COMPANHIA DE SANEAMENTO BASICO DO ESTADO DE SAO PAULO-SABESP
Form F-3
September 28, 2004
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As filed with the Securities and Exchange Commission on September 28, 2004

Registration No. 333-

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM F-3

REGISTRATION STATEMENT

UNDER THE

SECURITIES ACT OF 1933

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

(State or other jurisdiction of incorporation or organization)

Not Applicable

(I.R.S. Employer Identification No.)

Rua Costa Carvalho, 300

05429-900 São Paulo, SP, Brazil

(55-11) 3388-8000

(Address and Telephone Number of Registrant s Principal Executive Offices)

CT Corporation System

111 Eighth Avenue, New York, New York 10011

(212) 894-8400

(Name, Address, Including Zip Code and Telephone Number, Including Area Code, of Agent for Service of Process)

With copies to:

Sara Hanks

Clifford Chance US LLP

31 West 52nd Street

New York, New York 10019

(212) 878-8000

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New York, New York 10036

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Approximate date of commencement of proposed sale to the public: As soon as practicable after this Registration Statement becomes effective.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. ¨

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ¨

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price Per Share	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
Common shares, without par value(1)	4,532,127,704(2)	$ 11.755(3)	$ 213,100,645(2)(3)	$ 27,000

(1) A separate Registration Statement on Form F-6 (file number 333-86118) was filed for the registration of American depositary shares (ADSs) issuable upon deposit of the common shares registered hereby and became effective on May 9, 2002. Each ADS represents 250 common shares.

(2) Includes 3,940,980,612 common shares which are to be offered in a Brazilian offering but which may be resold from time to time in the United States in transactions requiring registration under the Securities Act, and 591,147,092 common shares, which can be in the form of ADSs, which the underwriters may purchase solely to cover over-allotments, if any.

(3) Estimated solely for purposes of calculating the amount of the registration fee pursuant to Rule 457(c) under the Securities Act based on the average of the high and low prices of the common shares represented by ADSs on the New York Stock Exchange on September 21, 2004.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED SEPTEMBER 28, 2004

P R O S P E C T U S

American Depositary Shares

Companhia de Saneamento Básico do Estado de São Paulo Sabesp

Representing Common Shares

$ per ADS

The selling shareholders are selling shares in the form of American depositary shares, or ADSs. Each ADS represents the right to receive 250 common shares. The selling shareholders are concurrently offering common shares in Brazil through Brazilian underwriters using a Portuguese-language prospectus. We will not receive any proceeds from the sale of the ADSs and common shares in these offerings. Each of these offerings is conditioned upon the closing of the other.

The selling shareholders have granted Citigroup Global Markets Inc., as global coordinator for the offerings, an option to purchase up to additional common shares, which can be in the form of ADSs, to cover over-allotments, if any.

The ADSs are listed on the New York Stock Exchange under the symbol SBS and the common shares are listed on the São Paulo Stock Exchange under the symbol SBSP3. On September , 2004, the last reported sale price of the ADSs on the New York Stock Exchange was $

per ADS and the last reported sale price of the common shares on the São Paulo Stock Exchange was R$ per 1,000 shares, equivalent to a price of $ per ADS, assuming an exchange rate of R$ per US dollar.

Investing in our ADSs involves risks. See **Risk Factors beginning on page 10.**

The offering of common shares in Brazil will be registered with the Brazilian Securities Commission. Neither the Securities and Exchange Commission, nor any state securities commission, nor the Brazilian Securities Commission, has approved or disapproved the distribution of the ADSs and common shares or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per 1,000 common shares	Per ADS	Total
Public Offering Price	$	$	$
Underwriting Discount	$	$	$
Proceeds to the Selling Shareholders (before expenses)	$	$	$

The underwriters expect to deliver the common shares and the ADSs to purchasers against payment on or about , 2004.

Global Coordinator and Sole Book Runner

Citigroup

Unibanco

, 2004

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You should rely only on the information contained in or incorporated by reference in this prospectus. Neither we nor the selling shareholders have authorized anyone to provide you with different information. This document may only be used where it is legal to sell these securities. The information in this prospectus is accurate only as of the date of this prospectus, regardless of when this prospectus is delivered or when any sale of the ADSs or of our common shares occurs.

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PRESENTATION OF FINANCIAL AND STATISTICAL INFORMATION

In this prospectus, references to *real* , *reais* or R$ are to the Brazilian *real*, the official currency of Brazil. All references to US dollars, US$ are to United States dollars. Solely for the convenience of the reader, we have translated some of the *real* amounts contained in this prospectus into US dollars at a rate equal (unless otherwise indicated) to R$3.1075 per US$1.00, the commercial selling rate as of June 30, 2004 as reported by the Central Bank of Brazil (*Banco Central do Brasil)* or the Central Bank. As a result of the recent fluctuations in the *real*/US dollar exchange rate, the commercial selling rate may not be indicative of current or future exchange rates. Therefore, you should not read these translations as representations that any such amounts have been, could have been or could be converted into US dollars at that or at any other exchange rate. See Exchange Rates for information regarding exchange rates applicable to the Brazilian currency since January 1, 1999.

Our audited financial statements as of December 31, 2002 and 2003 and for the years ended December 31, 2001, 2002 and 2003 and our unaudited interim consolidated financial statements as of June 30, 2004 and for the six months ended June 30, 2003 and 2004, are included in this prospectus. Our financial statements are presented in *reais* and are prepared in accordance with the Brazilian Corporate Law Method, which is based on the Brazilian Corporate Law (Law No. 6,404/76, as amended), the rules and regulations issued by the Brazilian Securities Commission (*Comissão de Valores Mobiliários,* or CVM) and the accounting standards issued by the Brazilian Institute of Independent Auditors (*Instituto dos Auditores Independentes do Brasil*, or IBRACON), referred to in this prospectus as the Brazilian Corporate Law Method.

Like other Brazilian companies, we have the option of presenting our primary financial statements on the basis of accounting principles established in accordance with the Brazilian Corporate Law Method with a reconciliation to generally accepted accounting principles in the United States of America, or US GAAP. Unless otherwise indicated, our financial statements and all financial data included in this prospectus have been prepared in accordance with the Brazilian Corporate Law Method. The Brazilian Corporate Law Method differs in significant respects from US GAAP. Note 24 to our financial statements provides a description of the differences between the Brazilian Corporate Law Method and US GAAP as they relate to our financial statements and a reconciliation from the Brazilian Corporate Law Method to US GAAP, for periods presented therein, of our net income (loss) and of our shareholders equity. The reconciliation from the financial statements prepared in accordance with the Brazilian Corporate Law Method to US GAAP includes, among others, adjustments for differences related to the accounting for past revaluations of property, plant and equipment, historical inflation accounting and accounting for pension and other employee benefits.

We do not have any subsidiaries.

Some figures included in this prospectus and in our annual report have been rounded. Therefore, figures in certain tables may not total.

Market data and other statistical information used in this prospectus are based on independent industry publications, government publications, publicly available information or other published independent sources. Some data is also based on the estimates of our management, which are derived from its review of internal surveys, and industry knowledge, as well as from independent sources. Although we believe these sources to be reliable, we have not independently verified the information and cannot guarantee its accuracy and completeness.

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INCORPORATION OF CERTAIN INFORMATION BY REFERENCE

The Securities and Exchange Commission, or the SEC, allows us to incorporate by reference the information we file with them, which means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is considered to be part of this prospectus, and some later information that we file with or furnish to the SEC will automatically be deemed to update and supersede this information. We incorporate by reference the following documents that have been filed with the SEC:

The Annual Report on Form 20-F we filed with the SEC on June 28, 2004 for the fiscal year ended December 31, 2003, which we refer to as our Form 20-F.

The Report on Form 6-K we furnished to the SEC on August 18, 2004 relating to our results for the six months ended June 30, 2004.

We also incorporate by reference into this prospectus any future filings on Form 20-F made with the SEC pursuant to the Exchange Act of 1934, as amended, which we refer to as the Exchange Act, after the date of this prospectus and prior to the consummation of this offering, and to the extent designated therein, future reports on Form 6-K furnished to the SEC.

Any statement contained in a document, all or a portion of which is incorporated or deemed to be incorporated by reference herein, shall be deemed to be modified or superseded for purposes of this prospectus to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute part of this prospectus.

We will provide without charge to each person, including any beneficial owner of our common shares or of ADSs, to whom a copy of this prospectus is delivered, upon the written or oral request of any such person, a copy of any or all of the documents referred to above which have been or may be incorporated herein by reference, other than exhibits to such documents (unless such exhibits are specifically incorporated by reference in such documents). Requests should be directed to the Investor Relations Department, Rua Costa Carvalho, 300, 05429-900 São Paulo, SP, Brazil (telephone no: (55 11) 3388-9135).

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FORWARD-LOOKING STATEMENTS

This prospectus includes forward-looking statements. 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 things:

- the interests of our controlling shareholder, the State of São Paulo;
- our ability to collect amounts owed to us by our controlling shareholder and by municipalities;
- existing and future governmental regulation, including taxes on, and charges to, us;
- our lack of formal concessions for the City of São Paulo and other municipalities;
- municipalities ability to terminate our existing concessions;
- our ability to obtain additional concessions and to renew current concessions when they come due;
- limitations on our ability to increase tariffs;
- our capital expenditure program and other liquidity and capital resources requirements;
- our level of indebtedness and limitations on our ability to incur additional indebtedness;
- droughts, water shortages and/or climate events;
- our costs relating to compliance with environmental laws and potential penalties for failure to comply with such laws;
- the outcome of our pending or future legal proceedings;
- general economic, political and other conditions in Brazil and in other emerging market countries;
- inflation and currency devaluation in Brazil;
- our management s expectations and estimates concerning our future financial performance;

- the size and growth of our customer base; and

- other risk factors as set forth in the Risk Factors section.

The words believes, may, will, estimates, continues, anticipates, intends, expects and similar words are intended to identify forward statements. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this prospectus might not occur. Our actual results could differ substantially from those anticipated in our forward-looking statements.

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SUMMARY

This summary highlights information contained elsewhere in this prospectus. You should read the entire prospectus carefully, including Risk Factors and our financial statements included in this prospectus, before making an investment decision. Unless otherwise specified, share amounts in this prospectus do not reflect the exercise of the over-allotment option.

Sabesp

We believe we are the largest water and sewage company in Latin America based on net revenue and customers in 2003. We provide water and sewage services in the State of São Paulo, in which the City of São Paulo, Brazil s largest city, is located. According to the Brazilian Institute of Geography and Statistics, the State of São Paulo is Brazil s most populous and economically productive state. We serve a broad range of residential, commercial, industrial and governmental customers in the area we refer to as the São Paulo Metropolitan Region, which comprises 33 municipalities in the metropolitan area of the City of São Paulo, and in the area we refer to as the Regional Systems, which comprises 335 municipalities in the interior and coastline regions of the State of São Paulo, for a total of 368 of the 645 municipalities in the State of São Paulo as of the date of this prospectus. We also supply water on a wholesale basis to six municipalities in the São Paulo Metropolitan Region in which we do not operate water systems. The São Paulo Metropolitan Region and the Regional Systems accounted for 74.0% and 26.0% of our net revenue from sales and services for the six months ended June 30, 2004, respectively.

As of June 30, 2004, we distributed water to approximately 22.2 million people, which we believe includes 60.0% of the urban population of the State of São Paulo, through 57,976 kilometers of water pipes and mains to more than 6.3 million water connections. As of June 30, 2004, we provided sewage services to approximately 18.0 million people, or 78.0% of our water customers, through 35,692 kilometers of sewer lines to approximately 4.7 million sewage connections. We currently sell water on a wholesale basis to six other municipalities having an estimated total population of approximately 3.1 million in the aggregate.

We had net revenue from sales and services of R$4,130.8 million (US$1,329.3 million) in 2003 and R$2,126.3 million (US$684.2 million) for the six months ended June 30, 2004. We had total assets of R$16,441.5 million (US$5,290.9 million) and shareholders equity of R$7,580.9 million (US$2,439.5 million) as of June 30, 2004.

The State of São Paulo, our controlling shareholder, is required by our by-laws and by State law to own at least one-half plus one of our voting (common) shares. After giving effect to the ADS and Brazilian offerings, the State of São Paulo will own 55.7% of our outstanding common shares assuming the over-allotment option is exercised in full.

Our Strengths

We believe that our strong business position, development and future prospects are reflected by the following strengths:

Well-established Business with Significant Size and Scale. We believe we are the largest water and sewage company in Latin America. We are the sole provider of water and sewage services in our areas of operations. We provide water services to approximately 22.2 million people and sewage services to approximately 18.0 million people or 78.0% of our water customers. We have a track record of consistent revenue growth and strong cash flows that fund a considerable portion of our capital expenditures, as well as regular dividends to our shareholders. The size of our operations enables us to achieve economies of scale which positively impact our business.

Operations in Brazil s Most Populous and Wealthy State. The State of São Paulo, part of the most developed and economically active region of Brazil, is the most populous state in Brazil, with an estimated population of 39.3 million as of June 30, 2004. The City of São Paulo had an estimated population of 10.7 million as of June 30, 2004, with 18.9 million inhabitants in the greater metropolitan region. The gross domestic product (GDP) of the State of São Paulo was approximately R$401.0 billion as of 2001, representing approximately 33.4% of Brazil s total GDP, making it the largest economy of any state in Brazil, based on GDP.

Visible Growth Opportunities. We currently have a sewage coverage ratio of 78%, and plan to increase this ratio to 85% by 2008 by adding over 835,000 sewage connections. In addition, there are municipalities in the State of São Paulo in which we currently do not operate water or sewage concessions or to which we currently supply water solely on a wholesale basis. This represents a total population of approximately 15 million. Since January 1, 1997, we have obtained concessions for 33 additional municipalities (representing a total population of 1.4 million).

High Quality Operations. We believe that our company adheres to high standards of service and utilizes the best available technology in the sanitation business. Five of our water quality laboratories in the São Paulo Metropolitan Region have received ISO 9001/2000 certification and three in the Regional Systems have received ISO 17025 certification. We have also received ISO 9001/2000 certification for the maintenance of our pumps and quality of our sewage collection services in the São Paulo Metropolitan Region. We believe our technology enhances the efficiency and quality of our operations.

Access to Attractive Financing. We benefit from long-term financing from domestic and international multilateral agencies and development banks at attractive interest rates. Our capital expenditures are funded by this financing in addition to our cash flows from operations.

Strong Corporate Governance Practices. In 2002, we joined and currently are the only mixed capital company in the *Novo Mercado* segment of the São Paulo Stock Exchange. We are committed to abide by certain corporate governance practices and disclosure requirements in addition to those already required under Brazilian law. These corporate governance practices require us to increase shareholders rights and to enhance the quality of information provided to shareholders.

Our Strategy

Our mission is to improve the quality of life of the population of the State of São Paulo and, in particular, to meet the growing demand for water and sewage services in an environmentally responsible manner. We are seeking to expand and improve our operations so that we can fulfill our mission and at the same time enhance shareholder value.

In order to achieve our objectives, we have defined the following key strategic initiatives:

Continue to Expand Our Water and Sewage Services in Our Existing Service Area. Our goal is to maintain universal coverage of water services and to increase penetration of sewage collection and treatment services in our existing service areas of operation. We aim to continue providing universal water coverage and meet population growth by adding 795,000 water connections by 2008. We also intend to provide increase our sewage coverage ratio to 85% of our customers by adding 835,000 sewage connections by 2008.

Maintain our Existing Concession Base and Obtain Additional Municipal Concessions and Operations. Our goal is to renew all of our existing concessions as they expire. We have assembled a special task force to address concession expiration in a timely and effective manner. In addition, we regularly explore the possibility of obtaining additional water and sewage concessions and operations in municipalities in the State of São Paulo in which we currently have no operations or to which we currently supply water solely on a wholesale basis.

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Set Our Tariffs to Cover Our Costs of Operations and to Provide a Return on Investment. We periodically adjust our tariffs for water and sewage services using a transparent formula which accounts for inflation, covers our operating costs and other expenses and provides for return on investment. We generally adjust our tariffs once a year during the month of August for a period of at least 12 months. Our most recent adjustment was a 6.8% increase effective as of August 29, 2004.

Continue to Reduce Operating Costs and to Increase Productivity. We are continuing our efforts to lower operating costs and to increase our productivity mainly through a head count reduction program and through an outsourcing and automation strategy. During the six months ended June 30, 2004, we reduced our total number of employees by 4%. Water and sewage connections per employee consequently increased from 566 to 615 in the same period.

Improve Operating Efficiency and Reduce Water Losses. Our central efficiency goal is to reduce physical water losses throughout our water system primarily through the replacement and repair of water mains and pipes and the installation of probing and other equipment, including strategically located pressure-regulating valves. We also aim to reduce non-physical water losses by upgrading and replacing inaccurate water meters and by increasing outsourcing of meter reading activities to third-party contractors outside the São Paulo Metropolitan Region. We aim to reduce water losses in the São Paulo Metropolitan Region and in the Regional Systems from 32% and 33%, respectively, to 26% in both regions by 2008.

Improve Collection of Overdue Accounts Receivable. We are continuing our efforts to improve our collection of overdue accounts receivable from municipalities to which we provide water on a wholesale basis, from the State of São Paulo and from other governmental entities. We are actively pursuing the amounts overdue and in some cases exploring opportunities to swap the amounts overdue in exchange for the rights and infrastructure to operate the water and sewage systems of certain municipalities. For example, we have recently acquired the right to operate the water and sewage services in the Municipality of São Bernardo do Campo through the transfer of all related assets from the municipality to us in partial exchange for overdue accounts receivable.

Diversify Sources of Financing. Our goal is to continue to identify and secure diverse sources of financing, both public and private, with an emphasis on borrowing in local currency to reduce our exposure to exchange rate fluctuations and on borrowing long-term funds to match the duration of our long-term assets.

Maintain Close Relationships with Municipal Governments and with Customers. We meet regularly with the mayors of municipalities and organize regional management commissions comprised of mayoral representatives and of our officers to discuss water and sewage services, capital expenditures, tariffs and other issues. We are also working to improve customer relations by shortening response times for customer installations as well as through a focused public relations program to enhance our image. We believe that these activities enhance our ability to obtain renewal of concessions or additional concessions in the future.

We are a mixed capital company (*sociedade de economia mista*), a corporation organized under the laws of Brazil of which a majority of the voting capital must be owned by the Federal Government, a state government or a municipality. Our principal executive offices are located at Rua Costa Carvalho, 300, 05429-900 São Paulo, SP, Brazil and our telephone number is (55-11) 3388-8000. Our website address is *www.sabesp.com.br*. The information on our website is not incorporated by reference in this prospectus and does not constitute a part of this prospectus.

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The Offerings

Issuer	Companhia de Saneamento Básico do Estado de São Paulo Sabesp.
Selling shareholders	State of São Paulo and Companhia Paulista de Parcerias, a company wholly owned by the State of São Paulo.
ADS offering	ADSs representing common shares are being offered through the underwriters in the United States and in other countries outside Brazil.
Brazilian offering	common shares are being offered by Brazilian underwriters in a public offering in Brazil pursuant to a Portuguese-language prospectus being filed with the Brazilian Securities Commission.
Reallocation between offerings	The number of ADSs to be offered in the ADS offering and the number of common shares to be offered in the Brazilian offering are subject to reallocation, without any limitation, between the offering outside Brazil and the offering in Brazil, as may be determined by Citigroup Global Markets Inc.
The ADSs	Each ADS represents 250 common shares. ADSs will be evidenced by American Depository Receipts, or ADRs. ADSs will be issued under a deposit agreement, dated as of May 9, 2002, among us, The Bank of New York, as Depositary, and the owners and holders of ADSs issued thereunder.
Offering price	The public offering price for the ADS offering is US$ per ADS. The offering price for the Brazilian offering is R$ per 1,000 common shares, which is the approximate *real* equivalent of the offering price per ADS in the ADS offering, adjusted to reflect the ratio of 250 common shares to one ADS.
Over-allotment option	The selling shareholders have granted Citigroup Global Markets Inc., as global coordinator for the ADS and Brazilian offerings, an option to purchase additional common shares, which can be in the form of ADSs, within 30 days from the date of this prospectus, solely to cover over-allotments, if any.
Use of Proceeds	We will not receive any proceeds from the sale of ADSs and common shares being offered in the ADS and Brazilian offerings. The selling shareholders will receive all of the net proceeds from the sale of ADSs and common shares in these offerings.
Outstanding share capital	We will have 28,479,577,827 common shares outstanding immediately prior to and after the ADS and Brazilian offerings. We do not have any other class of share capital.
Voting rights	Holders of our common shares and ADSs have voting rights; however, it may be difficult for holders of ADSs to exercise these rights. See Description of Capital Stock Rights of Common Shares and Description of American Depositary Shares Voting Rights.

