumulated losses from prior fiscal years and any amounts allocated to employees' and management's participation in our profits. In accordance with Brazilian Corporate Law, the amounts available for dividend distribution are the amounts equal to half of the net profit as increased or reduced by:

- the amount intended to form the legal reserve; and
- the amount intended to form the reserves for contingencies and any written-off amounts of the same reserves formed in previous fiscal years.

We are required to maintain a legal reserve, to which we must allocate 5.0% of net profits for each fiscal year until the amount for such reserve equals 20.0% of our paid in capital. However, we are not required to make any allocations to our legal reserve in respect of any fiscal year in which the aggregate amount of the legal reserve plus our other established capital reserves exceeds 30.0% of our capital. Net losses, if any, may be offset against the legal reserve. As of December 31, 2017, 2016 and 2015 the balance of our legal reserve was R\$1,058.3 million, R\$923.3 million and R\$785.0 million, respectively, which was equal to 10.6%, 9.3% and 7.8%, respectively, of our capital.

Brazilian Corporate Law also provides for two discretionary allocations of net profits that are subject to approval by the shareholders at each annual shareholders' meeting. First, a percentage of net profits may be allocated to a contingency reserve for anticipated losses that are deemed probable in future years. Any amount so allocated in a prior year must be either reversed in the fiscal year in which the loss was anticipated if such loss does not in fact occur, or written off in the event that the anticipated loss occurs. Second, if the mandatory distributable amount exceeds the sum of realized net profits in any given year, such excess may be allocated to an unrealized revenue reserve. Under Brazilian Corporate Law, realized net profits is defined as the amount of net profits that exceeds the net positive result of equity adjustments and profits or revenues from operations with financial results after the end of the next succeeding fiscal year.

Under Brazilian Corporate Law, any company may authorize in its bylaws the creation of a discretionary reserve. Bylaws which authorize the allocation of a percentage of a company's net income to the discretionary reserve must also indicate the purpose, criteria for allocation and maximum amount of the reserve. We may also allocate a portion of our net profits for discretionary allocations for plan expansion and other capital investment projects, the amount of which would be based on a capital budget previously presented by management and approved by our shareholders. Under Law No. 10,303/2001 of October 31, 2001, as amended, capital budgets for more than one year must be revised at each annual shareholders' meeting. After completion of the relevant capital projects, we may retain the allocation until the shareholders vote to transfer all or a portion of the reserve to capital or retained earnings. As of December 31, 2017, 2016 and 2015 we had an investment reserve of R\$6,939.3 million, R\$5,249.8 million and R\$3,273.6 million, respectively.

The amounts available for distribution may be further increased by a reversion of the contingency reserve for anticipated losses constituted in prior years but not realized. The amounts available for distribution are determined on the basis of our financial statements prepared in accordance with Brazilian GAAP.

The legal reserve is subject to approval by the shareholder vote at our annual shareholders' meeting and may be transferred to capital but is not available for the payment of dividends in subsequent years.

### ***Mandatory Distribution***

Brazilian Corporate Law generally requires that the bylaws of each Brazilian corporation specify a minimum percentage of the amounts available for distribution by such corporation for each fiscal year that must be distributed to shareholders as dividends, also known as the mandatory distributable amount. Under our bylaws, the mandatory distributable amount has been fixed at an amount equal to not less than 25.0% of the amounts available for distribution, to the extent amounts are available for distribution at the end of each given fiscal year.

The mandatory distribution is based on a percentage of adjusted net income, not lower than 25.0%, rather than a fixed monetary amount per share. Brazilian Corporate Law, however, permits a publicly held company, such as us, to suspend the mandatory distribution if the board of directors and the fiscal committee report to the shareholders' meeting that the distribution would be inadvisable in view of the company's financial condition. The suspension is subject to the approval of holders of common shares. In this case, the board of directors must file a justification for such suspension with the CVM. Profits not distributed by virtue of the suspension mentioned above shall be attributed to a special reserve and, if not absorbed by subsequent losses, must be paid as dividends as soon as the financial condition of such company permits such payments.