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Tag-along rights	Holders of our common shares and ADSs have tag-along rights, which enable them to, upon the sale of a controlling interest in us, receive 100.0% of the price paid per common share of the controlling block. However, US holders of common shares and ADSs may not be able to exercise these rights unless a registration statement under the US Securities Act of 1933 is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available.
Preemptive Rights	Holders of our common shares and ADSs have a general preemptive right to subscribe for shares in any capital increase according to the proportion of their holdings, as well as to subscribe for any convertible debentures, rights to acquire our shares and subscription warrants that we may issue. However, US holders of common shares and ADSs may not be able to exercise these rights unless a registration statement under the US Securities Act of 1933 is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available.
Dividends	Under the Brazilian Corporate Law and our by-laws, we are required to distribute dividends in an aggregate amount of not less than 25.0% of our annual net income, subject to adjustments and exceptions. The holders of ADSs will be entitled to receive dividends as of the date of the acquisition of such ADSs to the same extent as the owners of the common shares, subject to the deduction of any fees and charges of the Depositary for the ADSs. Dividends may be made in the form of interest on shareholders equity. See Description of Share Capital and Dividends and Dividend Policy.
	Purchasers of ADSs will not be entitled to receive the dividend declared by our Board of Directors in February 2004, which will be paid subsequent to the offerings.
Taxation	Dividend distributions with respect to common shares or ADSs are not currently subject to withholding of Brazilian income tax. However, payment of interest on shareholders equity is currently subject to withholding of Brazilian income tax. Gains from the sale or other disposition of ADSs outside of Brazil among individuals or corporations not domiciled in Brazil may be subject to Brazilian income tax. Such withholding tax may or may not be applicable to the holders of our common shares. See Taxation Brazilian Tax Considerations.
Lock-up	We, our officers and directors and the selling shareholders have agreed with the underwriters for the ADS offering, subject to certain exceptions, not to sell, offer or agree to sell, grant any option to sell or otherwise dispose of, directly or indirectly, any common shares, ADSs or securities convertible into or exchangeable or exercisable for common shares or ADSs or warrants or other rights to purchase

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	common shares or ADSs during the 90-day period following the date of the underwriting agreement without prior written consent of Citigroup Global Markets, Inc. on behalf of the underwriters.
Market for common shares and ADSs	Our ADSs began trading on the New York Stock Exchange on May 10, 2002 in connection with the initial offering of our equity securities in the United States. Our common shares are listed and traded on the *Novo Mercado* segment of the São Paulo Stock Exchange.
Listing	The existing ADSs are listed on the New York Stock Exchange under the symbol SBS. We will apply for the listing of ADSs being offered in the ADS offering on the New York Stock Exchange under the same symbol. Our common shares are listed on the São Paulo Stock Exchange under the symbol SBSP3. We will apply for the listing of the common shares being offered in the Brazilian offering on the São Paulo Stock Exchange under the same symbol.

This prospectus relates to ADSs being offered in the ADS offering. The registration statement, of which this prospectus is a part, also relates to common shares that are being offered in the Brazilian offering, but that may be resold in the form of ADSs from time to time in the United States.

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Summary Financial Information

The following summary financial and operating data should be read in conjunction with our financial statements included in this prospectus and information under the captions Presentation of Financial Information, Exchange Rates, Management s Discussion and Analysis of Financial Condition and Results of Operations and Selected Financial Data. Our financial statements have been prepared in accordance with the Brazilian Corporate Law Method, which differs in significant respects from US GAAP. Solely for the convenience of the reader, *real* amounts as at and for the year ended December 31, 2003 and the six months ended June 30, 2004 have been translated into US dollars at the commercial selling rate as of June 30, 2004 of R$3.1075 to US$1.00.

	As of and for the Year Ended December 31,				As of and for the Six Months Ended June 30,		
	2001	2002	2003	2003	2003	2004	2004
	(in millions, except per share and per ADS data)						
Brazilian Corporate Law Method							
	R$	R$	R$	US$	R$	R$	US$
Statement of Operations Data:							
Net revenue from sales and services	3,434.8	3,767.1	4,130.8	1,329.3	1,965.9	2,126.3	684.2
Cost of sales and services	(1,590.4)	(1,815.0)	(2,067.1)	(665.2)	(980.8)	(1,082.9)	(348.5)
Gross profit	1,844.3	1,952.2	2,063.6	664.1	985.2	1,043.4	335.8
Selling expenses	(332.6)	(385.1)	(297.5)	(95.7)	(186.2)	(231.3)	(74.4)
Administrative expenses	(203.1)	(226.0)	(254.1)	(81.8)	(107.5)	(138.8)	(44.7)
Financial income (expenses), net	(1,105.2)	(2,276.3)	(346.5)	(111.5)	86.5	(568.6)	(183.0)
Income (loss) from operations[1]	203.4	(935.3)	1,165.5	375.1	778.0	104.7	33.7
Non-operating income (expenses)	(76.9)	(3.4)	(54.5)	(17.5)	(32.0)	(11.5)	(3.7)
Income (loss) before taxes on income	126.5	(938.7)	1,111.1	357.6	745.9	93.2	30.0
Income tax and social contribution tax	89.7	323.3	(242.6)	(78.1)	(223.9)	(33.5)	(10.8)
Extraordinary item, net of income and social contribution taxes[2]		(35.1)	(35.1)	(11.3)	(17.6)	(17.6)	(5.7)
Net income (loss)	216.2	(650.5)	833.3	268.2	504.5	42.2	13.6
Net income (loss) per thousand common shares	7.59	(22.84)	29.26	9.4	17.71	1.48	0.5
Net income (loss) per ADS		(5.71)	7.32	2.4	4.43	0.37	0.1
Dividends and interest on shareholders equity per thousand common shares	17.20	3.80	17.70	5.7	5.56	1.38	0.4
Dividends and interest on shareholders equity per ADS		0.95	4.43	1.4	1.39	0.34	0.1
Number of common shares outstanding at year end (in thousands of shares)	28,479,578	28,479,578	28,479,578	28,479,578	28,479,578	28,479,578	28,479,578
Balance Sheet Data:							
Cash and cash equivalents	460.2	414.7	281.0	90.4	1,068.0	102.9	33.1
Customer accounts receivable, net	787.0	820.5	996.8	320.8	839.0	970.5	312.3
Reimbursement for pension benefits paid	326.3	403.9	491.0	158.0	442.7	527.6	169.8
Short- and long-term receivables from shareholders, net[3]	378.3	423.7	164.2	52.8	421.2	215.3	69.3
Property, plant and equipment, net	13,510.0	13,670.8	14,063.2	4,525.6	13,633.3	14,029.9	4,514.9
Total assets	15,917.9	16,348.7	16,530.7	5,319.6	16,861.1	16,441.5	5,290.9
Total short-term loans and financing	549.3	1,332.5	997.0	320.8	1,189.7	1,116.4	359.3
Total long-term loans and financing	5,920.6	6,545.2	6,267.3	2,016.8	6,648.7	6,202.0	1,995.8
Total liabilities	7,921.2	9,102.2	8,953.7	2,881.3	9,267.8	8,860.6	2,851.4
Shareholders equity	7,996.7	7,246.5	7,576.9	2,438.3	7,593.2	7,580.9	2,439.5
Other Financial Information:							
Cash provided by operating activities[4]	1,657.0	1,764.8	1,655.3	532.7	880.5	811.1	261.0
Cash provided by (used in)[4] investing activities	(709.5)	(597.2)	(650.8)	(209.4)	(226.3)	(317.6)	(102.2)
Cash used in financing activities[4]	(763.6)	(1,165.7)	(1,138.2)	(366.3)	(47.5)	(671.6)	(216.1)

Adjusted EBITDA[5]	1,785.9	1,860.1	2,076.5	668.2	960.9	966.1	310.9
Capital expenditures[4]	694.6	586.0	641.3	206.4	222.3	317.7	102.2
Depreciation and amortization	477.3	519.1	564.5	181.6	269.4	292.7	94.2

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	As of and for the Year Ended December 31,				As of and for the Six Months Ended June 30,		
	2001	2002	2003	2003	2003	2004	2004
	(in millions, except per share and per ADS data)						
	R$	R$	R$	US$	R$	R$	US$
US GAAP							
Statement of Operations Data:							
Net revenue from sales and services	3,434.8	3,767.1	4,130.8	1,329.3	1,965.9	2,126.3	684.3
Gross profit	1,613.8	1,820.1	1,853.3	596.4	898.2	956.3	307.7
Selling expenses	(349.9)	(393.6)	(323.4)	(104.1)	(198.4)	(240.3)	(77.3)
Administrative expenses	(214.8)	(328.8)	(276.3)	(89.0)	(123.7)	(143.3)	(46.1)
Income (loss) from operations(6)	951.1	1,086.5	1,136.5	365.7	496.9	541.9	174.4
Financial income (expenses), net	(1,107.1)	(2,284.5)	(329.4)	(106.0)	102.4	(581.6)	(187.2)
Net income (loss) for the period	16.7	(847.6)	642.6	206.8	418.0	(26.4)	(8.5)
Net income (loss) per thousand shares basic and diluted	0.59	(29.76)	22.56	7.3	14.68	(0.93)	(0.3)
Net income (loss) per ADS-basic and diluted	0.15	(7.44)	5.64	1.8	3.67	(0.23)	(0.1)
Weighted average number of common shares outstanding (in thousands of shares)	28,479,578	28,479,578	28,479,578	28,479,578	28,479,578	28,479,578	28,479,578
Balance Sheet Data:							
Property, plant and equipment, net	15,656.0	15,666.0	15,955.5	5,134.5	15,537.8	15,858.2	5,103.2
Total assets	17,581.8	17,625.6	17,630.4	5,673.5	18,066.9	17,423.0	5,606.8
Short-term loans and financing	549.3	1,753.6	997.0	320.8	1,617.3	1,408.7	453.3
Long-term loans and financing	5,873.2	6,124.0	6,267.3	2,016.8	6,174.4	5,909.7	1,901.8
Total liabilities	10,688.5	11,679.8	11,544.8	3,715.1	11,860.9	11,401.9	3,669.2
Shareholders equity	6,893.3	5,945.8	6,085.6	1,958.4	6,206.1	6,021.1	1,937.6

	As of and for the Year Ended December 31,			As of and for the Six Months Ended June 30,	
	2001	2002	2003	2003	2004
Operating Data (at period end):					
Number of water connections (in thousands)	5,717	5,898	6,044	5,975	6,285
Number of sewage connections (in thousands)	4,128	4,304	4,462	4,385	4,673
Percentage of population with water connections (%)	100.0	100.0	100.0	100.0	100.0
Percentage of population with sewer connections (%)	76.0	77.0	78.0	78.0	78.0
Volume of water billed during period (in millions of cubic meters)	1,698.0	1,770.0	1,765.0	888.6	837.9
Water loss percentage (average) (%)(7)	32.6	31.7	33.0	32.5	33.5
Number of employees	18,159	18,505	18,546	18,355	17,807

(1) Includes financial expenses, net.

(2) The extraordinary item charged to income in the years ended December 31, 2002 and 2003 and the six months ended June 30, 2003 and 2004 relates to the amortization (over a five-year period) of the actuarial liability recorded on December 31, 2001 upon first time recognition of the defined benefits pension plan. The presentation of the charge as an extraordinary item is consistent with the instructions of the Brazilian Securities Commission and the Brazilian Corporate Law Method. For purposes of US GAAP, the pension expense has been treated as a payroll expense from the first year presented.

(3) Short- and long-term receivables from shareholders, net represent amounts due from the State Government for water and sewage services. Amounts as of December 31, 2003 and June 30, 2004 are reflected net of R$401.7 million and R$347.0 million, respectively, of amounts due to the State Government related to interest on shareholders equity which has been designated for reciprocal offset under the terms of the agreement executed among the parties, as amended. See note 6 to our financial statements.

(4)

Based on the statements of cash flows for the years ended December 31, 2002 and 2003 and for the six months ended June 30, 2003 and 2004 included in note 26 to our financial statements.

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(5) Adjusted EBITDA means net income (loss) before financial expenses, net, income tax and social contribution tax (a federal tax on income), depreciation and amortization, non-operating income (expenses), net and extraordinary item, net of income tax and social contribution tax. Adjusted EBITDA is not a measurement recognized under Brazilian accounting principals, does not represent cash flow for the periods presented and should not be considered as an alternative to net income (loss), as an indicator of our operating performance or as an alternative to cash flows as an indicator of liquidity. Our definition of Adjusted EBITDA may not be comparable with EBITDA as recognized under Brazilian accounting principals. Although Adjusted EBITDA, as defined above, does not provide a measurement of operating performance as accepted under the Brazilian Corporate Law Method, our management uses it to measure our operating performance and it is commonly used by financial analysts in evaluating our business. Adjusted EBITDA is calculated as follows:

	As of and for the Year Ended December 31,				As of and for the Six Months Ended June 30,		
	2001	2002	2003	2003	2003	2004	2004
	(in millions)						
	R$	R$	R$	US$	R$	R$	US$
Brazilian Corporate Law Method							
Net income (loss)	216.2	(650.5)	833.3	268.2	504.5	42.2	13.6
Add:							
Financial expenses (income), net	1,105.2	2,276.3	346.5	111.5	(86.5)	568.6	183.0
Income tax and social contribution tax	(89.7)	(323.3)	242.6	78.1	223.9	33.5	10.8
Depreciation and amortization	477.3	519.1	564.5	181.6	269.4	292.7	94.2
Extraordinary item, net of income and social contribution taxes		35.1	35.1	11.3	17.6	17.6	5.7
Subtotal	1,709.0	1,856.7	2,022.0	650.7	928.9	954.6	307.2
Non-operating expenses, net	76.9	3.4	54.5	17.5	32.0	11.5	3.7
Adjusted EBITDA	1,785.9	1,860.1	2,076.5	668.2	960.9	966.1	310.9

(6) Under US GAAP, income from operations is determined before financial expenses, net.

(7) Includes both physical and non-physical losses. Water loss percentage represents the quotient of (a) the difference between (i) the total amount of water produced by us (after excluding certain non-physical water losses set out below) less (ii) the total amount of water invoiced by us to customers divided by (b) the total amount of water produced (after excluding certain non-physical water losses set out below) by us. We exclude from our calculation of water losses the following: (1) water discharged for periodic maintenance of water mains and water storage tanks; (2) water supplied for municipal uses such as firefighting; (3) water we consume in our facilities; and (4) estimated water losses associated with water we supply to *favelas* (shantytowns).

RISK FACTORS

Prior to making an investment decision, prospective purchasers should consider carefully all of the information set forth in this prospectus and, in particular, the risk factors applicable to us and relating to investments in Brazil that are not normally associated with investments in other countries and with other issuers.

Risks Relating to our Control by the State of São Paulo

We are controlled by the State of São Paulo, whose interests may be contrary to the interests of other holders of our common shares and ADSs.

The State of São Paulo, through its ownership of our common shares, has the ability to control the election of a majority of the members of our Board of Directors, the appointment of our senior management, and our operations and strategy. After giving effect to the ADS and Brazilian offerings, the State of São Paulo will own 55.7% of our outstanding common shares assuming the over-allotment option is exercised in full.

The State of São Paulo has from time to time in the past used, and may in the future use, its controlling interest in our company to direct that we engage in certain business activities and make certain expenditures which are designed primarily to promote the political, economic or social goals of the State of São Paulo and not necessarily to enhance our business and results of operations. Our capital expenditure budget is subject to approval by the legislature of the State of São Paulo and is approved in conjunction with the budget of the Energy, Water Resources and Sanitation Secretariat of the State of São Paulo (*Secretária de Energia, Recursos Hídricos e Saneamento*) and of the State of São Paulo as a whole. The Governor of the State of São Paulo has the power to modify our capital expenditure budget after it has been approved. In addition, there is no express requirement under Brazilian law or our by-laws that the terms of our transactions with the State of São Paulo be arm s length or otherwise fair to us or to our other shareholders. As a result, actions taken by the State of São Paulo in relation to us could be contrary to the interests of the other holders of our common shares and ADSs, according to Article 238 of the Brazilian Corporate Law.

Most of our Board of Directors and senior management are political appointees of the Governor of the State of São Paulo, who are subject to periodic change unrelated to our business needs.

Newly-elected Governors of the State of São Paulo typically make significant changes in our Board of Directors and senior management and, historically, the Chairman of our Board of Directors has been the Secretary of the Energy, Water Resources and Sanitation Secretariat of the State of São Paulo. In 2002, the current Governor, Mr. Geraldo Alckmin, appointed new senior officials for his administration, including Mr. Mauro Guilherme Jardim Arce as the new Secretary of the Energy, Water Resources and Sanitation Secretariat of the State of São Paulo. Mr. Arce was also elected as Chairman of our Board of Directors. In May 2003, Mr. Dalmo do Valle Nogueira Filho was appointed as our Chief Executive Officer and in July 2003, Mr. Rui de Britto Álvares Affonso was appointed as our Economic and Financial Officer and Investor Relations Officer. In addition, during 2003 our Board of Directors appointed the current technology and planning officer, metropolitan officer and regional systems officer.

Changes in government or government policy could lead to changes in our senior management which in turn could have a material adverse effect on our business strategy, cash flows, results of operations, financial condition or prospects.

We have accounts receivable owed by the State of São Paulo and some State entities, as well as a substantial amount of recently negotiated long-term receivables owed by the State of São Paulo, and we cannot assure you as to when or whether the State of São Paulo will pay amounts owed to us.

Historically, the State of São Paulo and some State entities have had substantial overdue accounts payable to us relating to (1) the provision of water and sewage services and (2) State-mandated special retirement and

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pension payments that we make to some of our former employees for which the State of São Paulo is required to reimburse us. As of June 30, 2004, we had accounts receivable due from the State of São Paulo and some State entities relating to the provision of water and sewage services totaling approximately R$176.9 million, net of R$347.0 million of amounts applied in respect of dividends due to the State Government and R$38.4 million to mature in the future. In addition, as of June 30, 2004, we had R$527.6 million in reimbursements due from the State of São Paulo in respect of State-mandated special retirement and pension payments to some of our former employees. However, the State of São Paulo has not agreed with these amounts. Under a federal law enacted in December 1996, we are not permitted to write off any amounts due to us from the State of São Paulo, our controlling shareholder, or entities controlled by the State of São Paulo. Accordingly, we have not established any provisions for any amounts due to us by the State of São Paulo.

In September 1997, December 2001 and March 2004, we entered into agreements with the State of São Paulo to settle these overdue amounts payable to us. Under the terms of these agreements, the amounts may be settled through the application of dividends payable by us to the State of São Paulo and by the transfer to us of certain reservoirs in the Alto Tietê System which we use, but which are owned by the State of São Paulo. However, the agreements do not require the State of São Paulo to apply all dividends payable by us to them to the repayment of amounts owed to us. Since the State of São Paulo entered into these agreements it has applied some, but not all, of the dividend received from us to the repayment of amounts it owes to us.

Under the December 2001 agreement, we converted a substantial amount of overdue accounts receivable due from the State of São Paulo and some State entities into long-term accounts receivable. According to the March 2004 agreement, which amended the December 2001 agreement, the State of São Paulo recognized a debt with us in the amount of R$581.8 million regarding unpaid receivables up to February 29, 2004 and we recognized an amount owed to the State of São Paulo as dividends declared in the form of interest on shareholders equity totaling R$518.7 million.

We cannot assure you as to when or if the State of São Paulo will pay overdue amounts due to us by them and by some State-controlled entities. Furthermore, due to the State s history of not making timely payments to us in respect of services provided by us and of not reimbursing us in a timely manner for the State of São Paulo-mandated special retirement and pension payments, we cannot assure you that the amount of accounts receivable owed to us by the State of São Paulo and some State entities will not significantly increase in the future. If the State does not pay the amounts it owes us, our cash flows, results of operations and financial condition will be adversely affected.

We expect that a portion of long-term accounts payable by the State of São Paulo to us will be settled by the transfer to us of State-owned reservoirs in the Alto Tietê System, but we cannot assure you of the value to be given to these reservoirs or of the timing of these transfers.

Under the terms of the December 2001 agreement referred to above, the State of São Paulo agreed to transfer the reservoirs in the Alto Tietê System to us in exchange for the cancellation of a portion of the accounts receivable due from the State of São Paulo and of reimbursements due from the State of São Paulo for State-mandated special pension payments we have made. Under the terms of the agreement, the value of these reservoirs will be determined by an appraisal process prior to their transfer and amounts owed to us from the State of São Paulo are subject to an audit by a State-appointed auditor.

In July and August 2002, a State-owned construction company, on behalf of the State of São Paulo, and an independent appraisal firm, on our behalf, presented their valuation reports relating to the reservoirs. The appraisals contained in these reports were in the amounts of R$335.8 million and R$341.2 million, respectively. Under the terms of the December 2001 agreement, the arithmetic average of these appraisals will be deemed to be the fair value of the reservoirs. 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

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which may be submitted for approval by an extraordinary general meeting of shareholders. However, we cannot assure you as to when such meeting will take place and a final determination as to the fair value of these reservoirs will be made, when the transfer of the reservoirs will occur, or when the reimbursement will take place.

The State of São Paulo has agreed to reimburse us for pension benefits owed to us; however, if agreement is not reached with respect to the amounts of these reimbursements or if the State of São Paulo delays in making these payments, our cash flows, results of operations and financial condition could be adversely affected.

The December 2001 agreement also provided that the State of São Paulo s legal advisors 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 of São Paulo. The commencement of reimbursement payments with respect to pension amounts owed to us by the State of São Paulo has been postponed until these analyses are completed, the appraisal report is approved and the credit assignments relating to the transfer of the reservoirs in the Alto Tietê System are formalized. Under the December 2001 agreement, the original first payment was to be made in July 2002, but no payment in this respect has been made as of the date of this prospectus. We cannot assure you as to when agreement among the parties will be reached or when the State of São Paulo will commence making payments in respect of these pension amounts. If an agreement among the parties is not reached or if the State of São Paulo delays or fails to make such payments, our cash flows, results of operations and financial condition could be adversely affected.

We may be required to acquire reservoirs that we use and that are owned by a State of São Paulo-controlled company, and we may be required to pay substantial fees to the owner in the form of rent and additional operational and maintenance expenses with respect to our use of such reservoirs.

In connection with the provision of water services, we use the Billings and Guarapiranga reservoirs that are owned by a State-controlled company. The State of São Paulo, through its control of our Board of Directors, could require us to acquire the Billings and Guarapiranga reservoirs. As a result of these acquisitions, our cash position and overall financial condition could be adversely affected. In addition, since we are not currently charged for the use of these reservoirs, we are uncertain as to whether in the future we will continue to be able to use the reservoirs without paying a fee, or what the likely fee scale would be, if imposed. We may also be required to pay additional maintenance and operational costs for our use of the Billings and Guarapiranga reservoirs. If we were required to pay substantial fees to the owner or additional maintenance or operational costs for these properties, our cash flows, results of operations and financial condition could be adversely affected.

Risks Relating to Our Business

The basic sanitation sector is not specifically regulated in Brazil and the approval of any proposed regulations for the water and sewage industry may negatively affect our operations in the São Paulo Metropolitan Region, as well as in other areas that we serve.

The Brazilian Federal Congress has, from time to time, discussed proposals for regulation, which would establish directives for basic sanitation services. Any proposed regulation, when and if approved, could establish a new municipal regulatory authority for our industry that may, in part, preempt the existing state regulatory authorities under which we operate.

Law Project No. 4,147, for example, has been under the analysis of the Brazilian Federal Congress since February 21, 2001. This proposed new legislation and regulatory regime would, for instance, grant the new regulatory authorities the power to deny renewals of our concessions after they expire or to cancel existing ones under certain conditions. In addition, the proposed new legislation could modify the way we charge for our water and sewage services businesses, as well as our capital expenditure program. Any of these changes could have an adverse effect on our revenue, by causing us to lose concessions we currently hold, or on our operating margins, by limiting our ability to pass our costs on to our customers. In addition, some changes have been introduced to

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the proposed legislation by which the State would share authority with municipalities comprising the São Paulo Metropolitan Region. These changes could negatively affect our operations in the São Paulo Metropolitan Region as well as other metropolitan areas which we serve.

As of the date of this prospectus, neither Law Project No. 4,147 nor any other proposed federal regulation for the water and sewage industry has been voted by the Brazilian Federal Congress or been sent to the Brazilian Senate for debate. However, representatives of the Federal Government have repeatedly informed the press that new regulation is expected to be proposed to the Brazilian Federal Congress in the near future. Our Board of Directors has recently become aware that such new regulation, if proposed to the Brazilian Federal Congress in the form presented to us, could have a negative effect on our operations in the São Paulo Metropolitan Region, as well as in other areas that we serve. We cannot anticipate when, in what terms, or if, Law Project No. 4,147 or any other proposed federal regulation will become effective.

We may become subject to substantial water-related and sewage-related charges imposed by governmental water agencies of the State of São Paulo and of the Federal Government.

Governmental water agencies of the State of São Paulo may be, and the Federal Government is, authorized to collect fees from entities, including us, that either abstract water from, or dump sewage into, water resources controlled by these agencies. The fees collected by these agencies are to be used to sponsor studies, programs, projects and constructions provided for in the Water Resources Plan (*Plano de Recursos Hídricos*) and for the payment of expenses concerning the creation of the Federal System for Water Resources Managing (*Sistema Nacional de Gerenciamento de Recursos Hídricos*), as well as administrative costs regarding the bodies and entities pertaining thereto and they may be loaned or provided as grants or subsidies to governmental agencies and corporations, including us, for use in the development and maintenance of water resources. The legislature of the State of São Paulo is also urgently debating new legislation that would establish procedures for the collection of these fees. In addition, the Federal Government enacted legislation under which we must pay fees to the Federal Government or an agency in respect of the use of water from specified sources. We are uncertain as to the likely fees that may be assessed, or whether we will be able to pass on the cost of any of these fees to our customers.

We may experience difficulty in collecting substantial overdue accounts receivable due from municipalities.

As of June 30, 2004, we had accounts receivable totaling R$554.0 million from municipalities to which we provide water on a wholesale basis. Of this amount, R$87.9 million was 90 to 360 days overdue and R$419.4 million was more than 360 days overdue. In some cases, the Brazilian courts have required that we continue to provide water on a wholesale basis to municipalities, even if they fail to pay our invoices. Additionally, as of June 30, 2004, we had accounts receivable in the amount of R$300.3 million, owed to us by municipalities to which we render water and sewage services, including R$227.2 million owed by the Municipality of the City of São Paulo.

Although we have entered into negotiations with municipalities to reschedule such accounts receivable and have also filed legal proceedings against municipalities to collect the overdue amounts, some municipalities are currently not paying our invoices in full or on a timely basis. In addition, some governmental entities located in municipalities we serve are also not paying us on a regular basis. We cannot assure you as to whether or when these municipalities will resume making regular payments or pay overdue amounts owing to us. If these municipalities and government agencies do not pay amounts they owe us, our cash flows, results of operations and financial condition will be adversely affected.

We do not hold formal concessions for the City of São Paulo and several other municipalities that we serve, and therefore we may not be able to enforce our rights to continue to provide services in these municipalities.

We do not hold formal concessions in the City of São Paulo, which accounts for 55.6% of our sales and services rendered, or in 41 other municipalities in the State of São Paulo. We believe, however, that

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we have a vested or implied right to provide water and sewage services in these municipalities based upon, among other things, our ownership through our predecessor entities of the water and sewage systems serving these areas and also upon certain rights of succession resulting from our predecessor companies. Because we do not hold concessions or formal contract rights to provide services in these municipalities, we may not be able to effectively enforce our right to continue to provide services or to be paid for the services we provide. In the future, our rights in respect of the City of São Paulo and these other municipalities could be modified or adversely affected by Brazilian federal, state or local governmental actions or other factors.

From time to time, mayors of the City of São Paulo, including the present Mayor, have initiated or proposed discussions with the State of São Paulo regarding entering into a formal concession contract with us to provide water and sewage services in the City of São Paulo. The City of São Paulo legislature approved Law 13,670 of November 25, 2003 that regulates articles 148 and 149 of the Organic Law of the City of São Paulo (*Lei Orgânica do Município de São Paulo*) in relation to public water supply and sewage services. The law establishes the Municipal System for the Regulation of Public Water Supply and Sewage Services (*Sistema Municipal de Regulação dos Serviços de Abastecimento de Água e Esgotamento Sanitário*), creates and provides for the organization and operation of the São Paulo Regulatory Authority for Public Water Supply and Sewage Services (*Autoridade Reguladora dos Serviços de Abastecimento de Água e Esgotamento Sanitário de São Paulo*), and establishes the Municipal Sanitation Plan (*Plano Municipal de Saneamento*). Following the enactment of Law No. 13,670, the Governor of the State of São Paulo filed a legal action alleging that the law is unconstitutional, as a result of which the enforcement of Law No. 13,670 has been suspended. The merits of this lawsuit have not yet been judged. We cannot assure you when or if the suspension of Law 13,670 will end, or if its renewed application would result in the City of São Paulo granting us a formal concession contract, or the terms of any concession contract.

Municipalities for which we hold concessions may choose not to renew their concessions to us.

We provide water and sewage services in 325 municipalities pursuant to concessions granted by the municipalities. Substantially all of these concessions have 30-year terms: 273 of these concessions expire between October 15, 2004 and 2010, of which 128 are scheduled to expire in 2006; and the rest expire between 2011 and 2034. The Botucatu concession, one of our significant concessions, will expire on October 18, 2004 and we are in discussions to renew this concession for 30 years. A majority of these concessions are automatically renewable for a period equal to its initial term, although we often renegotiate terms and conditions, unless we or the municipality exercise the right to terminate the concession prior to the six-month period ending on the expiration date of the concession. Although the relevant municipality would have to pay us the non-amortized book value of our assets relating to that concession and assume any related indebtedness, exclusive of any amounts paid to us by such municipality upon any termination or non-renewal of a concession, this termination payment may not be paid and any termination could adversely affect our cash flows, results of operations and financial condition. In addition, the municipalities hold elections for the office of Mayor every four years. If certain municipalities choose not to renew their concessions, it could adversely affect our cash flows, results of operations and financial condition. Even if they choose to renew these concessions, we cannot assure you that we will obtain the same terms that we currently have.

Municipalities may terminate our concessions for any good public reason or if we fail to meet our contractual obligations.

Municipalities may terminate our concessions under some circumstances, including if we fail to comply with our obligations under the relevant concession contracts. In addition to contractual termination provisions in concession contracts, municipalities have the inherent power under Brazilian law to terminate concessions prior to their contractual expiration dates for any good public reason. The meaning of good public reason has not been defined by Brazilian law or conclusively determined by Brazilian courts. In the event of the termination of a concession, we may receive inadequate compensation from the concessionaire municipality. We may also incur material litigation costs related to termination of concessions and compensation. The Constitution of the State of São Paulo establishes that the municipalities in which we operate as water and sewage service providers may, in the course of granting authority over these services, create their own autonomous entities to render such services

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in their territories instead of continuing to use our services, with the obligation to indemnify us for the termination of the concession with us over a term of up to 25 years rather than at the time the concession is terminated. The State of São Paulo obtained an injunction in a legal action alleging this indemnification to be unconstitutional. As a result, this indemnification has been suspended. In the event that this injunction is stayed and/or the outcome of the legal action is not favorable to us, the indemnification over a term of 25 years may adversely affect our operational results and financial condition. In 1997, the Municipality of Santos enacted a law expropriating our water and sewage systems in Santos. In response, we filed an action seeking an injunction against this expropriation which was denied by the lower court. This decision was later reversed by the Court of Appeals of the State of São Paulo, which issued a preliminary order suspending that law. On August 2, 2002, a decision on this matter was rendered in our favor by a lower court. This decision is still subject to appeal, and we cannot assure you that the ultimate determination will be favorable to us. Despite the pending lawsuit, we continue to provide water and sewage services to Santos.

We cannot assure you that other municipalities will not seek to terminate their concessions. Exercise of concession termination rights by substantial numbers of municipalities could have a material adverse effect on our cash flows, results of operations and financial condition.

We may be required to compete through a public bidding process in order to obtain new or renew existing concessions.

Substantially all of our concessions were granted without a public bidding process. Under current Brazilian Federal and State law, however, for any new concession we may be required to participate in a bidding process. In addition, if a public entity from which we hold a concession granted prior to the enactment of the concession laws determines that in order to comply with such laws it must engage in a public bidding process, we could be required to compete in order to renew our existing concession. While we may be able to obtain concessions without participating in a bidding process, we cannot assure you that the Brazilian courts will continue to interpret the concessions laws to permit municipalities to grant concessions without a public bidding process or that we will be able to secure all new water and sewage concessions that we may wish to obtain.

In the event we are obligated to participate in public bidding processes in order to renew our existing concessions or to obtain new ones, our failure to outbid our competitors for our existing concessions may adversely impact our cash flows, results of operations and financial condition.

The conditions attached to the renewal of our authorizations to abstract water may be burdensome and could result in an increase in costs and higher capital expenditure requirements.

We may abstract water from rivers or reservoirs only to the extent permitted by the Department of Water and Energy of the State of São Paulo (*Departamento de Águas e Energia Elétrica do Estado de São Paulo*). Under some circumstances, depending on the geographic location of the relevant river basin or reservoir, the approval of the National Water Agency (*Agência Nacional de Águas* ANA) is also required. The term of these authorizations will vary depending on the granting authority, and their renewal must be approved by their original grantors.

The conditions upon which such governmental authorities will renew our authorizations to abstract water are not known. If we are unable to renegotiate any burdensome condition imposed by such governmental authorities we may be exposed to increased costs and capital expenditures, which may negatively affect our cash flows, results of operations and financial condition.

We may be unable to increase customer tariffs in line with increases in inflation and operating expenses.

Our results of operations and financial condition are highly dependent upon our ability to set and collect adequate tariffs for our water and sewage services. Although we generally have broad power to establish tariffs, this power is, in practice, subject to political and legal constraints. From mid-1999 until mid-2001 we did not raise our tariffs, due to a State policy of not increasing tariffs for public services. In June 2001, we increased our average tariffs by approximately 13.1% which was broadly in line with the prevailing inflation rates in Brazil since mid-1999 and, in August 2002 we raised our tariffs by approximately 8.2%. In August 2003 we raised our tariffs for water and sewage services by approximately 19.0%, and in August 2004 we raised our tariffs for water and sewage services by approximately 6.8%. Tariffs with respect to the residential social (which includes residences of low-income families that live in sub-standard conditions, residences of persons unemployed for up to 12 months and collective living residences) and *favela* (shantytown) categories, are not always increased at the same rate as other tariffs. For example, in August 2003, these tariffs were increased by only 9.0%. Also in August 2003, a new readjustment formula was approved by our Board of Directors, although we are not certain if we will be able to use this formula in the future. We will continue to rely upon tariff revenue to provide funds for our capital expenditure program in addition to our financing activities and to meet our debt service requirements. However, we cannot assure you when and if a new tariff policy will be implemented or if such implementation will meet our expectations. Any failure to establish or maintain tariffs commensurate with these and our other needs could have an adverse effect on our cash flows, results of operations and financial condition.

We have substantial liquidity and capital resource requirements, and any failure to obtain new financing may have a material adverse effect on the operation and development of our business.

Our capital expenditure program calls for expenditures of approximately R$4.3 billion in the period from 2004 through 2008, including approximately R$883.0 million in 2004 and R$880.0 million in 2005. We spent approximately R$300.0 million on our capital expenditure program during the six months ended June 30, 2004. We plan to fund these expenditures and our other liquidity and capital resource needs out of funds generated by operations and domestic and foreign currency borrowings on acceptable terms. We are currently negotiating with BNDES and Caixa Econômica Federal for additional loans to finance portions of our capital expenditure program. If these negotiations are unsuccessful or do not result in financing on acceptable terms, our ability to finance our capital expenditure program may be impaired.

Historically, a significant portion of our financing needs has been funded by financing provided by lenders controlled by the Federal Government. If the policies of the Federal Government regarding the financing of water and sewage services change, our ability to finance our capital expenditure program may be impaired.

We cannot assure you that we will be able to obtain sufficient funds to complete our capital expenditure program or satisfy our other liquidity and capital resources requirements. Failure to obtain the requisite funds could delay or prevent completion of our capital expenditure program and other projects, which may have a material adverse effect on the operation and development of our business.

Brazilian regulations as well as contractual provisions may limit our ability to incur indebtedness in the future.

Because we are controlled by the State of São Paulo we are subject to special credit rules for the public sector published by the Brazilian monetary authorities. As a general rule, financial institutions and other institutions authorized to provide credit by the Central Bank may only provide loans to public sector entities, such as us, up to a certain percentage of such entities net equity. In addition, new loans in connection with certain water and sewage activities may only be given up to certain pre-established amounts. Because of these limitations on our ability to obtain credit from private financial institutions, our options for raising funds, other than the cash generated by our operations, consist principally of borrowing from state-owned financial institutions or development agencies and issuing bonds and other publicly traded obligations. These limitations on obtaining credit could adversely affect the development of our business, our ability to meet our obligations or continue our capital expenditure program, and our cash flows, results of operations and financial condition.

Under our existing debt instruments, we are subject to covenants limiting our ability to incur additional indebtedness, whether denominated in *reais* or foreign currency. Under these covenants, we would have been able to borrow up to an additional R$615.5 million as of June 30, 2004. If, however, these and other limitations prevent us from completing our capital expenditure program or executing our business plans generally, we may be unable to satisfy all of our liquidity and capital resources requirements, which could have a material adverse effect on our cash flows, results of operations and financial condition.

Droughts and our water consumption reduction program may result in a decrease in the volume of water billed and the revenue from water supplies, which may have a material adverse effect on our company.

We experience decreases in our water supply from time to time due to droughts. In the event of prolonged drought, the volume of water provided by us may be reduced, although the impact that droughts have may vary across our different water supply systems. Throughout 2003, rain levels were below average resulting in a weak replenishment of our reservoirs, particularly in the Cantareira System, the largest system in the São Paulo Metropolitan Region. In order to minimize the effects of this drought, in March 2004 we approved a water consumption reduction incentive program based on a bonus system, pursuant to which customers that achieved their consumption reduction goal would be entitled to a 20.0% discount on their water bill. This incentive program ended on September 15, 2004 and encompassed most of the customers in the São Paulo Metropolitan Region. We cannot assure you that any drought in the future will not materially adversely affect our water supply and, accordingly, our cash flows, results of operations and financial condition.

Potential costs of environmental compliance as well as potential environmental liability may have a material adverse effect on our company.

Our facilities are subject to many Brazilian federal, state and local laws and regulations relating to the protection of health and the environment. We have made, and will continue to make, substantial expenditures to comply with these provisions. In addition, because environmental laws and their enforcement are becoming more stringent, our capital expenditures and expenses for environmental compliance may increase substantially in the future. The amount of investments that we make in any given year is subject to limitations imposed by the State Government. Expenditures required for compliance with environmental regulation may result in reductions in other strategic investments that we have planned, which could negatively affect our profitability. We could also be exposed to criminal and administrative penalties, in addition to indemnification obligations, for possible damage for non-compliance with environmental laws and regulations. Any material unforeseen environmental costs and liabilities may have a material adverse effect on our future financial performance.

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

We are a party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among others, tax, labor, condemnation and other proceedings. A substantial monetary judgment against us in one or more of these legal proceedings may have a material adverse effect on our business or financial condition. Based on advice we received from our lawyers, we have provisioned a total aggregate amount of R$442.1 million as of June 30, 2004 to cover losses related to legal proceedings considered probable. This provision does not cover, however, all legal proceedings involving monetary claims filed against us. Any unfavorable judgment in relation to these proceedings may have an adverse effect on our cash flows, results of operations and financial condition.

Because we are not insured for all business-related and environmental-related contingencies, the occurrence of any such event may have a material adverse effect on our future financial performance.

We do not have insurance coverage for business interruption risk or for liabilities arising from contamination or other problems involving our water supply to customers. In addition, we do not have insurance coverage for liabilities relating to non-compliance with environmental laws and regulations relating to our sewage services. As a result, any major business interruption or environmental-related liability may have a material adverse effect on our future financial performance.

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Risks Relating to Brazil

Brazilian economic, political and other conditions may have a material adverse effect on our business and the market price of our common shares and ADSs.

The Brazilian economy has been characterized by significant involvement on the part of the Brazilian government, which often changes monetary, credit and other policies to influence Brazil s economy. The Brazilian government s actions to control inflation and affect other policies have often involved wage and price controls, currency devaluations, increases in the Central Bank s base interest rates, capital controls and limits on imports, as well as other measures, such as the freezing of bank accounts.

Actions taken by the Brazilian government concerning the economy may have important effects on Brazilian corporations and other entities, including us, and on market conditions and prices of Brazilian securities, including our equity and debt securities. Our financial condition and results of operations may be adversely affected by the following factors or the Brazilian government s response to them:

- currency devaluation and other exchange rate movements;
- inflation;
- currency exchange control policies;
- social instability;
- price instability;
- energy shortages;
- interest rates;
- liquidity of domestic capital and lending markets;
- the upcoming municipal elections in Brazil;
- tax policy; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

Brazil s President, Luiz Inacio Lula da Silva took office on January 1, 2003. In the period leading up to his election and for a period of time thereafter, there was substantial uncertainty relating to the policies that the new government would pursue, including the potential implementation of macroeconomic policies that differed significantly from those of the prior administration. This uncertainty resulted in a lower level of confidence in the Brazilian currency and capital markets, contributing to the rapid depreciation of the *real* against the US dollar during that period. Although the Government has not departed significantly from policies of the previous administration, and the *real* appreciated 22.3% against the US dollar during 2003 before depreciating by 7.0% during the first six months of 2004, there remains concern about the policies of the current Brazilian government. Uncertainty over whether current policies will be continued or whether the Brazilian government will adopt different policies in the future may contribute to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets and securities issued abroad that are supported by Brazilian issuers. In addition, the next municipal elections and State elections are scheduled to occur in October 2004 and October 2006, respectively. We cannot predict the outcome of the elections, the policies that current or future administrations may adopt, or the effect those policies may have. Any substantial negative reaction to the policies adopted by the Brazilian Federal or State Government from time to time could adversely affect our cash flows, results of operations and financial condition and the market price of our common shares and ADSs.

Any further devaluation of the real could adversely affect our ability to service our foreign currency-denominated debt, and could lead to a decline in the market price of our common shares and ADSs.

The Brazilian currency has been devalued frequently during the last four decades. Throughout this period, the Brazilian government has implemented various economic plans and utilized various exchange rate policies,

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including sudden devaluations, periodic mini-devaluations (during which the frequency of adjustments has ranged from daily to monthly), exchange controls, multiple exchange rate markets and a floating exchange rate system. From time to time, there have been significant fluctuations in the exchange rates between the Brazilian currency and the US dollar and other currencies. For example, in 2000, 2001 and 2002, the *real* devalued 8.5%, 15.7% and 34.3% respectively, while appreciating 22.3% in 2003 and depreciating 7.0% for the six months ended June 30, 2004 against the US dollar.

In the event of a significant devaluation of the *real* in relation to the US dollar or other currencies, our ability to meet our foreign currency-denominated obligations could be adversely affected, particularly because our tariff revenue and other sources of income are based solely in *reais*. In addition, because we have substantial foreign currency-denominated indebtedness, any significant devaluation of the *real* during a financial period will increase our financial expenses as a result of foreign exchange losses that we must record. We had total foreign currency-denominated indebtedness of R$3,147.8 million as of June 30, 2004, and we anticipate that we may incur substantial amounts of foreign currency-denominated indebtedness in the future. For example, our overall results of operations for 2003 were significantly positively affected by 65.0% due to the appreciation of the *real* against the US dollar in 2003 and negatively affected by 7.0% due to the depreciation of the *real* against the US dollar during the six months ended June 30, 2004. We do not currently have any hedging instruments in place to protect us against a devaluation of the *real* in relation to any foreign currency.

A devaluation would also reduce the US dollar value of distributions and dividends on our common shares and ADSs and could reduce the market price of our common shares and ADSs.

The Brazilian government s actions to combat inflation and public speculation about possible future action may contribute significantly to economic uncertainty in Brazil and cause the price of our equity and debt securities to fall.

Historically, Brazil has experienced high rates of inflation. Inflation itself as well as governmental efforts to combat inflation have had significant negative effects on the Brazilian economy in general. Inflation, action taken to combat inflation and public speculation about possible future action has also materially contributed to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets.

Inflation, as measured by the General Price Index-Market, or the IGP-M (*Índice Geral de Preços de Mercado*), was 20.1% in 1999, 10.0% in 2000, 10.4% in 2001, 25.3% in 2002, 8.7% in 2003 and 6.8% during the six months ended June 30, 2004. There can be no assurance that levels of inflation in Brazil will not increase in future years and have a material adverse effect on our cash flows, results of operations or financial condition.

If Brazil experiences significant inflation in the future, our costs and expenses may rise, we may be unable to increase our tariffs to counter the effects of inflation, and our overall financial performance may be adversely affected. In addition, a substantial increase in inflation may weaken investor confidence in Brazil and lead to a decline in the market price of our equity and debt securities.