### ***Payment of Dividends***

We are required by Brazilian Corporate Law and by our bylaws to hold an annual shareholders' meeting by the fourth month after the end of each fiscal year at which, among other things, the shareholders have to decide on the payment of an annual dividend when profits were accrued. The decision to distribute annual dividends is based on the financial statements prepared for the relevant fiscal year. Under Brazilian Corporate Law, dividends generally are required to be paid within 60 days following the date the dividend was declared, unless a shareholders' resolution sets forth another date for payment, which, in either case, must occur prior to the end of the fiscal year in which the dividend was declared. A shareholder has a three year period from the dividend payment date to claim dividends (or interest payments on shareholders' equity as described under "—Record of Dividend Payments and Interest on Shareholders' Equity") distributed on his or her shares, after which the amount of the unclaimed dividends reverts to us. The depositary will set the currency exchange date to be used for payments to ADS holders as soon as practicable upon receipt of those payments from us.

Our bylaws allow us to pay interim dividends from preexisting and accumulated profits related to the current or preceding fiscal year.

In general, shareholders who are not residents of Brazil must register with the Central Bank to have dividends, sales proceeds or other amounts with respect to their shares eligible to be remitted outside of Brazil. The common shares underlying our ADSs are held in Brazil by Banco Bradesco S.A., as the custodian and agent for the depositary, which is the registered owner of the common shares underlying the ADSs. Our current registrar is Banco Bradesco S.A. The depositary electronically registers the common shares underlying the ADSs with the Central Bank and, therefore, is able to have dividends, sales proceeds or other amounts with respect to these shares eligible to be remitted outside Brazil. See "Item 10.D. Exchange Controls".

Payments of cash dividends and distributions, if any, will be made in Brazilian *reais* to the custodian on behalf of the depositary, which will then convert such proceeds into U.S. dollars and will cause such U.S. dollars to be delivered to the depositary for distribution to holders of ADSs. See "Item 10.D. Exchange Controls". Under current Brazilian law, dividends generally paid to shareholders who are not Brazilian residents, including holders of ADSs, will not be subject to Brazilian withholding income tax, except for dividends declared based on profits generated prior to December 31, 1995. See "Item 10.E. Taxation".

### ***Record of Dividend Payments and Interest on Shareholders' Equity***

Brazilian corporations are permitted to distribute dividends in the form of a tax deductible notional interest expense on shareholders' equity in accordance with Law No. 9,249/1995 of December 26, 1995, as amended. The amount of tax deductible interest that may be paid is calculated by applying the daily *pro rata* variation of the government's long-term interest rate (TJLP) on the shareholders' equity during the relevant period and cannot exceed the greater of:

- 50.0% of net income (before taking into account such distribution and any deductions for income taxes and after taking into account any deductions for social contributions on net profits) for the period in respect of which the payment is made; or
- 50.0% of earnings reserves and retained earnings.

Any payment of interest on shareholders' equity to holders of ADSs or common shares, whether or not they are Brazilian residents, is subject to Brazilian withholding income tax at the rate of 15.0% or 25.0% if the beneficiary is resident in a low tax jurisdiction (tax haven). See "Item 10.E. Taxation". The amount paid to shareholders as interest on shareholders' equity, net of any withholding tax, may be included as part of the mandatory dividends distributable

amount as prescribed in Brazilian Corporate Law.

Dividends and interest on shareholders' equity over the minimum established in a company's bylaws are recognized when approved by the shareholders in the general meeting. Consequently, the amounts recognized as of December 31, 2017 correspond to the minimum established by law of 25.0% of the net income and the difference of R\$703.9 million will be recorded in 2018 after the annual shareholders' meeting.

***Distributions of dividends***

The following table sets forth the distributions of dividends that we made to our shareholders in respect of our 2017, 2016 and 2015 earnings. All these amounts distributed or to be distributed were or will be in the form of interest on shareholders' equity.