Brazilian law might permit claims directly against our shareholders for harm to the environment.

Brazilian law might permit claims directly against our shareholders for harm to the environment. Brazilian Law No. 9,605 of February 12, 1998 provides that the liability protection associated with the corporate structure of a company may be disregarded if it impedes recovery for undue harm to the environment. We cannot assure you that, in the case of claim for environmental damage under this law, liabilities would be limited to shareholders capable of exercising control over the company at the time of the environmental damage. Accordingly, if we were unable to redress claims against us for environmental damages, which might happen, for example, if we were to become insolvent, our shareholders and the members of our management might become liable for those claims. We are not aware of any successful assertion of claims against any shareholders of any Brazilian corporation under this law and cannot predict the circumstances in which this might happen.

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The relative volatility and illiquidity of the Brazilian securities market may substantially limit a holder s ability to sell the common shares underlying our ADSs at the prices and time he or she desires.

The Brazilian securities markets are substantially smaller, less liquid, more concentrated and more volatile than major securities markets in the United States and other jurisdictions, and are not as highly regulated or supervised as some of these other markets. The relatively small market capitalization and illiquidity of the Brazilian equity markets may substantially limit a holder s ability to sell the common shares underlying our ADSs at the price and time he or she desires.

Developments in other emerging market countries may adversely affect the Brazilian economy and, therefore, the market prices of our common shares and ADSs, as well as of our debt securities.

In the past, the Brazilian economy and the securities of Brazilian companies have been, to varying degrees, influenced by economic and market conditions in other emerging market countries as well as investors responses to those conditions.

In addition, although economic conditions are different in each country, investors reactions to adverse developments in one country may affect the market price of securities of issuers in other countries, including Brazil. For example, the 1997 Asian economic crisis, the 1998 Russian debt moratorium and devaluation of the Russian currency and the recent economic crises in Argentina and Venezuela triggered market volatility in Latin America and securities markets in other emerging market countries. Accordingly, adverse developments in other emerging market countries could lead to a reduction in the demand for, and market prices of, our common shares and ADSs.

Risks Relating to our Common Shares and ADSs

Restrictions on the movement of capital out of Brazil may impair the ability of holders to receive dividends and distributions on, and the proceeds of any sale of, the common shares underlying our ADSs.

The Brazilian government may impose temporary restrictions on the conversion of Brazilian currency into foreign currencies and on the remittance to foreign investors of the proceeds of their investments in Brazil. Brazilian law permits the Government to impose these restrictions whenever there is a serious imbalance in Brazil s balance of payments or there are reasons to foresee a serious imbalance.

The Brazilian government imposed remittance restrictions for approximately six months in 1990. Similar restrictions, if imposed, would impair or prevent the conversion of dividends, distributions, or the proceeds from any sale of common shares, as the case may be, from *reais* into US dollars and the remittance of the US dollars abroad. We cannot assure you that the Brazilian government will not take similar measures in the future. In such a case, the Depositary for our ADSs will hold the *reais* it cannot convert for the account of the ADR holders who have not been paid. The Depositary will not invest the *reais* and it will not be liable for interest.

Holders of our common shares and ADSs may not receive any dividends or interest on shareholders equity.

According to our by-laws, we must generally pay our shareholders at least 25.0% of our annual net income as dividends or interest on shareholders equity, as determined and adjusted under the Brazilian Corporate Law Method. This adjusted income may be capitalized, used to absorb losses or otherwise appropriated as allowed under the Brazilian Corporate Law Method and may not be available to be paid as dividends or interest on shareholders equity. We may not pay dividends or interest on shareholders equity to our shareholders in any particular fiscal year if our Board of Directors determines that such distributions would be inadvisable in view of our financial condition.

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If a holder exchanges ADSs for common shares, he or she risks losing the ability to remit foreign currency abroad and Brazilian tax advantages.

The Brazilian Custodian for the common shares underlying our ADSs must obtain a certificate of registration from the Central Bank to be entitled to remit US dollars abroad for payments of dividends and other distributions relating to our common shares or upon the disposition of our common shares. If a holder decides to exchange his or her ADSs for the underlying common shares, he or she will be entitled to continue to rely for five business days from the date of exchange on the Custodian s certificate of registration. After that period, the holder may not be able to obtain and remit US dollars abroad upon the disposition 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 under Resolution No. 2,689, of January 26, 2000, of the National Monetary Council, which entitles registered foreign investors to buy and sell on the Brazilian stock exchanges. If the holder does not obtain a certificate of registration or register under Resolution No. 2,689, he or she will generally be subject to less favorable tax treatment on gains with respect to our common shares. We may face difficulties in distributing the proceeds from the sale of our common shares abroad.

If a holder attempts to obtain his or her own certificate of registration, he or she 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. We cannot assure you that the Custodian s certificate of registration or any foreign capital registration obtained by a holder may not be affected by future legislative changes, or that additional restrictions applicable to the holder, the disposition of the underlying common shares or the repatriation of the proceeds from disposition will not 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 subject to different corporate rules and regulations as a Brazilian company and holders may have fewer and less well-defined shareholders rights despite the fact that we are listed on the Novo Mercado.

Despite the fact that we are listed on the *Novo Mercado* segment of the São Paulo Stock Exchange, our corporate affairs are governed by our by-laws and the Brazilian Corporate Law, which differ from the legal principles that would apply if we were incorporated in a jurisdiction in the United States, such as the State of Delaware or the State of New York, or in other jurisdictions outside Brazil. In addition, the rights of holders of our ADSs or common shares under the Brazilian Corporate Law to protect their interests relative to actions by our Board of Directors may be fewer and less well-defined than under the laws of those other jurisdictions.

Although insider trading and price manipulation are crimes under Brazilian law, the Brazilian securities markets are not as highly regulated and supervised as the US securities markets or markets in some other jurisdictions. In addition, rules and policies against self-dealing and regarding the preservation of shareholder interests may be less well-defined and enforced in Brazil than in the United States, putting holders of our common shares and ADSs at a potential disadvantage. Corporate disclosures may be less complete or informative than what may be expected of a US public company.

A holder of common shares or ADSs may face difficulties in protecting his or her interests as a shareholder because we are a Brazilian 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 fixed assets and those of these other persons 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 US courts for civil liabilities based upon the US federal securities laws may only be enforced in Brazil if certain requirements are met, a holder may face more difficulties in protecting his or her interests in the case of actions by our directors, officers or our controlling shareholder than would shareholders of

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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 as payment of such judgment must be made pursuant to the State s budget in a subsequent fiscal year. None of the public property of our controlling shareholder is subject to execution or attachment, either prior to or after judgment.

The protections afforded to minority shareholders in Brazil are different from those in the United States and other jurisdictions, and may be more difficult to enforce.

Under Brazilian law, the protections afforded to minority shareholders are different from those in the United States and other jurisdictions. In particular, the case law with respect to shareholder disputes is less developed under Brazilian law than under US law and the laws of other jurisdictions and there are different procedural requirements for bringing shareholder lawsuits, such as shareholder derivative suits. As a result, in practice it may be more difficult for our minority shareholders to enforce their rights against us or our directors or controlling shareholder than it would be for shareholders of a non-Brazilian company.

Actual or anticipated sales of a substantial number of our common shares could decrease the market prices of our common shares and ADSs.

Sales of a substantial number of our common shares, or the perception that such sales may occur, could decrease the trading price of our common shares and ADSs. After giving effect to the ADS and Brazilian offerings, we will have 28,479,577,827 common shares outstanding, including 15,549,779,728 shares held by the State of São Paulo. As a consequence of the issuance of common shares or sales by the State of São Paulo or by other existing shareholders, the market price of our common shares and, by extension, our ADSs may decrease significantly. As a result, a holder may not be able to sell his or her common shares at or above the price he or she paid for them.

Mandatory arbitration provisions in our by-laws may limit the ability of a holder of our ADSs to enforce liability under US securities laws.

Under our by-laws, any disputes among us, our shareholders and our management with respect to the application of *Novo Mercado* rules, the Brazilian Corporate Law and the application of the rules and regulations regarding Brazilian capital markets, will be resolved by arbitration conducted pursuant to the São Paulo Stock Exchange Arbitration Rules in the São Paulo Stock Exchange Arbitration Chamber. Any disputes among shareholders, including holders of ADSs, and disputes between us and our shareholders, including holders of ADSs, will also be submitted to arbitration. The State of São Paulo is currently not permitted by law to sell its control shares. As a result, a court in the United States might require that a claim brought by a holder of ADSs predicated upon the US securities laws be submitted to arbitration in accordance with our by-laws. In that event, a purchaser of ADSs would be effectively precluded from pursuing remedies under the US securities laws in the US courts.

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

US 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 US Securities Act of 1933 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, a 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 holder will receive no value for them.

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A holder of our ADSs may find it more difficult than a holder of our common shares to exercise his or her voting rights at our shareholders meetings.

Holders may exercise voting rights with respect to the common shares represented by our ADSs only in accordance with the deposit agreement relating to our ADSs. There are no provisions under Brazilian law or under our by-laws that limit the exercise by ADS holders of their voting rights through the Depositary with respect to the underlying common shares. However, there are practical limitations upon the ability of ADS holders to exercise their voting rights due to the additional procedural steps involved in communicating with these holders. For example, our common shareholders will receive notice of shareholders meetings through publication of a notice in an official government publication in Brazil and will be able to exercise their voting rights by either attending the meeting in person or voting by proxy. ADS holders, by comparison, will not receive notice directly from us. Instead, in accordance with the deposit agreement, we will provide the notice to the Depositary, which will, in turn, as soon as practicable thereafter mail to holders of ADSs the notice of the meeting and a statement as to the manner in which instructions may be given by holders, but only if we request the Depositary to do so. To exercise their voting rights, ADS holders must instruct the Depositary as to voting the common shares represented by their ADSs. Due to these procedural steps involving the Depositary, the process for exercising voting rights may take longer for ADS holders than for holders of common shares. ADSs for which the Depositary does not receive timely voting instructions will not be voted at any meeting.

Changes in Brazilian tax laws may have an adverse impact on the taxes applicable to a disposition of the ADSs.

According to Law No. 10,833, enacted on December 29, 2003, the disposition of assets located in Brazil by a non-resident to either a Brazilian resident or a non-resident is subject to taxation in Brazil, regardless of whether the disposition occurs outside or within Brazil. In the event that the disposition of assets is interpreted to include a disposition of the ADSs, this tax law could result in the imposition of withholding taxes on a disposition of ADSs by a non-resident of Brazil to another non-resident of Brazil. Due to the fact that Law No. 10,833 has been recently enacted and no judicial guidance as to its application yet exists, we are unable to predict whether an interpretation applying such tax laws to dispositions of ADSs between non-residents could ultimately prevail in the courts of Brazil.

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USE OF PROCEEDS

We will not receive any proceeds from the sale of ADSs and common shares being offered in the ADS and Brazilian offerings. The selling shareholders will receive all of the net proceeds from the sale of ADSs and common shares in these offerings.

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EXCHANGE RATES

There are two principal legal foreign exchange markets in Brazil, the commercial rate exchange market and the floating rate exchange market. Most trade and financial foreign-exchange transactions are carried out on the commercial rate exchange market. These transactions include the purchase or sale of common shares or the payment of dividends or interest with respect to common shares. Foreign currencies may only be purchased through a Brazilian bank authorized to operate in these markets. In both markets, rates are freely negotiated but may be strongly influenced by intervention from the Central Bank.

In 1999, the Central Bank placed the commercial exchange rate and the floating rate exchange market under identical operational limits, which led to a convergence in the pricing and liquidity of both markets. Since February 1, 1999, the floating market rate has been substantially the same as the commercial market rate. However, there is no guarantee that these rates will continue to be substantially the same in the future. Despite the convergence in pricing and liquidity of both markets, each market continues to be regulated separately.

Since 1999, the Central Bank has allowed the *real*/US dollar exchange rate to float freely, and during that period, the *real/*US dollar exchange rate has fluctuated considerably. In the past, the Central Bank has intervened occasionally to control unstable movement in foreign exchange rates.

At the present time, we cannot predict whether the Central Bank will continue to let the *real* float freely or whether it will intervene in the foreign exchange market through a currency band system or otherwise. The *real* may appreciate or depreciate against the U.S. dollar substantially in the near future.

As of September 27, 2004, the commercial selling rate published by the Central Bank was R$2.8728 per US$1.00.

The following table shows the commercial selling rate for US dollars for the periods and dates indicated. The information in the Average column represents the average of the exchange rates for the period indicated.

	Low	High	Average	Period-end
		(*Reais* per US$1.00)		
Year ended December 31,				
1999	1.2078	2.1647	1.8158	1.7890
2000	1.7234	1.9847	1.8295	1.9554
2001	1.9353	2.8007	2.3522	2.3204
2002	2.2709	3.9552	2.9309	3.5333
2003	2.8219	3.6623	3.0715	2.8892
2004 (through September 27)	2.8022	3.2051	2.9753	2.8728
Month ended				
First Quarter	2.8022	2.9878	2.9211	2.9086
Second Quarter	2.8743	3.2051	3.0604	3.1075
January 31, 2004	2.8022	2.9409	2.8518	2.9409
February 28, 2004	2.9042	2.9878	2.9303	2.9138

March 31, 2004	2.8752	2.9410	2.9055	2.9086
April 30, 2004	2.8743	2.9522	2.9060	2.9447
May 31, 2004	2.9569	3.2051	3.1004	3.1291
June 30, 2004	3.1030	3.1651	3.1291	3.1075
July 31, 2004	2.9939	3.0747	3.0368	3.0268
August 31, 2004	2.9338	3.0637	3.0029	2.9338
September 1 through 27, 2004	2.8676	2.9361	2.8959	2.8728

Source: Central Bank of Brazil

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MARKET INFORMATION

Market Price of Common Shares

Our common shares are traded on the São Paulo Stock Exchange under the symbol SBSP3. As of August 31, 2004, we had 3,202 registered holders of common shares. All of our ADSs are held through the Depositary which is registered as one holder.

The table below sets forth, for the periods indicated, the reported high and low closing sale prices in *reais* for common shares on the São Paulo Stock Exchange. The table also sets forth prices per ADS assuming that ADSs had been outstanding on all such dates and translated into US dollars at the commercial market rate for the sale of US 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. See Exchange Rates for information with respect to exchange rates applicable during the periods set forth below.

	Reais per 1,000 common shares		US dollars per 250 common shares (equivalent of one ADS)		Average daily trading volume (in lots of 1,000 common shares)
	Low	High	Low	High	
1999	R$ 47.0	R$ 213.0	US$ 8.91	US$ 29.11	19,352
2000	128.5	211.0	17.41	29.29	20,551
2001:					
First quarter	172.01	238.60	22.14	27.71	17,515
Second quarter	151.00	194.49	16.14	21.04	15,722
Third quarter	104.50	176.89	9.51	16.56	10,337
Fourth quarter	98.00	137.50	8.95	14.87	16,363
2002:					
First quarter	121.00	141.00	12.47	15.04	21,078
Second quarter	96.60	152.00	8.65	16.33	49,444
Third quarter	74.60	101.50	6.03	8.82	42,226
Fourth quarter	74.00	92.00	4.77	6.51	44,699
2003:					
First quarter	74.60	100.90	5.21	7.62	43,677
Second quarter	84.45	117.49	6.33	10.30	68,442
Third quarter	100.80	136.51	8.20	11.77	59,222
Fourth quarter	125.39	168.00	10.91	14.29	48,800
2004:					
First Quarter	129.80	182.00	11.00	16.24	60,063
Second Quarter	117.05	153.50	9.20	13.30	50,401
January	135.00	182.00	11.48	16.24	73,437
February	129.80	154.50	11.00	13.20	69,314
March	132.85	160.00	11.35	13.82	40,613
April	134.00	153.50	11.38	13.30	46,532
May	117.05	145.00	9.20	12.24	65,352
June	120.50	134.00	9.54	10.78	39,134
July	134.98	145.93	11.04	12.15	30,420

August	127.36	147.05	10.53	12.36	28,650
September 1 through 27	127.20	141.30	10.95	12.06	33,174

Source: São Paulo Stock Exchange and Bloomberg.

Our common shares have been listed on the São Paulo Stock Exchange since June 4, 1997 and since April 24, 2002 our common shares have been included on the *Novo Mercado* segment of that Exchange. Prior to June 4, 1997, our common shares were traded on *Sociedade Operadora do Mercado de Acesso* (SOMA), an over-the-counter market in Brazil.

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As of September 27, 2004, the closing sale price for our common shares on the São Paulo Stock Exchange was R$135.52 per 1,000 shares, which is equivalent to US$11.80 per ADS when translated into US dollars at the exchange rate in effect on that date.

Market Price of ADSs

Our ADSs, each of which represents 250 of our common shares, are listed on the New York Stock Exchange under the symbol SBS. Our ADSs began trading on the New York Stock Exchange on May 10, 2002 in connection with the initial offering of our equity securities in the United States. The State of São Paulo was the selling shareholder in that offering, and we did not receive any of the offering proceeds.

The table below sets forth, for the periods indicated, the reported high and low closing prices for our ADSs on the New York Stock Exchange.

	Price in US dollars per ADS		
	Low	High	Average daily trading volume
2002:			
Second quarter (commencing May 10)	US$ 8.60	US$ 11.90	186,311
Third quarter	4.75	8.80	42,784
Fourth quarter	4.65	6.45	25,098
2003:			
First quarter	5.29	7.80	17,014
Second quarter	6.33	10.05	30,020
Third quarter	8.20	11.9	83,056
Fourth quarter	10.92	14.47	69,912
2004:			
First quarter	11.21	16.07	116,007
Second quarter	9.24	13.45	73,831
January	11.68	16.07	135,935
February	11.21	13.18	115,879
March	11.38	13.85	98,974
April	11.45	13.45	66,381
May	9.24	12.30	95,485
June	9.64	10.93	60,657
July	10.93	12.17	54,629
August	10.55	12.35	41,891
September 1 through 27	11.00	12.09	43,867

Source: New York Stock Exchange

As of September 27, 2004, the closing sale price for our ADS on the New York Stock Exchange was US$11.83 per ADS.

Trading on the Brazilian Stock Exchanges

In 2000, the Brazilian stock exchanges were reorganized through the execution of memoranda of understanding by the Brazilian stock exchanges. Pursuant to the memoranda, all securities are now traded only on the São Paulo Stock Exchange, with the exception of electronically traded public debt securities and privatization auctions, which are traded on the Rio de Janeiro Stock Exchange. Consequently, in 2001, 2002 and 2003, the São Paulo Stock Exchange accounted for 100.0% of the trading value of equity securities on all Brazilian stock exchanges.

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If you were to trade in our common shares on the São Paulo Stock Exchange, your trade would settle in three business days after the trade date without adjustment of the purchase price for inflation. The seller is ordinarily required to deliver the shares to the exchange on the second business day following the trade date. Delivery of and payment for shares are made through the facilities of the clearinghouse, or *Companhia Brasileira de Liquidação e Custódia*.

Each Brazilian stock exchange is a nonprofit entity owned by its member brokerage firms. Trading on each exchange is limited to member brokerage firms and a limited number of authorized non-members. The São Paulo Stock Exchange has two open outcry trading sessions each day from 11:00 a.m. to 1:30 p.m. and from 2:30 p.m. to 5:45 p.m. Brazil local time, except during daylight savings time in the United States. During daylight savings time in the United States, the sessions are from 10:00 a.m. to 1:00 p.m. and from 2:00 p.m. to 4:45 p.m. Brazil local time, to closely mirror New York Stock Exchange trading hours. Trading is also conducted between 11:00 a.m. and 6:00 p.m., or between 10:00 a.m. and 5:00 p.m. during daylight savings time in the United States, on an automated system known as the Computer Assisted Trading System (*Sistema de Negociação Assistida por Computador*) on the São Paulo Stock Exchange and on the National Electronic Trading System (*Sistema Eletrônico de Negociação Nacional*). This system is a computerized system which links electronically with the seven smaller regional exchanges. The São Paulo Stock Exchange also permits trading from 5:45 p.m. to 7:30 p.m., on an online system connected to traditional and internet brokers called the After Market. Trading on the After Market is subject to regulatory limits on price volatility and on the volume of shares transacted through internet brokers. There are no specialists or officially recognized market makers for our shares.

In order to better control volatility, the São Paulo Stock Exchange adopted a circuit breaker system pursuant to which trading sessions may be suspended for a period of 30 minutes or one hour whenever the indices of these stock exchanges fall below the limits of 10.0% or 15.0%, respectively, in relation to the index registered in the previous trading session.

The São Paulo Stock Exchange is significantly less liquid than the New York Stock Exchange or other major exchanges in the world. As of August 31, 2004, the aggregate market capitalization of the 357 companies listed on the São Paulo Stock Exchange was equivalent to approximately R$745.3 billion (US$254.0 billion) and the 10 largest companies listed on the São Paulo Stock Exchange represented approximately 48.5% of the total market capitalization of all listed companies. Although any of the outstanding shares of a listed company may trade on a Brazilian stock exchange, in most cases fewer than half of the listed shares are actually available for trading by the public, the remainder being held by small groups of controlling persons, by governmental entities or by one principal shareholder. As of August 31, 2004, we accounted for approximately 0.5% of the market capitalization of all listed companies on the São Paulo Stock Exchange.

Trading on Brazilian stock exchanges by a holder not deemed to be domiciled in Brazil for Brazilian tax and regulatory purposes (a non-Brazilian holder) is subject to certain limitations under Brazilian foreign investment legislation. With limited exceptions, non-Brazilian holders may only trade on Brazilian stock exchanges in accordance with the requirements of Resolution No. 2,689, of January 26, 2000, of the National Monetary Council. Resolution No. 2,689 requires that securities held by non-Brazilian holders be maintained in the custody of, or in deposit accounts with, financial institutions duly authorized by the Central Bank and the Brazilian Securities Commission. In addition, Resolution No. 2,689 requires non-Brazilian holders to restrict their securities trading to transactions on Brazilian stock exchanges or qualified over-the-counter markets. With limited exceptions, non-Brazilian holders may not transfer the ownership of investments made under Resolution No. 2,689 to other non-Brazilian holders through a private transaction. See Taxation Brazilian Tax Considerations Taxation of Gains for a description of certain tax benefits extended to non-Brazilian holders who qualify under Resolution No. 2,689.