Year ended December 31,	Aggregate amount proposed	Payment Dates	Payment per share	Payment per ADS
	(in millions of <i>reais</i> )			(in <i>reais</i> )
2017	703.9	June 26, 2018	1.03	1.03
2016	823.5	June 27, 2017	1.20	1.20
2015	149.9	June 28, 2016	0.22	0.22

\* We recorded dividends in the amount of R\$598.3 million, which pursuant to our bylaws is our minimum dividend amount. The dividends are expected to be paid on June 26, 2018.

#### *Dividend Policy*

We intend to declare and pay dividends and/or interest on shareholders' equity, as required by Brazilian Corporate Law, our bylaws and our dividend policy. Our board of directors may propose the distribution of interest on shareholders' equity, calculated based on our semiannual or quarterly financial statements. The declaration of dividends is annual, including dividends in excess of the mandatory distribution, and requires approval by the vote of the majority of the holders of our common shares. The proposed distribution of dividends should consider (i) the need for investments to universalize basic sanitation services; (ii) the achievement of our corporate purpose, as set forth in our bylaws; (iii) the cash generation and cash requirements; and (iv) our economic and financial sustainability. The amount of any distributions will depend on many factors, such as our results of operations, financial condition, cash requirements, prospects and other factors deemed relevant by our board of directors and shareholders. Within the context of our tax planning, we may in the future continue to determine that it is in our best interest to distribute interest on shareholders' equity.

#### **B. Significant Changes**

Other than as disclosed in this annual report, no significant change has occurred since the date of the audited financial statements included in this annual report.

### **ITEM 9. THE OFFER AND LISTING**

#### **A. Offer and Listing Details**

##### *Market Price of Common Shares*

Our common shares have been listed on the B3 under the symbol "SBSP3" since June 4, 1997 and, starting on April 24, 2002, have been included in the *Novo Mercado* segment of that exchange. As of December 31, 2017, we had 5,532 registered holders of common shares.

On April 30, 2007, our shareholders approved a reverse stock split of 125 common shares into one common share. Following a ratio change effected on January 24, 2013, each ADS currently represents one of our common shares. On

April 22, 2013 our shareholders approved a stock split, following which each common share represented three new common shares. IFRS requires the retrospective application of earnings per share computations for stock dividends, stock splits, and reverse splits.

The table below sets forth, for the periods indicated, the reported high and low closing sale prices in *reais* for common shares on the B3. The table also sets forth prices per ADS assuming that ADSs had been outstanding on all such dates and translated into U.S. dollars at the commercial market rate for the sale of U.S. dollars for each of the respective dates of such quotations. In addition, the table sets forth the average daily trading volume for our common shares.