Novo Mercado

Since April 24, 2002, our shares have been listed on the *Novo Mercado*. The *Novo Mercado* is a listing segment under the São Paulo Stock Exchange designed for the trading of shares issued by companies that

voluntarily undertake to abide by certain corporate governance practices and disclosure requirements in addition to those already imposed by Brazilian law. A company in the *Novo Mercado* must follow a series of corporate rules known as good practices of corporate governance. These rules generally increase shareholders rights and enhance the quality of information provided to shareholders.

In addition to the obligations imposed by current Brazilian law, a company listed on the *Novo Mercado* is obligated to:

- issue only voting shares;
- hold public offerings of shares in a manner favoring diversification of the company s shareholder base and broader retail access;
- maintain a minimum free float equal to 25.0% of the outstanding share capital of the company;
- grant tag-along rights for all shareholders in connection with a transfer of control of the company;
- limit the term of all members of the board of directors to one year;
- prepare annual and quarterly financial statements, including cash flow statements, in accordance with US GAAP or International Accounting Standards;
- disclose information on a quarterly basis, including insider share ownership and amount of free float of shares;
- if it elects to delist from the *Novo Mercado*, hold a tender offer by the company s controlling shareholder (the minimum price of the shares to be offered will be determined by an appraisal process);
- make greater disclosure of related party transactions;
- adherence to the São Paulo Stock Exchange Arbitration Chamber;
- disclose any shareholders agreements and share option plans; and
- make available to its shareholders a timetable of corporate events.

Regulation of Brazilian Securities Markets

The Brazilian securities markets are principally governed by Law No. 6,385, of December 7, 1976, and the Brazilian Corporate Law, each as amended and supplemented, and by regulations issued by the Brazilian Securities Commission, which has regulatory authority over the stock exchanges and securities markets generally, the National Monetary Council, and by the Central Bank, which has licensing authority over brokerage firms and regulates foreign investment and foreign exchange transactions. These laws and regulations, among others, provide for disclosure requirements applicable to issuers of traded securities, protection of minority shareholders and criminal penalties for insider trading and price manipulation. They also provide for licensing and oversight of brokerage firms and governance of the Brazilian stock exchanges. Nevertheless, the Brazilian securities markets are not as highly regulated and supervised as the US securities markets.

Under the Brazilian Corporate Law, a company is either public (*companhia aberta*), such as we are, or closely held (*companhia fechada*). All public companies, including us, are registered with the Brazilian Securities Commission and are subject to reporting requirements. A company registered with the Brazilian Securities Commission may have its securities traded on the Brazilian stock exchanges or in the Brazilian over-the-counter market. Our common shares are listed and traded on the São Paulo Stock Exchange and may be traded privately subject to some limitations.

To be listed on a Brazilian stock exchange a company must apply for registration with the Brazilian Securities Commission and the stock exchange where the head office of the company is located.

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We have the option to ask that trading in our securities on the São Paulo Stock Exchange be suspended in anticipation of a material announcement. Trading may also be suspended on the initiative of the São Paulo Stock Exchange or the Brazilian Securities Commission, among other reasons, based on or due to a belief that a company has provided inadequate information regarding a material event or has provided inadequate responses to the inquiries by the Brazilian Securities Commission or the São Paulo Stock Exchange.

The Brazilian over-the-counter market consists of direct trades between individuals in which a financial institution registered with the Brazilian Securities Commission serves as intermediary. No special application, other than registration with the Brazilian Securities Commission, is necessary for securities of a public company to be traded in this market. The Brazilian Securities Commission requires that it be given notice of all trades carried out in the Brazilian over-the-counter market by the respective intermediaries.

Trading on the São Paulo Stock Exchange by non-residents of Brazil is subject to limitations under Brazilian foreign investment and tax legislation. The Brazilian Custodian for the common shares underlying the ADSs must, on behalf of the Depositary for our ADSs, obtain registration from the Central Bank to remit US dollars abroad for payments of dividends, any other cash distributions, or upon the disposition of the shares and sales proceeds thereto. In the event that a holder of ADSs exchanges ADSs for common shares, the holder will be entitled to continue to rely on the Custodian s registration for five business days after the exchange. Thereafter, the holder may not be able to obtain and remit US dollars abroad upon the disposition of our common shares, or distributions relating to our common shares, unless the holder obtains a new registration.

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CAPITALIZATION

The following table sets forth our total short-term loans and financing and capitalization as of July 31, 2004 derived from our unaudited interim financial information prepared in accordance with the Brazilian Corporate Law Method. You should read this table in conjunction with Selected Financial Data, Management s Discussion and Analysis of Financial Condition and Results of Operations and our financial statements included elsewhere in this prospectus.

		As of July 31, 2004 (in millions of *reais*)
Short-term loans and financing(1):		
Real-denominated loans and financing(2):		
Guaranteed(3)	R$	225.8
Unguaranteed		770.3
Foreign currency-denominated loans and financing(2):		
Guaranteed(3)		136.7
Unguaranteed		909.4
Total short-term loans and financing	R$	2,042.2
Long-term loans and financing:		
Real-denominated loans and financing(2):		
Guaranteed(3)	R$	2,832.0
Unguaranteed		468.6
Foreign currency-denominated loans and financing(2):		
Guaranteed(3)		1,273.3
Unguaranteed		711.2
Total long-term loans and financing	R$	5,285.1
Shareholders equity:		
Paid-in capital	R$	3,403.7
Capital reserves(4)		52.0
Revaluation reserve(5)		2,658.7
Profit reserves(6)		1,398.8
Retained earnings		144.0
Total shareholders equity	R$	7,657.2
Total capitalization (long-term loans and financing plus shareholders equity)	R$	12,942.3

(1) Includes current portion of long-term loans and financing. As of July 31, 2004, we did not have any short-term loans and financing other than the current portion of long-term loans and financing.
(2) Of our *real*-denominated loans and financing, R$3,057.8 million was secured and R$1,238.9 million was unsecured as of July 31, 2004. Of our foreign currency-denominated loans and financing, R$1,410.0 million was secured and R$1,620.6 million was unsecured as of July 31, 2004.
(3) Loans and financing guaranteed by either the Government of the State of São Paulo or the Federal Government of Brazil.
(4) Capital reserves comprise tax incentives and donations from government entities. See note 17 to our financial statements.
(5) Revaluation reserve refers to the adjustment amount in connection with the revaluation of property, plant and equipment in use to market values in 1990 and 1991 and for the effects of inflation through 1995. See note 17 to our financial statements.
(6) Profit reserves comprise the amount by which the distributable amount exceeds the realized net income in a given fiscal year. See note 17 to our financial statements.

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SELECTED FINANCIAL DATA

The selected financial data as of December 31, 2002 and for the two years in the period ended December 31, 2002 are derived from our financial statements audited by PricewaterhouseCoopers Auditores Independentes included in this prospectus. The selected financial data as of December 31, 2003 and for the year ended December 31, 2003 is derived from our unaudited financial statements audited by Deloitte Touche Tohmatsu Auditores Independentes, also included in this prospectus. The selected financial data as of and for the six months ended June 30, 2003 and June 30, 2004 is derived from our interim financial statements included in this prospectus. The selected financial data as of December 31, 1999, 2000 and 2001 and for the two years ended December 31, 2000 is derived from our financial statements audited by PricewaterhouseCoopers Auditores Independentes, which are not included in this prospectus.

Our financial statements have been prepared in accordance with the Brazilian Corporate Law Method, which differs in significant respects from US GAAP. You should read this selected financial data in conjunction with our financial statements and the related notes thereto included in this prospectus. Solely for the convenience of the reader, *real* amounts as of and for the year ended December 31, 2003 and for the six months ended June 30, 2004 have been translated into US dollars at the commercial selling rate as of June 30, 2004 of R$3.1075 per US$1.00.

The following table presents our selected financial data as of and for each of the periods indicated.

	As of and for the Year Ended December 31,						As of and for the Six Months Ended June 30,		
	1999	2000	2001	2002	2003	2003	2003	2004	2004
	(in millions, except per share and per ADS data)								
Brazilian Corporate Law Method									
	R$	**R$**	**R$**	**R$**	**R$**	**US$**	**R$**	**R$**	**US$**
Statement of Operations Data:									
Net revenue from sales and services	3,235.7	3,355.8	3,434.8	3,767.1	4,130.8	1,329.3	1,965.9	2,126.3	684.2
Cost of sales and services	(1,364.2)	(1,474.1)	(1,590.4)	(1,815.0)	(2,067.1)	(665.2)	(980.8)	(1,082.9)	(348.5)
Gross profit	1,871.5	1,881.7	1,844.3	1,952.2	2,063.6	664.1	985.2	1,043.4	335.8
Selling expenses	(278.7)	(332.7)	(332.6)	(385.1)	(297.5)	(95.7)	(186.2)	(231.3)	(74.4)
Administrative expenses	(153.8)	(137.3)	(203.1)	(226.0)	(254.1)	(81.8)	(107.5)	(138.8)	(44.7)
Financial income (expenses), net	(1,529.9)	(737.7)	(1,105.2)	(2,276.3)	(346.5)	(111.5)	86.5	(568.6)	(183.0)
Income (loss) from operations	(90.9)	673.9	203.4	(935.3)	1,165.5	375.1	778.0	104.7	33.7
Non-operating income (expenses)[1]	(124.5)	(82.3)	(76.9)	(3.4)	(54.5)	(17.5)	(32.0)	(11.5)	(3.7)
Income (loss) before taxes on income	(215.4)	591.6	126.5	(938.7)	1,111.1	357.6	745.9	93.2	30.0
Income tax and social contribution tax	(20.2)	(70.2)	89.7	323.3	(242.6)	(78.1)	(223.9)	(33.5)	(10.8)
Extraordinary item, net of income and social contribution taxes[2]				(35.1)	(35.1)	(11.3)	(17.6)	(17.6)	(5.7)
Net income (loss)	(235.6)	521.4	216.2	(650.5)	833.3	268.2	504.5	42.2	13.6
	(8.28)	18.31	7.59	(22.84)	29.26	9.4	17.71	1.48	0.5

Net income (loss) per thousand common shares									
Net income (loss) per ADS				(5.71)	7.32	2.4	4.43	0.37	0.1
Dividends and interest on shareholders equity per thousand common shares		18.97	17.20	3.80	17.70	5.7	5.56	1.38	0.4
Dividends and interest on shareholders equity per ADS				0.95	4.43	1.4	1.39	0.34	0.1
Number of common shares outstanding at year end (in thousands of shares)	28,437,155	28,479,578	28,479,578	28,479,578	28,479,578	28,479,578	28,479,578	28,479,578	28,479,578

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	As of and for the Year Ended December 31,						As of and for the Six Months Ended June 30,		
	1999	2000	2001	2002	2003	2003	2003	2004	2004
	(in millions, except per share and per ADS data)								
	R$	R$	R$	R$	R$	US$	R$	R$	US$
Balance Sheet Data:									
Cash and cash equivalents	185.3	232.7	460.2	414.7	281.0	90.4	1,068.0	102.9	33.1
Customer accounts receivable, net	890.5	887.4	787.0	820.5	996.8	320.8	839.0	970.5	312.3
Reimbursement for pension benefits paid	184.2	253.5	326.3	403.9	491.0	158.0	442.7	527.6	169.8
Short and long-term receivables from shareholders, net(3)	196.5	116.6	378.3	423.7	164.2	52.8	421.2	215.3	69.3
Property, plant and equipment, net	13,298.3	13,346.4	13,510.0	13,670.8	14,063.2	4,525.6	13,633.3	14,029.9	4,514.9
Total assets	15,116.9	15,192.1	15,917.9	16,348.7	16,530.7	5,319.6	16,861.1	16,441.5	5,290.9
Total short-term loans and financing	841.6	381.7	549.3	1,332.5	997.0	320.8	1,189.7	1,116.4	359.3
Total long-term loans and financing	5,023.6	5,616.1	5,920.6	6,545.2	6,267.3	2,016.8	6,648.7	6,202.0	1,995.8
Total liabilities	6,845.3	6,923.7	7,921.2	9,102.2	8,953.7	2,881.3	9,267.8	8,860.6	2,851.4
Shareholders equity	8,271.5	8,268.5	7,996.7	7,246.5	7,576.9	2,438.3	7,593.2	7,580.9	2,439.5
Other Financial Information:									
Cash provided by operating activities(4)	1,874.2	1,744.1	1,657.0	1,764.8	1,655.3	532.7	880.5	811.1	261.0
Cash provided by (used in) investing activities(4)	(801.8)	(598.4)	(709.5)	(597.2)	(650.8)	(209.4)	(226.3)	(317.6)	(102.2)
Cash used in financing activities(4)	(943.4)	(1,098.3)	(763.6)	(1,165.7)	(1,138.2)	(366.3)	(47.5)	(671.6)	(216.1)
Adjusted EBITDA(5)	1,873.1	1,868.6	1,785.9	1,860.1	2,076.5	668.2	960.9	966.1	310.9
Capital expenditures(4)	790.7	596.3	694.6	586.0	641.3	206.4	222.3	317.7	102.2
Depreciation and amortization	434.1	457.0	477.3	519.1	564.5	181.6	269.4	292.7	94.2
US GAAP									
Statement of Operations Data:									
Net revenue from sales and service	3,235.7	3,355.8	3,434.8	3,767.1	4,130.8	1,329.3	1,965.9	2,126.3	684.3
Gross profit	1,691.3	1,668.6	1,613.8	1,820.1	1,853.3	596.4	898.2	956.3	307.7
Selling expenses	(295.9)	(349.6)	(349.9)	(393.6)	(323.4)	(104.1)	(198.4)	(240.3)	(77.3)
Administrative expenses	(198.5)	(184.1)	(214.8)	(328.8)	(276.3)	(89.0)	(123.7)	(143.3)	(46.1)
Income (loss) from operations(6)	963.2	983.0	951.1	1,086.5	1,136.5	365.7	496.9	541.9	174.4
Financial income (expenses), net	(1,563.2)	(740.6)	(1,107.1)	(2,284.5)	(329.4)	(106.0)	102.4	(581.6)	(187.2)
Net income (loss) for the period	(449.3)	284.4	16.7	(847.6)	642.6	206.8	418.0	(26.4)	(8.5)
Net income (loss) per thousand common shares basic and diluted	(15.95)	10.00	0.59	(29.76)	22.56	7.3	14.68	(0.93)	(0.3)
Net income (loss) per ADS-basic and diluted	(3.99)	2.50	0.15	(7.44)	5.64	1.8	3.67	(0.23)	(0.1)
Weighted average number of common shares outstanding (in thousands of shares)	28,159,721	28,448,607	28,479,578	28,479,578	28,479,578	28,479,578	28,479,578	28,479,578	28,479,578

Balance Sheet Data:									
Property, plant and equipment, net	15,643.0	15,583.8	15,656.0	15,666.0	15,955.5	5,134.5	15,537.8	15,858.2	5,103.2
Total assets	17,493.2	17,381.0	17,581.8	17,625.6	17,630.4	5,673.5	18,066.9	17,423.0	5,606.8
Short-term loans and financing	816.5	381.7	549.3	1,753.6	997.0	320.8	1,617.3	1,408.7	453.3
Long-term loans and financing	5,023.6	5,612.2	5,873.2	6,124.0	6,267.3	2,016.8	6,174.4	5,909.7	1,901.8
Total liabilities	9,883.2	10,046.5	10,688.5	11,679.8	11,544.8	3,715.1	11,860.9	11,401.9	3,669.2
Shareholders equity	7,610.0	7,334.4	6,893.3	5,945.8	6,085.6	1,958.4	6,206.1	6,021.1	1,937.6

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	As of and for the Year Ended December 31,			As of and for the Six Months Ended June 30,	
	2001	2002	2003	2003	2004
Operating Data (at period end):					
Number of water connections (in thousands)	5,717	5,898	6,044	5,975	6,285
Number of sewage connections (in thousands)	4,128	4,304	4,462	4,385	4,673
Percentage of population with water connections (%)	100.0	100.0	100.0	100.0	100.0
Percentage of population with sewer connections (%)	76.0	77.0	78.0	78.0	78.0
Volume of water billed during period (in millions of cubic meters)	1,698.0	1,770.0	1,765.0	888.6	837.9
Water loss percentage (average) (%)(7)	32.6	31.7	33.0	32.5	33.5
Number of employees	18,159	18,505	18,546	18,355	17,807

(1) Including financial expenses, net.

(2) The extraordinary item charged to income in the years ended December 31, 2002 and 2003 and for the six months ended June 30, 2003 and 2004 relates to the amortization (over a five-year period) of the actuarial liability recorded as of December 31, 2001 upon first time recognition of the defined benefits pension plan. The presentation of the charge as an extraordinary item is consistent with the instructions of the Brazilian Securities Commission and the Brazilian Corporate Law Method. For purposes of US GAAP, the pension expense has been treated as a payroll expense from the first year presented.

(3) Short- and Long-term receivables from State Government agreements represent amounts due from the State Government for water and sewage services. Amounts for 2003 and June 30, 2004 are reflected net of R$401.7 million, and R$347.0 million, respectively, of amounts due to the State Government related to interest on shareholders equity which has been designated for reciprocal offset under the terms of the agreement executed among the parties, as amended. See note 6 to our financial statements.

(4) Based on the statements of cash flows for the years ended December 31, 2002 and 2003 and for the six months ended June 30, 2003 and 2004 included in note 26 to our financial statements and the audited statements of cash flows for the years ended December 31, 1999, 2000 and 2001 which are not included in this prospectus.

(5) Adjusted EBITDA means net income (loss) before financial expenses, net, income tax and social contribution tax (a federal tax on income), depreciation and amortization, non-operating income (expenses), net and extraordinary item, net of income tax and social contribution tax. Adjusted EBITDA is not a measurement recognized under Brazilian accounting principles, does not represent cash flow for the periods presented and should not be considered as an alternative to net income (loss), as an indicator of our operating performance or as an alternative to cash flows as an indicator of liquidity. Our definition of Adjusted EBITDA may not be comparable with EBITDA as defined by other companies. Although Adjusted EBITDA, as defined above, does not provide a measurement of operating performance as recognized under Brazilian accounting principles, our management uses it to measure our operating performance and it is commonly used by financial analysts in evaluating our business. Adjusted EBITDA is calculated as follows:

	As of and for the Year Ended December 31,						As of and for the Six Months Ended June 30,		
	1999	2000	2001	2002	2003	2003	2003	2004	2004
	(in millions)								
	R$	R$	R$	R$	R$	US$	R$	R$	US$
Brazilian Corporate Law Method									
Net income (loss)	(235.6)	521.4	216.2	(650.5)	833.3	268.2	504.5	42.2	13.5
Add:									
Financial expenses (income), net	1,529.9	737.7	1,105.2	2,276.3	346.5	111.5	(86.5)	568.6	183.0
Income tax and social contribution tax	20.2	70.2	(89.7)	(323.3)	242.6	78.1	223.9	33.5	10.8
Depreciation and amortization	434.1	457.0	477.3	519.1	564.5	181.6	269.4	292.7	94.2
Extraordinary item, net of income and social contribution taxes				35.1	35.1	11.3	17.6	17.6	5.7
Subtotal	1,748.6	1,786.3	1,709.0	1,856.7	2,022.0	650.7	928.9	954.6	307.2
Non-operating expenses, net	124.5	82.3	76.9	3.4	54.5	17.5	32.0	11.5	3.7
Adjusted EBITDA	1,873.1	1,868.6	1,785.9	1,860.1	2,076.5	668.2	960.9	966.1	310.9

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(6) Under US GAAP, income from operations is determined before financial expenses, net.

(7) Includes both physical and non-physical losses. Water loss percentage represents the quotient of (a) the difference between (i) the total amount of water produced by us (after excluding certain non-physical water losses set out below) less (ii) the total amount of water invoiced by us to customers divided by (b) the total amount of water produced (after excluding certain non-physical water losses set out below) by us. We exclude from our calculation of water losses the following: (1) water discharged for periodic maintenance of water mains and water storage tanks; (2) water supplied for municipal uses such as firefighting; (3) water we consume in our facilities; and (4) estimated water losses associated with water we supply to *favelas* (shantytowns).

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following management s discussion and analysis of financial condition and results of operations should be read in conjunction with our audited financial statements and unaudited interim financial statements included in this prospectus. This prospectus 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.

The financial statements in this prospectus have been prepared in accordance with the Brazilian Corporate Law Method, which differs in certain significant respects from US GAAP. We have included a discussion below of the material differences between the Brazilian Corporate Law Method and US GAAP related to each critical accounting policy in our audited financial statements. For additional information regarding other differences between the Brazilian Corporate Law Method and US GAAP, please see note 24 to our financial statements.

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.

Overview

We operate water and sewage systems in the State of São Paulo, including in the City of São Paulo, Brazil s largest city, and in more than one-half of the other municipalities in the State. We also make wholesale sales of water to six additional municipalities in which we do not operate water systems.

The São Paulo Metropolitan Region, which includes the City of São Paulo, is our most important service territory. With a population of approximately 18.9 million, the São Paulo Metropolitan Region accounted for approximately 75.8%, 75.9% and 74.1% of our net revenue from sales and services in 2002, 2003 and during the six months ended June 30, 2004, respectively. Approximately 72.5% of the property, plant and equipment reflected on our balance sheet as of June 30, 2004 is located in this region. In an effort to respond to the demand in the São Paulo Metropolitan Region and because the region represents the principal opportunity to increase our net revenue from sales and services, we have dedicated 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

Effects of Tariff Increases

Our results of operations and financial condition are highly dependent upon our ability to set and collect adequate tariffs for our water and sewage services. Although we generally have broad power to establish tariffs within our service territories, this power is, in practice, subject to limits due to, among other factors, the following:

political considerations arising from our status as a State of São Paulo-controlled company;

anti-inflation measures promulgated by the Federal Government from time to time; and

federal laws that in some circumstances limit to 12.0% per year the return on the assets of some of our concessions.

Tariffs have often failed to keep up with inflation during periods of high inflation in the past. During the past few years, we generally have been able to raise tariffs in line with increases in cost of sales and services and operating expenses and to support our liquidity and capital resource requirements. In 2000, we did not raise tariffs due to the State of São Paulo policy for that year of not increasing tariffs for many public services. In June 2001, however, we increased our average tariff by approximately 13.1%, which was broadly in line with prevailing inflation rates in Brazil since mid-1999 as measured by the consumer price index, and in August 2002,

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we increased our tariffs by approximately 8.2%. In August 2003, we increased our tariffs for water and sewage services by approximately 19.0%, and in August 2004 we raised our tariffs for water and sewage services by approximately 6.8%. Currently, our tariffs are determined using a transparent formula which accounts for inflation, covers our operating costs and other expenses and provides for a return on investment. Tariffs have historically been adjusted once a year during the month of August. The following table sets forth, for the periods indicated, the percentage increase of our tariffs, as compared to three inflation indices:

	Twelve months ended June 30,				
	2000	**2001**	**2002**	**2003**	**2004**(1)
Increase in Average Tariff(2)		13.1%	8.2%	18.9%(3)	6.8%
Inflation *Índice de Preços ao Consumidor IPC-FIPE* (Consumer Price Index)	6.9%	6.2%	5.8%	14.2%	5.6%
Inflation *Índice de Preços ao Consumidor Ampliado IPCA* (Extended Consumer Price Index)	6.5%	7.4%	7.7%	16.6%	6.1%
Inflation *Índice Geral de Preços do Mercado IGP-M* (General Price Index-Market)	14.4%	11.2%	9.5%	28.2%	9.6%

(1) Tariff increase effective August 29, 2004 for all categories.
(2) Tariff increases, if any, for each twelve-month period took effect in June, July or August.
(3) Tariff increase effective August 29, 2003 for all categories except residential social (residences of low income families that live in sub-standard conditions, residences of persons unemployed for up to 12 months and collective living residences) and *favela* (shantytown).

Sources: Central Bank, *Fundação Getúlio Vargas* 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 currency exchange rate movements, inflation rates and interest rate levels. For example, the general performance of the Brazilian economy affects demand for water and sewer services, and inflation affects our costs and our margins. The Brazilian economic environment has been characterized by significant variations in economic growth rates.

General Economic Conditions. The growth of the Brazilian economy slowed in 2001, as the effects of the ongoing economic crisis in Argentina and lower levels of economic growth in the United States economy led to declines in investment and consumption in Brazil as well as in other emerging markets. The economic situation was exacerbated by the energy shortage and the resulting measures taken by the Brazilian government to reduce the consumption of electricity. In 2001, the *real* gross domestic product in Brazil grew 1.3%, the *real* depreciated by 15.7% against the US dollar and inflation was 10.4%, as measured by the IGP-M. The Central Bank increased the base interest rate from 15.3% early in 2001 to 19.0% beginning in July 2001.

In 2002, several negative economic factors continued to adversely affect consumer confidence levels in Brazil. Prior to and subsequent to the presidential elections in November 2002, there was substantial uncertainty relating to Brazil s own political and economic future. Other negative economic factors in 2002 included the continued economic and political uncertainties in Argentina and in Venezuela, concerns over the impact of the conflict in the Persian Gulf and its effects on the price of oil products and the global economic slowdown. The sharp devaluation of the *real* in the second half of 2002 heightened concerns over a possible return to high inflation. The monetary authorities under both the former and new presidential administrations acted quickly to increase interest rates through the end of the year, which severely restricted credit available in the economy and consequently affected growth. In 2002, *real* gross domestic product in Brazil grew 1.9% and inflation was 25.3%, as measured by the IGP-M. The *real* depreciated by 34.3% against the US dollar during 2002. Interest rates increased, as the Central Bank increased the base interest rate repeatedly, from 19.0% early in 2002 to 25.0% at year-end.

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In 2003, the new administration largely continued the macroeconomic policies of the previous administration. The *real* appreciated by 22.3% against the US dollar in 2003 to R$2.8892 per US$1.00 as of December 31, 2003. Inflation for 2003, as measured by the IGP-M, was 8.7%. However, *real* gross domestic product decreased by 0.2% during 2003 largely because the very high interest rates that prevailed at the beginning of 2003 also constrained economic growth. The Brazilian economy showed signs of improvement in the third and fourth quarters of 2003 that continued through the first eight months of 2004. During the first eight months of 2004 the *real* depreciated 1.5% as the *real*/US dollar exchange rate increased to 2.9338 *reais* as of August 31, 2004.

Interest Rates. Interest rate levels in Brazil are closely linked to exchange rate movements and inflation rates. High domestic interest rates result in increases in our financial expenses and also negatively affect our ability to obtain financing, on a cost-effective basis, in domestic capital and lending markets. As a result, we may continue to require substantial amounts of foreign currency-denominated debt in order to satisfy our liquidity and capital resource requirements, which increases our exposure to exchange rate movements as discussed below.

The Central Bank increased the base interest rate to 25.5% on January 22, 2003 and to 26.5% on February 19, 2003 and decreased it to 16.5% on January 21, 2004, to 16.25% on March 17, 2004, to 16.0% on April 14, 2004. On September 15, 2004, the Central Bank increased the base interest rate to 16.25%.

We currently do not utilize derivative financial instruments or other hedging instruments to mitigate interest rate risk. We do, however, continually monitor market interest rates in order to evaluate the possible need to refinance our debt.

Inflation. Inflation affects our financial performance by increasing our costs of services rendered and operating expenses. In addition, all of our *real*-denominated debt is indexed to take into account the effects of inflation. Most of our *real*-denominated debt provides for inflation-based increases in the respective principal amounts of that debt, which increases are determined by reference to the daily government interest rate (*Taxa Referencial-TR*) plus an agreed margin. We cannot assure you that we will be able, in future periods, to increase tariffs to address, in full or in part, the effects of inflation.

The following table shows Brazilian inflation for the periods indicated:

		December 31,			Six Months ended June 30,	
		2001	**2002**	**2003**	**2003**	**2004**
Inflation	Consumer Price Index (IPC-FIPE)	7.1%	9.9%	8.2%	5.3%	2.7%
Inflation	General Price Index-Market (IGP-M)	10.4%	25.3%	8.7%	5.9%	6.8%

Sources: *Fundação Getúlio Vargas.*

Currency Exchange Rates. We had total foreign currency-denominated indebtedness of R$3,147.8 million as of June 30, 2004. In the event of further significant devaluations of the *real* in relation to the US 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 are 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. For example, the 34.3% devaluation of the *real* in 2002 increased our financial expenses and negatively affected our overall results of operations for that year. In contrast, in 2003, the *real* appreciated 22.3% against the US dollar, which resulted in a foreign exchange gain of R$540.6 million. The 7.0% depreciation of the *real* against the US dollar in the first six months of 2004 led to a foreign exchange loss of R$192.4 million, which was the primary factor in our net loss for that period.

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The following table shows the devaluation (appreciation) of the *real* against the US dollar, the period-end exchange rates and average exchange rates for the periods indicated:

	December 31,			Six Months ended June 30,	
	2001	2002	2003	2003	2004
Devaluation (appreciation) of the *real* versus US dollar	15.7%	34.3%	(22.3)%	(23.0)%	7.0%
Period-end exchange rate US$1.00[1]	R$ 2.3204	R$ 3.5333	R$ 2.8892	R$ 2.8700	R$ 3.1075
Average exchange rate US$1.00[2]	R$ 2.3522	R$ 2.9309	R$ 3.0715	R$ 3.2381	R$ 2.9710

(1) The *real*/US dollar exchange rate as of September 27, 2004 was R$2.8728.
(2) Represents the average for period indicated.
Sources: The Central Bank.

We currently do not utilize derivative financial instruments or other hedging instrument to mitigate foreign currency risk, given the amounts and related costs involved. However, at times, we hold foreign currency deposits to mitigate foreign currency exposure.

Effects of Drought

Much of Brazil experienced a prolonged and severe drought during 2000 and 2001, although historically droughts have not impacted all of our water supply systems equally. During this period, the São Paulo Metropolitan Region, in particular, faced its worst drought in 65 years. As a result, from mid-June to mid-September in 2000, we rationed water in the south of the São Paulo Metropolitan Region, affecting approximately 3.5 million people, or 20.0% of the total population of this region. Under this rationing, water was made available to our customers for only two out of every three days. During this period of rationing, we also reduced our total water production by 8.0%. From April 2001 through January 2002, we rationed water in the west of the São Paulo Metropolitan Region, affecting approximately 300,000 people. Under this rationing, water was made available to these 300,000 customers for only 40 out of every 78 hours. Throughout 2003 rain levels were below average resulting in a weak replenishment of our reservoirs, particularly in the Cantareira System, the largest water supply system in the São Paulo Metropolitan Region. From October to December 2003, we rationed water on the western part of the São Paulo Metropolitan Region, served by the Alto Cotia System, affecting approximately 450,000 people, or 2.0% of the region s population. Under this rationing, water was available to those people for three days, followed by two days of rationing. During this period our total water production volume was reduced by 0.8%. As a result of the drought, our revenue declined as our volume of water billed decreased, and our costs increased because of required expenditures to protect and develop water sources and to preserve water quality. The impact that droughts have may vary across our different systems, which may allow us to mitigate the effects of any particular drought.

Effects of the Water Reduction Bonus Program

In order to encourage customers to use less water in drought conditions, we have instituted a bonus system, rewarding customers who reduced their water consumption by specified amounts. The bonus is shown on each customer s bill as a discount, and is calculated based on the customer s water usage each month, and applied to decrease the amount payable by that customer.

This usage reduction discount took effect on March 15, 2004, and has had the following effects:

- customers have reduced their overall water usage, leading to lower revenue from lower volumes of water and sewage services;
- we have discounted the amounts payable by customers who have successfully lowered their water usage; and
- many customers have, by reducing their water usage, shifted their households into a lower tariff category.

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Our results for the six months ended June 30, 2004 reflect the impact of these effects, all of which lowered our revenue from March 15, 2004 to the end of the period. We also expect our revenue in the third quarter of 2004 to be lower as a result of the bonus plan, which ended on September 15, 2004. Revenue is expected to be lower due to a reduction in consumption levels and due to the effects of the reduction incentive program, but these reductions are expected to be offset in part by the positive impact of tariff readjustments. During the first six months of 2004, our water production volumes were reduced by 3.0% as a result of our conservation programs.

Critical Accounting Policies

Critical accounting policies are those that are both (1) important to the portrayal of our financial condition and results of operations and (2) require management s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. As the number of variables and assumptions affecting the possible future resolution of the uncertainties increase, those judgments become even more subjective and complex. In order to provide an understanding about how our management forms its judgments about future events, including the variables and assumptions underlying the estimates, and the sensitivity of those judgments to different circumstances, we have identified the critical accounting policies discussed below.

Our management discussion and analysis of financial condition and results of operations are based upon our primary financial statements, which have been prepared in accordance with the Brazilian Corporate Law Method which differs in significant respects from US GAAP. In addition, we have included a discussion on material differences between the Brazilian Corporate Law Method and US GAAP related to each critical accounting policy in our audited financial statements.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts in an amount we consider sufficient to cover any probable losses on realization of our accounts receivable from our customers. Our accounting policy for establishing the allowance for doubtful accounts includes:

- accounts receivable balances (excluding accounts receivable from the State Government) more than R$5,000 and less than R$30,000 overdue more than 360 days are included in the allowance for doubtful accounts;

- accounts receivable balances (excluding accounts receivable from the State Government) more than R$30,000 overdue more than 360 days, with respect to which we have taken legal action, are included in the allowance for doubtful accounts; and

- accounts receivable balances (excluding accounts receivable from the State Government) less than R$5,000 overdue more than 180 days are written off through a direct charge to selling expenses (debts recovered are recorded as a reduction of selling expenses).

Provisions for the allowance for doubtful accounts are included in selling expenses, net of recoveries. The net charge to this allowance was R$106.3 million in the six months ended June 30, 2004, R$37.6 million in 2003, R$162.9 million in 2002 and R$153.8 million in 2001.

Our methodology for determining the allowance for doubtful accounts receivable 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. While we believe that the estimates we use are reasonable, actual results could differ from those estimates.

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In addition, we have substantial assets consisting of amounts owed by the State of São Paulo. These amounts consist primarily of accounts receivable for services, reimbursement for pensions paid and amounts due under our December 2001 and March 2004 agreement with the State of São Paulo. See Related Party Transactions. We do not reserve against any of these amounts owed by the State of São Paulo due to the following factors:

- we do not expect to incur losses from these accounts receivable;
- we entered into agreements in September 1997, December 2001 and March 2004 under which the State Government has committed to settle the outstanding amounts due to us described in these agreements by applying dividends declared by us to the remaining balance of the accounts receivable owed by the State of São Paulo or its controlled entities; and
- under Brazilian Federal Law No. 9,430, we are not permitted to write off or record an allowance for doubtful accounts against any amounts owing to us from the State Government or entities controlled by the State Government.

As of June 30, 2004, the amounts owed to us by the State of São Paulo consisted of R$523.9 million in accounts receivable related to the provision of services (net of R$347.0 million of amounts applied in respect of dividends payable to the State of São Paulo) and R$38.4 million to mature in the future and R$527.6 million in reimbursement for pensions paid on behalf of the State Government. We expect that these amounts will continue to increase in the future. If the State of São Paulo does not pay the amounts it owes to us, our cash flows, results of operations and financial condition will be impacted.

For US GAAP purposes, the amounts receivable from the State Government for pensions paid is not recorded as accounts receivable, but rather is included as part of our estimated pension and other postretirements obligations. Only amounts effectively reimbursed by the State of São Paulo are presented as additional paid-in capital. No additional differences have been identified between accounting policies for accounts receivable and allowance for doubtful accounts under the Brazilian Corporate Law Method and US GAAP.

Indemnities Receivable

Indemnities receivable is a long-term asset representing amounts receivable from the Municipalities of Diadema and Mauá as indemnification for the unilateral withdrawal by those authorities of our water and sewage service concessions in 1995. As of June 30, 2004, this asset amounted to R$148.8 million.

Under our concession agreements we invested in the construction of water and sewage systems in these municipalities to meet our concession service commitments. Upon the unilateral termination of the Diadema and Mauá concessions, our assets were impounded by the municipal authorities, which took on the responsibility of providing water and sewage services in these areas. At that time, we reclassified our property, plant and equipment balances relating to the impounded assets to long-term assets (indemnities receivable) and recorded impairment charges to reduce the carrying value of the assets to the estimated recoverable amounts for which we had contractually agreed as fair compensation with the relevant authorities.

Our rights to the recovery of these amounts are being disputed by the municipalities and no amounts have been received to date. Based on the advice of legal counsel, we continue to believe that we have the right to receive such amounts and we continue to monitor the status of the legal proceedings. However, the ultimate amounts to be received, if any, will most likely be subject to a final court decision. As such, actual amounts received could differ from those recorded.

No differences have been identified between accounting policies on compensation for concession termination adopted under the Brazilian Corporate Law Method and US GAAP.

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Property, Plant and Equipment

Valuation of Long-Lived Assets. We review long-lived assets, primarily buildings, water and sewage system assets and acquired concession assets to be held and used in our business, for the purpose of determining and measuring impairment on a recurring basis or when events or changes in circumstances indicate that the carrying value of an asset or group of assets may not be recoverable. Under the Brazilian Corporate Law Method, we evaluate possible impairment by determining whether projected future operating income is sufficient to absorb the depreciation or amortization of long-lived assets, within the context of the balance sheet as a whole.

Studies supporting the write-offs for obsolescence and abandonment of projects are conducted by our engineering department in the accounting period of the write-offs based on undiscounted cash flow projections, and approved by our Board of Directors. We monitor the carrying value of our property, plant and equipment on an on-going basis and adjust the net book value to assure future projected operations will be sufficient to recover the carrying value of the assets. Depreciation is provided using the straight-line method based on the estimated useful lives of the underlying assets. When possible, depreciation rates are adjusted to take account of changes in estimated prospective depreciable lives as assets are replaced.

US GAAP Statement of Financial Accounting Standards, or SFAS, No. 144, Accounting for the Impairment of Long-lived Assets , requires companies to periodically evaluate the carrying value of long-lived assets to be held and used, and for long-lived assets to be disposed of, when events and circumstances warrant such a review. Companies are required to identify the smallest unit, or group, of assets at which cash flows generated by the group can be measured. The projected undiscounted cash flows from each such asset group is compared to its carrying value. For those assets for which the projected cash flows are not sufficient to recover the carrying values, a loss is recognized to the extent that the carrying value exceeds the fair market value of the assets.

In evaluating impairment of our long-lived assets, we make significant assumptions and estimates regarding matters that are inherently uncertain, including projections of future operating income and cash flows, future growth rates, and the remaining useful lives of the assets, among others. In addition, projections are computed over an extended period of time, which subjects those assumptions and estimates to an even larger degree of uncertainty. While we believe that the estimates we use are reasonable, the use of different assumptions could materially affect our valuations.

No adjustments have been included in the reconciliation from the Brazilian Corporate Law Method to US GAAP to take account of differences between the measurement criteria, because no impairment provisions were required based on our analysis of cash flows. Losses on the write-off of property, plant and equipment arose primarily from adjustments upon withdrawal of concession assets, construction-in-progress projects which were deemed no longer to be economically feasible and obsolescence write-offs.

Depreciation of Property, Plant and Equipment. Depreciation of our property, plant and equipment, primarily buildings, water and sewage service and other assets acquired, is provided using the straight-line method based on the estimated useful lives of the underlying assets, which generally do not exceed the contractual terms of our concession agreements.

While we believe that our estimates of current remaining estimated lives is reasonable, the use of different assumptions and estimates and changes in future circumstances, could affect the remaining useful lives of our asset, which could have a significant impact on our results of operations in the future.

Loss Contingencies

We are a party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among others, tax, labor, civil, environmental, condemnation and other proceedings. We accrue for probable losses resulting from these claims and proceedings when we determine that the likelihood

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that a loss has occurred is probable and the amount of such loss can be reasonably estimated. As such, 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 loss contingencies, actual losses realized in future periods could differ significantly from our estimates.

No differences have been identified between accounting policies on loss contingencies adopted under the Brazilian Corporate Law Method and US GAAP.

Pension Plans

Plan G1. We sponsor a funded defined-benefit pension and benefits fund (Plan G1), which is operated and administered by SABESPREV *Fundação SABESP de Seguridade Social*.

Under the Brazilian Corporate Law Method, prior to January 1, 2002, we recorded pension expense on an accrual basis based on our contributions to the plan. Effective January 1, 2002, in accordance with the issuance of a new accounting standard, we began accounting for our actuarial obligation under Plan G1. As permitted under this standard, we are amortizing the transition liability related to the actuarial value of our obligation at the date of adoption of the new standard over a period of five years, which is recorded in our statements of operations as an extraordinary item, net of the related tax impacts. For the six months ended June 30, 2004, pension costs charged to income totaled R$44.8 million, of which R$17.6 million (net of tax effects totaling R$9.0 million) was presented as extraordinary item net of income tax and social contribution . The remaining R$27.2 million was charged to cost of services rendered, general and administrative expenses and selling expenses.

Under US GAAP, we had already adopted the provisions of SFAS No. 87, Employers Accounting for Pensions prior to 2002, which requires that we recognize an actuarial liability for pension benefits under Plan G1. While the actuarial assumptions used for US GAAP are the same as those used in determining the actuarial liability under the Brazilian Corporate Law Method, pension costs and obligations under US GAAP and the Brazilian Corporate Law Method are not the same, mainly due to differences related to the first year of application, the amortization of the initial transition obligation, amortization periods for other actuarial gains and losses, and actuarial calculation methods, among others.

We are currently evaluating the possible introduction of a defined contribution plan for new employees and providing exiting employees an option to switch to this new plan from Plan G1.

Plan G0. Pursuant to a law enacted by the State Government, some of its employees who provided service to us prior to May 1974 and retired as employees of ours acquired a legal right to receive supplemental pension payments (which rights are referred to as Plan G0). These amounts are paid by us on behalf of the State of São Paulo and are claimed as reimbursement from the State of São Paulo. As such, no pension expense related to Plan G0 is recorded and no future obligations are recorded under the Brazilian Corporate Law Method.

Consistent with the guidance in SEC Staff Accounting Bulletin Topic 5-T (SAB No. 5-T), under US GAAP, we recognize the costs and obligations associated with Plan G0 supplemental pension benefits on a push-down basis, as we are the recipients of the benefits of the employee service for which the supplemental pension benefits are made. The Plan G0 benefit obligation and expenses are accounted for in accordance with SFAS No. 87. Eventual amounts received as reimbursement from the State Government, if any, are treated as additional paid-in-capital. As such, Plan G0 is considered unfunded for purposes of US GAAP.

Assumptions. Accounting for these pension benefits under the Brazilian Corporate Law Method and US GAAP, requires an extensive use of assumptions, including those related to the inflation adjusted discount rate, expected return on plan assets, the expected rate of future compensation increases received by our employees, mortality rates, and turnover. We review each assumption annually, with the assistance of our actuarial consultant who provides guidance in establishing the assumptions. The assumptions are selected to represent the weighted average expected experience over time and may differ in any one year from actual experience due to changes in the capital markets and the overall economy, regulatory events, judicial rulings, and higher or lower actual rates of withdrawal, turnover or mortality among our participating employees. While we believe that our assumptions used are appropriate, differences in actual experience or changes in assumptions could affect the amount of pension expense that we recognize.

The present value of our pension obligations was based on a discount rate of 12.32%, 15.56% and 10.50% for 2003, 2002 and 2001, respectively. Our pension obligation and expense increases as the discount rate is reduced.