	<i>Reais per common share</i>		U.S. dollar equivalent per ADS <sup>(1)</sup>		Average daily trading volume
	Low	High	Low	High	
<b>2018</b>					
January	33.24	36.89	10.24	11.65	941,119
February	33.34	38.30	10.16	11.83	1,388,138
March	34.11	38.75	10.22	11.77	1,827,938
April	33.28	35.70	9.71	10.30	1,422,805
May (through May 24)	25.83	34.50	6.97	9.74	2,088,094
<b>2017</b>	27.56	35.38	8.39	11.17	1,612,448
First Quarter	28.37	34.38	8.67	11.17	1,531,092
Second Quarter	27.56	34.14	8.39	11.04	1,881,846
Third Quarter	30.12	35.38	9.42	11.17	1,487,653
Fourth Quarter	28.46	34.52	8.69	10.87	1,554,779
<b>2016</b>	16.62	33.70	4.11	10.51	1,973,766
First Quarter	16.62	21.32	4.11	5.27	1,551,121
Second Quarter	25.59	29.08	7.12	9.06	2,469,756
Third Quarter	28.39	31.49	8.50	9.58	1,450,438
Fourth Quarter	26.58	33.70	7.98	10.51	1,688,341
<b>2015</b>	13.25	20.29	5.10	5.45	1,341,147
First quarter	13.25	19.40	5.10	6.10	1,474,031
Second quarter	15.74	19.65	5.07	6.46	1,314,025
Third quarter	14.50	18.99	4.09	5.92	1,273,028
Fourth quarter	16.00	20.29	4.02	5.45	1,306,283
<b>2014</b>	15.98	25.96	5.83	10.83	1,432,670
First quarter	19.61	25.96	8.37	10.83	1,605,502
Second quarter	19.60	24.35	8.81	10.81	1,386,168
Third quarter	19.30	23.97	8.47	10.78	1,398,368
Fourth quarter	15.98	20.50	5.83	8.07	1,343,589
<b>2013</b>	19.55	32.13	8.15	15.95	1,373,958
First quarter	85.00	96.40	41.90	47.87	557,193
Second quarter <sup>(2)</sup>	20.40	31.38	9.06	15.66	1,755,594
Third quarter	19.55	23.96	8.15	10.76	1,719,845
Fourth quarter	21.40	26.55	9.70	11.28	1,401,226

(1) Following a ratio change effected on January 24, 2013, each ADS represents one common shares.

(2) After April 22, 2013 our common shares are traded considering the stock split.

*Market Price of ADSs*

Our ADSs, each of which represents one of our common shares, as of the date of this annual report, are listed on the NYSE under the symbol “SBS”. Prior to June 8, 2007, each ADS represented 250 of our common shares. From that date through January 23, 2013, each ADS represented two of our common shares. Following a ratio change effected on January 24, 2013, each ADS currently represents one of our common shares. On April 22, 2013 our shareholders approved a stock split, following which each common share represented three new common shares. Our ADSs began trading on the NYSE on May 10, 2002 in connection with the initial offering of our equity securities in the United States.



The table below sets forth, for the periods indicated, the reported high and low closing prices for our ADSs on the NYSE.

	Price in U.S. dollars per ADS		
	Low	High	Average daily trading volume
<b>2018</b>			
January	10.23	11.47	1,339,009
February	10.14	11.72	1,488,395
March	10.32	11.78	2,339,937
April	9.74	10.43	1,495,140
May (through May 24)	7.01	9.95	2,597,381
<b>2017</b>	8.39	11.20	1,772,612
First quarter	8.81	11.13	1,521,758
Second quarter	9.47	11.20	1,802,381
Third quarter	9.47	11.20	1,802,381
Fourth quarter	8.73	10.81	1,652,643
<b>2016</b>	4.07	10.52	2,317,594
First quarter	4.07	6.64	2,079,094
Second quarter	5.45	6.65	2,571,512
Third quarter	6.12	9.71	2,680,041
Fourth quarter	7.89	10.52	1,774,031
<b>2015</b>	3.57	6.56	2,300,672
First quarter	4.86	6.39	2,987,516
Second quarter	5.00	6.56	2,212,398
Third quarter	3.57	5.93	2,299,456
Fourth quarter	3.88	5.38	1,734,132
<b>2014</b>	5.86	10.93	2,554,714
First quarter	8.39	10.83	2,781,129
Second quarter	8.86	10.93	2,281,039
Third quarter	8.11	10.86	2,197,585
Fourth quarter	5.86	8.56	2,965,438
<b>2013</b>	41.60	48.63	490,280
First quarter <sup>(1)</sup>	9.33	15.88	1,649,436
Second quarter <sup>(2)</sup>	8.38	10.82	2,055,875
Third quarter	9.76	11.45	1,725,844
Fourth quarter	41.60	48.63	490,280

(1) After January 23, 2013 our common shares have traded considering the ratio change. On April 22, 2013 our shareholders approved a stock split, following which each common share represented three new common shares.

(2) After April 29, 2013 our ADSs are traded considering the stock split.