Our expected return on assets for Plan G1 is determined by evaluating the asset class return expectations with our advisors, as well as actual, long-term historical results of our asset returns. For 2003, we used an expected rate of return on assets assumption of 12.06%, which is expected to remain the same for 2004. The expected return on assets assumption is based on a targeted allocation of investments in accordance with the investment strategies of the plans. We believe that this targeted allocation will, on average, approximate actual long-term asset allocation.

Certain Transactions with Controlling Shareholder

Reimbursement Due from State Government. Reimbursement due from the State Government for pensions paid represent supplementary pensions (Plan G0) and leave benefits (sabbatical paid leave) that we pay, on behalf of the State Government, to former employees of the State-owned companies which merged to form a company. These amounts are reimbursed to us by the State Government, as primary obligor. However, these amounts have been outstanding for a long period. We account for these as long-term assets, and we do not reserve against such accounts receivable as we expect to recover these amounts and loss is not considered probable.

Accounts Receivable from the State Government for Water and Sewage Service Provided. Certain of these accounts receivable have been overdue for a long period. We account for these as long-term assets, and we do not reserve against such accounts receivable as we fully expect to recover these amounts and loss is not considered probable.

Use of Certain Assets Owned by the State Government. We currently use certain reservoirs in the Alto Tietê System and the Billings and Guarapiranga reservoirs which are owned indirectly by the State Government. We currently do not pay any fees with respect to the use of these reservoirs. However, we are responsible for maintaining and meeting the operating costs of these reservoirs. If these facilities had not been made available for our use, we would have had to obtain water from more distant sources, which would be more costly. The State does not incur operating costs on our behalf.

The arrangement not to pay any fees to the State of São Paulo for the use of certain reservoirs of the Alto Tietê System is addressed by a number of formal agreements first entered into on March 31, 1992 and on April 24, 1997 and later amended on March 16, 2000 and on November 21, 2001. As part of the arrangement, we agreed to fund 100.0% of the estimated costs of the 1992 agreement (equal to R$27.8 million) and 75.0% of the 1997 agreement (equal to R$63.4 million) which was already disbursed, and the Government of the State of São Paulo, through the State Department of Water and Energy, agreed to fund approximately 25.0% of the estimated costs of the 1997 agreement (equal to R$21.1 million), to construct ducts, tunnels and other facilities to interconnect the Tietê River with the Biritiba and Jundiaí reservoirs and other bodies of water in exchange for our use of the reservoirs during a 30-year period. The amendments to the 1997 agreement increased our obligations under such agreement by R$5.9 million.

We have the right to draw water and release emissions in the reservoirs in the Alto Tietê system during a 30-year period which began in 1997. We capitalize our expenditures on the facilities we construct. The project subject to the 1992 agreement was concluded and the assets entered operations in 1994. The project subject to the 1997 contract became operational in 2002 and is being depreciated on a straight-line basis through 2027.

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The arrangement for use of the Billings and Guarapiranga reservoirs is provided for through a grant issued by the Department of Water and Energy. We have a right to use these reservoirs so long as we remain responsible for maintaining and meeting their operating costs.

Results of Operations

The following table sets forth, for the periods indicated, certain items in our statement of operations, each expressed as a percentage of net revenue from sales and services:

	As of and for the Year ended December 31,			As of and for the Six months ended June 30,	
	2001	2002	2003	2003	2004
Net revenue from sales and services	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of sales and services	(46.3)	(48.2)	(50.0)	(49.9)	(50.9)
Gross profit	53.7	51.8	50.0	50.1	49.1
Selling expenses	(9.7)	(10.2)	(7.2)	(9.5)	(10.9)
Administrative expenses	(5.9)	(6.0)	(6.2)	(5.5)	(6.5)
Financial expenses, net	(32.2)	(60.4)	(8.4)	4.4	(26.7)
Income (loss) from operations	5.9	(24.8)	28.2	39.5	5.0
Non-operating expenses, net	(2.2)	(0.1)	(1.3)	(1.6)	(0.5)
Income (loss) before taxes on income	3.7	(24.9)	26.9	37.9	4.5
Income tax and social contribution tax	2.6	8.5	(5.8)	(11.3)	(1.6)
Extraordinary item, net of income tax and social contribution tax		(0.9)	(0.9)	(0.9)	(0.9)
Net income (loss)	6.3%	(17.3)%	20.2%	25.7%	2.0%

Six months ended June 30, 2004 compared to six months ended June 30, 2003

Net Revenue from Sales and Services

Net revenue from sales and services for the six months ended June 30, 2004 increased by R$160.4 million, or 8.2%, to R$2,126.3 million from R$1,965.9 million for the corresponding period in 2003.

Net revenue from sales and services relating to water services for the six months ended June 30, 2004 increased by R$72.6 million, or 6.3%, to R$1,226.8 million from R$1,154.2 million for the corresponding period in 2003. This increase was mainly due to the August 2003 tariff increase and revenue received for the first time for water services provided in São Bernardo do Campo after the acquisition of that municipality s water and sewage assets.

This increase was offset by a 2.3% decrease in volume of water distributed in the six months ended June 30, 2004, resulted from our campaign to reduce water consumption throughout the period together with, from March 15, 2004, the effects of the usage reduction discount plan which, as discussed above, lowered usage, discounted the bill of consumers who lowered their usage, and shifted some households into lower tariff categories. Total discounts given to consumers under this plan amounted to R$35.0 million, which would otherwise have been recognized as revenue.

Net revenue from sales and services relating to sewage services for the six months ended June 30, 2004 increased by R$87.7 million, or 10.8%, to R$899.5 million from R$811.8 million for the corresponding period in 2003. Lower volumes were offset by an average increase of 19.0% in tariffs, as sewage tariffs are set by reference to water tariffs, together with revenue received for the first time for sewage services provided in São Bernardo do Campo after the acquisition of that municipality s water and sewage assets.

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Cost of Sales and Services

Cost of sales and services for the six months ended June 30, 2004 increased by R$102.1 million, or 10.4%, to R$1,082.9 million from R$980.8 million for the same period in 2003. As a percentage of net revenue from sales and services, costs of sales and services increased slightly to 50.9% for the six months ended June 30, 2004 from 49.9% for the corresponding period in 2003. The increase was primarily due to the following factors:

- an increase of R$34.4 million, or 22.6%, in electric power costs, due primarily to an increase in electricity tariffs and, to a lesser extent, to increased consumption of electricity;

- an increase of R$27.6 million, or 7.4%, in payroll and related costs, primarily resulting from a 4.2% increase in salaries which took effect in May 2004, a R$7.2 million payment to certain employees in connection with bonuses paid for internal cost reduction, increases in union dues, taxes, social benefits, education;

- an increase of R$19.9 million, or 7.6%, in depreciation and amortization expenses, principally due to recognition of sites under construction as permanent assets; and

- an increase of R$18.1 million, or 18.9%, in outside services, primarily due to works relating to the acquisition of the São Bernardo do Campo infrastructure.

Gross Profit

As a result of the above factors, gross profit for the six months ended June 30, 2004 increased by R$58.2 million, or 5.9%, to R$1,043.4 million from R$985.2 million for the corresponding period in 2003. As a percentage of net revenue from sales and services, gross profit decreased slightly to 49.1% for the six months ended June 30, 2004 from 50.1% for the corresponding period in 2003.

Selling Expenses

Selling expenses for the six months ended June 30, 2004 increased by R$45.1 million, or 24.2%, to R$231.3 million from R$186.2 million for the corresponding period in 2003. As a percentage of net revenue from sales and services, selling expenses increased to 10.9% for the six months ended June 30, 2004 from 9.5% for the corresponding period in 2003.

The increase in selling expenses was primarily due to the following factors:

- an increase of R$40.8 million, or 62.2%, in bad debt expenses, net of recoveries due to an increase in the amount of lawsuits related to bad debts, which forced recognition of bad debts as accounts receivable in amounts more than R$30,000 overdue for more than 360 days old are not generally recognized until legal action is taken under the Brazilian Corporate Law Method;

an increase of R$9.3 million, or 15.6%, in payroll and related charges primarily resulting from a 4.2% increase in salaries which took effect in May 2004, a R$1.4 million bonus paid to certain employees in connection with an internal cost reduction plan; and

an increase of R$6.1 million, or 39.1%, in general expenses, primarily due to an increase in fees for bank collection services.

These increases were offset by the following:

a decrease of R$11.6 million, or 28.1%, in outside services, primarily for debt collection services. These services have been temporarily suspended while we re-bid the contract for these services, and consider our strategy for using outside contractors for collection services. This decrease should therefore not be regarded as a trend.

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Administrative Expenses

Administrative expenses for the six months ended June 30, 2004 increased by R$31.3 million, or 29.1%, to R$138.8 million from R$107.5 million for the corresponding period in 2003. As a percentage of net revenue from sales and services, administrative expenses increased to 6.5% for the six months ended June 30, 2004 from 5.5% for the corresponding period in 2003. The increase in administrative expenses primarily reflected:

- an increase of R$23.7 million, or 117.6%, in payments to outside contractors, primarily advertising agencies in connection with publicizing the water usage reduction campaign;

- an increase of R$6.9 million, or 14.0%, in payroll and related costs primarily resulting from a 4.2% increase in salaries, taxes, social benefits and education costs amounting to R$3.5 million, which took effect in May 2004, a R$0.8 million bonus payment to certain employees as part of an internal cost reduction plan, and increases in dues amounting to R$1.2 million in relation to labor suits; and

- an increase of R$3.4 million in depreciation expenses, principally due to recognition of sites under construction as permanent assets.

Financial Expenses, Net

Net financial expenses consist principally of interest on our indebtedness, foreign exchange losses in respect of indebtedness and inflation-based indexation charges relating to indebtedness, offset partially by interest income on cash and time deposits and inflation-based indexation accruals, mainly relating to agreements entered into with some customers to settle overdue accounts receivable.

Net financial expenses for six months ended June 30, 2004 were R$568.6 million, compared to net financial income of R$86.5 million for the corresponding period in 2003. As a percentage of net revenue from sales and services, net financial expenses were 26.7% for the six months ended June 30, 2004. As a percentage of net revenue from sales and services, net financial income was 4.4% for the corresponding period in 2003. The absolute and relative increases in net financial expenses were primarily due to the fact that for the six months ended June 30, 2003 we recorded a foreign exchange gain, reflecting the effects on our foreign currency-denominated debt of the significant recovery of the *real* against the US dollar during that time period. Foreign exchange loss was R$192.4 million for the six months ended June 30, 2004 as compared to the foreign exchange gain of R$627.0 million for the corresponding period in 2003.

Interest and other charges on *real*-and foreign-currency loans and financings for the six months ended June 30, 2004 decreased by R$55.0 million, or 14.0%, to R$337.2 million from R$392.2 million for the same period in 2003. This decrease was principally due to:

- a decrease of R$48.9 million in interest relating to our *real*-denominated debt for the six months ended June 30, 2004 due to the decrease in interest rates partially offset by other charges related to indexation-based increases in the principal amount of such debt; and

- a decrease of R$6.0 million of interest and other charges related to our foreign currency-denominated debt due to the decrease in the principal amounts.

As of June 30, 2004, 57.0% of our debt was *real*-denominated, and 70.2% of such *real*-denominated debt was floating rate debt and indexed to take into account the effects of inflation.

Interest income for the six months ended June 30, 2004 decreased by R$4.2 million, or 25.0%, to R$12.8 million from R$17.0 million for the corresponding period in 2003. This decrease was primarily due to the decrease in income from temporary cash investments by R$26.5 million, or 69.4%, to R$11.7 million from R$38.2 million due to the decrease in our cash balances resulting from use of cash for repayment of outstanding debt.

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Income (Loss) From Operations

As a result of the above factors (including, in particular, foreign exchange losses) income from operations for the six months ended June 30, 2004 totaled R$104.8 million as compared to income from operations of R$778.0 million for the corresponding period in 2003, a decrease of 86.5%.

Non-Operating Income (Expenses)

Net non-operating expenses for six months ended June 30, 2004 decreased by R$20.6 million, or 64.2%, to R$11.5 million, from R$32.0 million for the same period in 2003. In both periods, most of such expenses consisted of losses on disposal of property and write-offs of obsolete and other non-productive fixed assets, amounting to R$16.3 million in the six months ended June 30, 2004 and R$35.3 million for the corresponding period in 2003, offset in each case by other income.

Income Tax and Social Contribution Tax

Income tax and social contribution tax (including deferred taxes) for the six months ended June 30, 2004 decreased by R$190.5 million, or 85.1%, to R$33.4 million from R$223.9 million for the corresponding period in 2003, due to the reduction in the profit before income tax and social contribution tax, that amounted to R$93.2 million for the first six months of 2004, compared to a profit of R$746.0 million for the same period in 2003.

During the six months ended June 30, 2004, deferred taxes decreased by R$73.6 million, or 106.7%, from an expense of R$69.0 million during the first six months of 2003 to a benefit of R$4.6 million for the same period in 2004.

In addition, during the first six months of 2004, we took advantage of the income tax benefit related to interest on shareholders equity. This benefit totaled R$13.4 million for the first six months of 2004, compared to R$53.8 million during the same period in 2003, representing approximately 14.4% of our income before taxes as of June 30, 2004, which amounted to R$93.2 million, compared to 7.2% of our income before taxes during the first six months of 2003, which amounted to R$746.0 million.

For the six months ended June 30, 2004 and the corresponding period in 2003, the statutory composite tax rate was 34.0%.

Extraordinary Item

In accordance with the requirements of the Brazilian Securities Commission, under CVM Deliberation No. 371/2000, we have elected to recognize the actuarial liability of R$226.1 million calculated as of December 31, 2001 with respect to our defined benefits pension plan (Plan G1) on a straight-line basis against earnings over the five years ending December 31, 2006.

As permitted, the expense is presented as an extraordinary item of R$17.6 million (net of tax effects of R$9.0 million) for the six months ended June 30, 2003 and 2004.

Net Income (Loss)

As a result of the above factors, net income for the six months ended June 30, 2004 decreased by R$462.3 million, or 91.6%, to R$42.2 million, compared to net income of R$504.5 million for the corresponding period in 2003.

2003 Compared to 2002

Net Revenue from Sales and Services

Net revenue from sales and services for 2003 increased by R$363.7 million, or 9.7%, to R$4,130.8 million from R$3,767.1 million for 2002.

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Net revenue from sales and services relating to water services increased by R$197.0 million, or 8.9%, to R$2,418.2 million from R$2,221.2 million for 2002. This increase was primarily due to an average increase of 19.0% in tariffs, which came into effect on August 29, 2003, together with the continuing effect of an average tariff increase of 8.2% in August 2002. The volume of water distributed in 2003 decreased by 0.3%.

Net revenue from sales and services relating to sewage services increased by R$166.6 million, or 10.8%, to R$1,712.5 million from R$1,545.9 million for 2002. This increase was due primarily to an increase in tariffs, as sewage tariffs are set by reference to water tariffs, together with a 0.4% increase in volume.

Cost of Sales and Services

Cost of sales and services for 2003 increased by R$252.2 million, or 13.9%, to R$2,067.2 million from R$1,815.0 million for 2002. As a percentage of net revenue from sales and services, costs of sales and services increased to 50.0% for 2003 from 48.2% in 2002. The increase in cost of sales and services was primarily due to the following factors:

- an increase of R$139.5 million, or 21.4%, in payroll and related costs primarily resulting from (1) a 14.45% increase in salaries which took effect in May 2003 and a 2.0% increase in salaries of certain employees in connection with the Performance-based Compensation Plan (as from September 2003), (2) a R$2.4 million increase in profit-sharing from R$26.9 million for 2002 to R$29.3 million for 2003, (3) the recognition in 2003 of pension and retirements benefits granted or to be granted to our employees totaling R$17.3 million, (4) allocation of R$12.8 million for former employees who left the company through the PDI Dismissal Encouragement Program and R$13.2 million of related charges;

- an increase of R$56.3 million, or 21.3%, in energy costs mainly due to an increase in electric power tariffs and consumption volumes;

- an increase of R$42.8 million, or 8.5%, in depreciation expenses principally due to recognition to sites under construction as permanent assets; and

- an increase of R$10.9 million, or 14.0%, in the costs of materials used in the treatment of water and sewage. The increase in cost was largely a result of the recent drought, which led to lower quality in water in 2003 as compared to 2002 and so increased our need for these materials. The increase was also due to an increase in prices of these materials.

Gross Profit

As a result of the above factors, gross profit for 2003 increased by R$111.5 million, or 5.7%, to R$2,063.6 million from R$1,952.2 million for 2002. As a percentage of net revenue from sales and services, gross profit decreased to 50.0% for 2003 from 51.8% for 2002.

Selling Expenses

Selling expenses for 2003 decreased by R$87.6 million, or 22.7%, to R$297.5 million from R$385.1 million for 2002. As a percentage of net revenue from sales and services, selling expenses decreased to 7.2% for 2003 from 10.2% for 2002.

The decrease in selling expenses was primarily due to the following factors:

- a decrease of R$125.3 million, or 76.9%, in bad debt expense, net of recoveries in 2003, which is recorded under selling expenses, mainly due to recovery against allowances related to invoices issued to the Municipality of São Bernardo do Campo. The municipality owed us receivables in the amount of R$265.4 million when subjected to monetary adjustment, and this amount was recorded as a recovery against allowances; and

- a decrease of R$6.9 million, or 7.7%, in the costs of third-party services, mainly for technical maintenance services.

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These decreases were offset by an increase of R$30.2 million, or 30.0%, in payroll and related charges primarily resulting from (1) an 14.5% increase in salaries which took effect in May 2003 and a 2.0% increase in salaries of certain employees, in connection with the Performance-based Compensation Plan (as from September 2003), (2) a R$1.8 million increase in profit-sharing from R$4.0 million for 2002 to R$5.8 million for 2003, (3) the recognition in 2003 of pension and retirements benefits granted or to be granted to our employees totaling R$2.7 million, (4) allocation of R$1.8 million for former employees who left the company through the PDI Dismissal Encouragement Program and R$1.8 million of related charges (FGTS); and an increase of R$10.4 million due to the readjustment of banking collection services.

Administrative Expenses

Administrative expenses for 2003 increased by R$28.1 million, or 12.4%, to R$254.1 million from R$226.0 million for 2002. As a percentage of net revenue from sales and services, administrative expenses increased to 6.2% for 2003 from 6.0% for 2002. The increase in administrative expenses primarily reflected:

- an increase of R$26.0 million in general expense costs. The increase in general expense costs was primarily attributable to provisions for losses related to receivables from suppliers and from judicial deposits;

- an increase of R$17.1 million, or 18.3%, in payroll and related costs primarily resulting from (1) an 14.45% increase in salaries which took effect in May 2003, (2) a 2.0% increase in salaries of certain employees, in connection with the Performance-based Compensation Plan (as from September 2003), and (3) a R$1.0 million increase in profit-sharing from R$3.8 million for 2002 to R$4.8 million for 2003, a recognition of R$2.9 million relating to the liability of pension and retirements benefits granted or to be granted to our employees after retirement, and allocation of R$2.8 million for former employees who left the company through the PDI Dismissal Encouragement Program and R$2.4 million of related charges; and

- an increase of R$2.6 million in depreciation expenses principally due to recognition of sites under construction as permanent assets.

These increases were offset by:

- a decrease of R$20.4 million in the costs of third-party services mainly due to the reduction in services for publicity and lease of information technology equipment.

Financial Expenses, Net

Net financial expenses consist principally of interest on our indebtedness, foreign exchange losses in respect of indebtedness and inflation-based indexation charges relating to indebtedness, offset partially by interest income on cash and time deposits and inflation-based indexation accruals mainly relating to agreements entered into with some customers to settle overdue accounts receivable.

Net financial expenses for 2003 decreased by R$1,929.8 million, or 84.8%, to R$346.5 million from R$2,276.3 million for 2002. As a percentage of net revenue from sales and services, net financial expenses decreased to 8.4% for 2003 from 60.4% for 2002.

The absolute and relative decreases in net financial expenses were primarily due to a foreign exchange gain in 2003 as compared to 2002, reflecting the effects on our foreign currency-denominated debt of the significant recovery of the *real* against the US dollar in 2003. Foreign exchange gain was R$540.6 million for 2003 as compared to the foreign exchange loss of R$1,345.3 million in 2002.

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Interest and other charges on *real*-and foreign-currency loans and financings for 2003 increased by R$46.1 million, or 6.2%, to R$785.0 million from R$738.9 million for 2002. This increase was principally due to:

- an increase of R$62.0 million in interest relating to, and other charges related to indexation-based increases in the principal amount of, our *real*-denominated debt in 2003; and

- a decrease of R$20.9 million of interest and other charges related to a decrease in foreign-currency denominated indebtedness when translated into *reais* as a result of the appreciation of the *real* against the US dollar in 2003.

As of December 31, 2003, all of our *real*-denominated debt was floating rate debt and indexed to take into account the effects of inflation.

Interest income for 2003 increased by R$1.0 million, or 1.4%, to R$70.0 million from R$69.0 million for 2002. This increase was primarily due to increase in interest earned from cash and time deposits.

In addition, indexation accruals relating to overdue accounts receivable increased by R$163.2 million to R$203.9 million for 2003 as compared to R$78.2 million for 2002. This increase was principally due to (1) a renegotiation of existing agreements with some customers to pay overdue accounts receivable over time based on inflation-based indexation arrangements, (2) recognition of R$75.0 million resulting from the monetary variation on accounts receivable from the Municipality of São Bernardo do Campo, recorded in connection with the purchase agreement and (3) the recognition of R$58.5 million resulting from monetary variation recorded on amounts due from the State in connection with the settlement agreement reached with the State Government.

Income (Loss) from Operations

As a result of the above factors (including, in particular, foreign exchange gains) income from operations for 2003 totaled R$1,165.5 million as compared to the loss from operations of R$935.3 million for 2002.

Non-Operating Income (Expenses)

Net non-operating expenses for 2003 increased by R$51.0 million, or 1,490.4%, to R$54.5 million in 2003 from R$3.4 million for 2002. The non-operating expenses were primarily due to R$61.7 million in dispositions and write-offs of obsolete and other non-productive fixed assets in 2003 as compared to R$16.5 million in dispositions and write-offs in 2002.

The decrease in non-operating income of R$8.5 million, or 49.4%, to R$8.7 million in 2003, from R$17.2 million in non-operating income in 2002, was primarily due to decreases in donations of property, plant and equipment received in 2003 and to decreases income from the provision of technical assistance to municipalities where we do not provide water and sewage services.

Income Tax and Social Contribution Tax

Income tax and social contribution tax for 2003 increased by R$566.0 million, or 175.0%, to an expense of R$242.6 million from benefit of R$323.3 million for 2002.

Although for 2003 we had pre-tax income, we had an income tax benefit which was directly related to the interest on shareholders equity paid or accrued within that year which was not charged to pre-tax income as it is treated in a manner similar to a dividend but generates a tax deductible expense. That benefit amounted to R$171.4 million, representing approximately 15.4% of the R$1,111.1 million pre-tax income in 2003.

Although for 2002 we had pre-tax loss, we had an income tax benefit which was directly related to the interest on shareholders equity paid and or accrued within that year which was not charged to pre-tax income as it is treated in a manner similar to a dividend but generates a tax deductible expense.

For both 2003 and 2002, the statutory composite tax rate was 34.0%.

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Extraordinary Item

In accordance with the requirements of the Brazilian securities commission, under CVM Deliberation No. 371/2000, we have elected to recognize the actuarial liability calculated as of December 31, 2001 with respect to our defined benefits pension plan (Plan G1) on a straight-line basis against earnings over the five years ending December 31, 2006.

As permitted, the expense is presented as an extraordinary item of R$35.1 million (net of tax effects of R$18.1 million) for 2003.

Net Income (Loss)

As a result of the above factors, we had net income for 2003 of R$833.3 million, compared to a net loss of R$650.5 million for 2002.

2002 Compared to 2001

Net Revenue from Sales and Services

Net revenue from sales and services for 2002 increased by R$332.4 million, or 9.7%, to R$3,767.1 million from R$3,434.8 million for 2001.

Net revenue from sales and services relating to water increased by R$179.0 million, or 8.8%, to R$2,221.2 million from R$2,042.3 million for 2001. This increase was primarily due to an average increase of 8.2% in tariffs, effective on August 1, 2002. The increase was also due to an increase of 4.2% in volume of water distributed, primarily relating to the return of customer consumption to regular levels following the end of the Brazilian energy consumption restrictions in March 2002.

Net revenue from sales and services relating to sewage services increased by R$153.4 million, or 11.0%, to R$1,545.9 million from R$1,392.5 million for 2001. This increase was due primarily to increases in revenue from water services, because our sewage charges are generally fixed as a function of the monthly water charges. See Business-Tariffs.

Cost of Sales and Services

Cost of sales and services for 2002 increased by R$224.5 million, or 14.1%, to R$1,815.0 million from R$1,590.4 million for 2001. As a percentage of net revenue from sales and services, costs of sales and services increased to 48.2% for 2002 from 46.3% in 2001. The increase in cost of services was primarily due to the following factors:

an increase of R$74.0 million, or 12.8%, in payroll and related costs primarily resulting from (1) an 8.0% increase in salaries which took effect in May 2002, (2) a R$15.6 million increase in profit-sharing from R$11.3 million for 2001 to R$26.9 million for 2002, (3) the recognition in 2002 of pension and retirements benefits granted or to be granted to our employees totaling R$4.2 million and (4) the most recent collective bargaining agreement which changed the holiday benefits policy resulting in an increase of R$4.4 million in cost of services;

an increase of R$68.1 million, or 34.6%, in energy costs mainly due to an increase in electric power tariffs and consumption volumes;

an increase of R$40.3 million, or 8.7%, in depreciation expenses principally related to the commencement of operations of new water and sewage systems in the São Paulo Metropolitan Region in 2002;

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- an increase of R$19.0 million, or 32.3%, in the costs of materials used in the treatment of water and sewage. The increase in cost was largely a result of the recent drought, which led to lower quality water in 2002 as compared to 2001 and so increased our need for these materials. The increase was also due to an increase in prices of these materials; and

- an increase of R$13.0 million, or 6.5%, in the costs of third-party services, mainly for technical maintenance services.

Gross Profit

As a result of the above factors, gross profit for 2002 increased by R$107.8 million, or 5.8%, to R$1,952.2 million from R$1,844.3 million for 2001. As a percentage of net revenue from sales and services, gross profit decreased to 51.8% for 2002 from 53.7% for 2001.

Selling Expenses

Selling expenses for 2002 increased by R$52.5 million, or 15.8%, to R$385.1 million from R$332.6 million for 2001. As a percentage of net revenue from sales and services, selling expenses increased to 10.2% for 2002 from 9.7% for 2001.

The increase in selling expenses was primarily due to the following factors:

- an increase of R$21.2 million, or 31.1%, in the costs of third-party services, mainly for technical maintenance services and costs related to the recovery of accounts receivable;

- an increase of R$20.0 million, or 24.8%, in payroll and related charges primarily resulting from (1) an 8.0% increase in salaries which took effect in May 2002, (2) a R$2.3 million increase in profit-sharing from R$1.7 million for 2001 to R$4.0 million for 2002, (3) the recognition in 2002 of pension and retirements benefits granted or to be granted to our employees totaling R$0.6 million and (4) the most recent collective bargaining agreement, which changed the holiday benefits policy resulting in an increase of R$1.0 million in cost of services; and

- an increase of R$9.1 million, or 5.9%, in bad debt expense, net of recoveries in 2002, which is recorded under selling expenses. The higher allowance for doubtful accounts expense in 2002 reflects an increase in direct write-offs (net of recoveries) of overdue accounts receivable from small customers in 2002 as compared to 2001. The higher direct write-off level was partially offset by a lower charge for the provision (net of recoveries) of approximately R$89.6 million in respect of overdue accounts receivable from large customers as well as municipalities to which we provide water on a wholesale basis.

Administrative Expenses

Administrative expenses for 2002 increased by R$22.9 million, or 11.3%, to R$226.0 million from R$203.1 million for 2001. As a percentage of net revenue from sales and services, general and administrative expenses increased to 6.0% for 2002 from 5.9% for 2001. The increase in administrative expenses primarily reflected:

an increase of R$11.6 million, or 14.2%, in payroll and related costs due to an 8.0% increase in salaries which took effect in May 2001 as well as a R$2.2 million increase in profit-sharing from R$1.6 million for 2001 to R$3.8 million for 2002, a recognition of R$1.1 million relating to the liability of pension and retirement benefits granted or to be granted to employees after retirement, described in note 13 of our financial statements. In addition, revisions to vacation policy contained in our most recent annual collective bargaining agreement increased administrative expenses by R$0.6 million; and

an increase of R$6.6 million in general expense costs. The increase in general expense costs was primarily attributable to an increase in provision for contingencies.

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Financial Expenses, Net

Net financial expenses consist principally of interest on our indebtedness, foreign exchange losses in respect of indebtedness and inflation-based indexation charges relating to indebtedness, offset partially by interest income on cash and time deposits and inflation-based indexation accruals mainly relating to agreements entered into with some customers to settle overdue accounts receivable.

Net financial expenses for 2002 increased by R$1,171.1 million, or 106.0%, to R$2,276.3 million from R$1,105.2 million for 2001. As a percentage of net revenue from sales and services, net financial expenses increased to 60.4% for 2002 from 32.2% for 2001.

The absolute and relative increases in net financial expenses were primarily due to a higher foreign exchange loss in 2002 as compared to 2001, reflecting the effects on our foreign currency-denominated debt of the significant devaluation of the *real* against the US dollar in 2002. Foreign exchange loss increased to R$1,345.3 million for 2002 as compared to the foreign exchange loss of R$387.0 million in 2001.

Interest and other charges on *real*-and foreign-currency loans and financings for 2002 increased by R$123.0 million, or 20.0%, to R$738.1 million from R$615.1 million for 2001. This increase was principally due to:

- an increase of R$37.2 million of interest and other charges related to an increase in foreign-currency denominated indebtedness when translated into *reais* as a result of the depreciation of the *real* against the US dollar in 2002, even though the aggregate principal amount of our US dollar-denominated debt declined during 2002; and

- an increase of R$85.7 million of interest and other charges related to indexation-based increases in the principal amount of our *real*-denominated debt in 2002.

As of December 31, 2002, all of our *real*-denominated debt was floating rate debt and indexed to take into account the effects of inflation.

Interest income for 2002 increased by R$8.7 million, or 14.4%, to R$69.0 million from R$60.3 million for 2001. This increase was primarily due to higher average balances of cash and time deposits.

In addition, indexation accruals relating to overdue accounts receivable increased by R$34.8 million to R$78.2 million for 2002 as compared to R$43.4 million for 2001. This increase was principally due to a renegotiation of existing agreements with some customers to pay overdue accounts receivable over time based on inflation-based indexation arrangements.

Income (Loss) from Operations

As a result of the above factors (including, in particular, foreign exchange losses), the loss from operations for 2002 totaled R$935.3 million as compared to the income from operations of R$203.4 million for 2001.

Non-Operating Income (Expenses)

Net non-operating expenses for 2002 decreased by R$73.5 million, or 95.6%, to R$3.4 million from R$76.9 million for 2001. The non-operating expenses were primarily due to a R$16.5 million net loss on dispositions and write-offs of obsolete and other non-productive fixed assets in 2002 as compared to a net loss of R$84.9 million in 2001.

The decrease in net non-operating expenses was also due to an increase of R$5.4 million, or 43.8%, to R$17.2 million in 2002, from R$11.8 million in non-operating income in 2001. This increase, in turn, was primarily due to increases in donations of property, plant and equipment and income from the provision of technical assistance to municipalities where we do not provide water and sewage services.

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Income Tax and Social Contribution Tax

Income tax and social contribution tax benefit for 2002 increased by R$233.6 million, or 260.4%, to R$323.3 million from R$89.7 million for 2001.

Although for 2001 we had pre-tax income, we had an income tax benefit which was directly related to the interest on shareholders equity paid and or accrued within that year which was not charged to pre-tax income as it is treated in a manner similar to a dividend but generates a tax deductible expense. Such benefit amounted to R$166.5 million, representing approximately 131.6% of the R$126.5 million pre-tax income in 2001.

For 2002, although the tax effect arising from interest on shareholder s equity decreased to R$36.8 million, the pre-tax loss amounting to R$938.7 million was the primary reason for the R$233.6 million increase in income tax and social contribution tax benefit for the year. See Interest on Shareholders Equity above.

For both 2002 and 2001, the statutory composite tax rate was 34.0%.

Extraordinary Item

In accordance with the requirements of the Brazilian Securities Commission, under CVM Deliberation No. 371/2000, we have elected to recognize the actuarial liability calculated as of December 31, 2001 with respect to our defined benefits pension plan (Plan G1) on a straight-line basis against earnings over the five years ending December 31, 2006.

Under this CVM Deliberation, the expense recognition is presented as an extraordinary item of R$35.1 million (net of tax effects of R$18.1 million) for 2002.

Net Income (Loss)

As a result of the above factors, we had a net loss for 2002 of R$650.5 million, compared to net income of R$216.2 million for 2001.

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, borrowings from Brazilian Federal and State governmental financial institutions, and financing from multilateral organizations and from domestic and international capital markets. As of June 30, 2004, we had R$102.9 million of cash and cash equivalents and total debt of R$7,318.5 million, 43% of which was foreign currency-denominated. Outstanding short-term debt was approximately R$1,116.4 million at June 30, 2004, of which R$257.1 million was denominated in foreign currency. Long-term debt was approximately R$6,202.0 million, of which R$2,890.7 million consisted of foreign currency-denominated obligations. We believe that we have sufficient sources of liquidity and capital to meet our liquidity and capital requirements for the next few years, in light of our current financial position and our expected cash generated by operating activities.

Cash Provided by Operating Activities. Cash provided by operating activities is, and we anticipate that it will continue to be, the single largest source of our liquidity and capital resources in future years and financial periods. Our cash generated by operating activities was R$1,655.3 million in 2003, R$1,764.8 million in 2002, R$1,657.0 million in 2001 and R$811.1 million in the six months ended June 30, 2004.

We have overdue accounts receivable from the State Government and from the municipalities to which we provide water on a wholesale basis. In December 2001, we entered into an agreement with the State Government under which the State of São Paulo, among other things, agreed to transfer the reservoirs in the Alto Tietê System

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in exchange for the cancellation of a portion of accounts receivable then due from the State of São Paulo and reimbursement then due from the State Government for pensions paid by us. The transfer of assets contemplated by this agreement will be a non-cash transaction.

Under the December 2001 agreement, in July and August 2002, a State-owned construction company, on behalf of the State of São Paulo, and an independent appraisal firm, on behalf of us, presented their valuation reports relating to the reservoirs. The appraisals contained in these reports were in the amounts of R$335.8 million and R$341.2 million, respectively. Under the December 2001 agreement, the arithmetic average of these appraisals will be deemed to be the fair value of the reservoirs. Because we already had 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 and they will be submitted for approval to an extraordinary general meeting of shareholders. However, we cannot assure you as to when a final determination as to the fair value of these reservoirs will be made, when the transfer of the reservoirs will occur or when cancellation of accounts receivable will take place.

The December 2001 agreement also provided that the legal advisors of the State Finance Secretariat of São Paulo 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 of São Paulo. The commencement of payments with respect to pension amounts owed to us by the State of São Paulo has been postponed until these analyses are completed, the appraisal report is approved and the credit assignments relating to the transfer of the reservoirs described above are formalized. Under the December 2001 agreement, the original first payment was to be made in July 2002. We cannot assure you as to when agreement among the parties will be reached or when the State of São Paulo will commence making payments in respect of these pension amounts.

In March 2004, we entered into an amended agreement with the State Government that provides, among other things, that we would set off a portion of the amounts due to us by the State of São Paulo against dividends, in the form of interest on shareholder s equity, payable by us to the State of São Paulo, and that the State of São Paulo would pay us the portion of the accounts receivable not subject to the set-off. The amount owed to us according to the amended agreement was R$581.8 million, of which R$360.7 million is to be set off, with the remaining R$221.1 million to be paid by the State Government in 60 consecutive monthly installments beginning May 30, 2004. On June 30, 2004, the State of São Paulo owed us R$176.4 million related to the agreement and R$38.4 million related to values not yet overdue. As of June 30, 2004, the State of São Paulo was to receive R$55.0 million to be offset against accounts receivable. Our accounts receivable from the State Government and municipalities to which we provide water on a wholesale basis equaled R$592.3 million as of June 30, 2004, of which R$543.6 million was overdue.

On December 19, 2003, we agreed to purchase the water and sewage assets of the Municipality of São Bernardo do Campo, thus obtaining the right to provide water and sewage services in that municipality, which had previously been one of our bulk sale customers. The economic value of the transaction was R$415.5 million, which was recorded as an intangible asset. The municipality owed us receivables in the amount of R$265.4 million when subjected to monetary adjustment, and this amount was recorded as a recovery against allowances for doubtful accounts. The R$150.0 million balance is being paid in cash, in installments through November 2004.

Debt Financing. As of June 30, 2004, we had approximately R$6,202.0 million in long-term debt outstanding (excluding the current portion of long-term debt), of which approximately R$2,890.7 million consisted of foreign currency-denominated long-term debt. We had outstanding short-term debt of approximately R$1,116.4 million at June 30, 2004, representing the current portion of our long-term debt. As of June 30, 2004, approximately R$257.1 million of this short-term debt was denominated in foreign currencies. Substantially all of our foreign currency-denominated debt of R$3,147.8 as of June 30, 2004 was denominated in U.S. dollars or in baskets of foreign currencies. It consisted principally of US$447.2 million (R$1,389.7 million) in loans from the Inter-American Development Bank, US$13.3 million (R$41.4 million) in loans from the World Bank, US$500.0 million (R$1,553.8 million) in aggregate principal amount of 10.0% Notes due 2005 and of 12.0% Notes due 2008 sold in the international capital markets in July 1997 and in June 2003, respectively, and an aggregate of US$30.0 million (R$93.2 million) in syndicated loans. Our borrowings from multilateral institutions, such as the World Bank and the Inter-American Development Bank, have in the past been, and in the future are likely to be, guaranteed by the Government of the State of São Paulo or the Federal Government. We do not pay fees for these guarantees.

On June 17, 2004, our Board of Directors authorized the issuance of 40 promissory notes guaranteed by us and each with an individual face value of R$5.0 million for an aggregate amount of R$200.0 million. These promissory notes were issued on July 16, 2004. These promissory notes have a final maturity date of 180 days from subscription and bear interest at a floating rate of 105.0% of the CDI rate over the individual face value from the issuance date. On September 22, 2004, 26 of these promissory notes totaling R$130 million were prematurely prepaid.

Our outstanding long-term debt as of June 30, 2004 included approximately R$711.7 million due during 2004, approximately R$1,519.7 million due during 2005, approximately R$643.9 million due during 2006, approximately R$553.9 million due during 2007, approximately R$1,081.6 million due during 2008 and approximately R$2,087.7 million due during 2009 or thereafter. We believe that we can service this 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 current interest rates borne by our outstanding indebtedness, see note 10 to our financial statements.

Our outstanding domestic debt was approximately R$4,170.7 million as of June 30, 2004 and consisted primarily of *real*-denominated loans from Federal and State Government-owned banks (in particular, Banco do Brasil S.A. and Caixa Econômica Federal), and debentures issued in March 1999, April 2001 and April 2002.

On August 6, 2004, we entered into a credit agreement with the Japan Bank for International Cooperation for the financing of the Environmental Recovery Program for the Santos Metropolitan Region, which was guaranteed by the Federal Government for an aggregate principal amount of R$588.0 million. In addition to the amount received under the JBIC credit agreement, we intend to invest up to R$493.0 million in this program. In addition, we are currently negotiating with BNDES and Caixa Econômica Federal for additional loans to finance portions of our capital expenditure program.

On September 17, 2004, we registered with the Brazilian Securities Commission a securities shelf program through which we will be able to offer certain debt securities, including non-convertible debentures and commercial paper up to an aggregate amount of R$1.5 billion over the next two years. As part of this program, we issued R$600.0 million in aggregate principal amount of debentures in September 2004 (our 6th issue), to be offered in three separate series. The debentures of the first, second and third series will mature within three, five and six years after issuance, respectively. The debentures of the first series will pay interest at the CDI rate plus 1.75% per year, and the debentures of the second and third series will pay interest at rates of IGP-M plus 11.0% per year. The final amounts of the debentures of each new series to be offered will be determined before their public distribution.

All of our *real*-denominated debt is indexed to take into account the effects of inflation. Most of our *real*-denominated debt provides for inflation-based increases in their respective principal amounts; the increases are determined by reference to the daily government interest rate (*Taxa Referencial-TR*) plus an agreed margin.

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The following table sets forth information on our outstanding debt as of June 30, 2004. See note 10 to our financial statements.

Facility	**Aggregate Principal Amount**	**Additional Amounts Available**	**Interest Rate**[1]
	(in millions of *reais*)		
Real-denominated loans and financings:			
Federal Government/Banco do Brasil	R$ 2,391.5		UPR + 8.50%
Debentures 3rd Issue	366.6		CDI + 2.85%
Debentures 4th Issue	250.0		CDI + 1.20%
Debentures 5th Issue	438.5		CDI + 2.00% /IGP-M +12.70%
Caixa Econômica Federal[2]	509.7	346.9	UPR + 5.00% to 9.50%
Brazilian Economic and Social Development Bank (BNDES)	145.3	98.7	TJLP + 3.00% (up to 6.00%)
Other	27.6		UPR + 12.00% /CDI
Accrued interest and charges	41.4		
Foreign currency denominated loans and financings:			
Long-term Notes: US$500,000,000	1,553.8		10%[3] 12%[4]
Inter-American Development Bank (IDB):			
US$447,200,000	1,389.7	395.7	Variation in the basket of currencies + 3.00% to 7.70%
International Bank for Reconstruction and Development (World Bank):			
US$13,314,000	41.4		Variation in the basket of currencies + 4.85%
Deutsche Bank Luxembourg:			
US$30,000,000	93.2		11.125%
Société Générale: 2,351,000	8.9		4.99%
Accrued interest and charges	60.8		
Total Debt	**R$ 7,318.5**	**R$ 841.3**	

(1) UPR stands for Standard Reference Unit (*Unidade Padrão Referência*) and is equal to the Daily Government Interest Rate (*Taxa Referencial TR*), which was 0.13% per month as of June 30, 2004; CDI stands for Interbank Rate (*Certificado de Depósitos Interbancarios*), which was 15.72% per annum as of June 30, 2004; IGP-M stands for *Índice de Preços a Mercado*, which was 6.8% per semester as of June 30, 2004; TJLP stands for Long-term rate fixed by the Federal Government on a quarterly basis (*Taxa de Juros a Longo Prazo*), which was 9.75% per annum as of June 30, 2004.

(2) Agreements to provide up to aggregate of approximately R$554.2 million in financing for our capital expenditure program. We have pledged amounts in certain bank accounts into which customers pay their bills as collateral for these loans.

(3) Interest rate on US$275.0 million Notes issued July 1997 and due 2005.

(4) Interest rate on US$200.0 million Notes issued June 2000 and due 2003.

We are subject to covenants under agreements evidencing or governing our outstanding indebtedness, including but not limited to those set forth in a loan agreement with the Inter-American Development Bank, the indenture relating to the 10.0% Notes due 2005, the 12.0% Notes due 2008 and the loan agreements relating to the syndicated loans. Each of these agreements contains, among other provisions, limitations on our ability to incur debt. The indenture relating to the 10.0% Notes due 2005 and the 12.0% Notes due 2008 are the most stringent of these debt agreements. Both of these indentures prohibit, subject to some exceptions, the incurrence of additional debt in the event that (1) the ratio of Indebtedness to Adjusted Capitalization (as defined therein) is greater than 0.42x or (2) the Debt Service Coverage Ratio (as defined in the indentures) is less than 2.50x. These ratios are calculated using financial statements prepared under the constant currency method (which is an

accounting methodology that differs from the Brazilian Corporate Law Method and that incorporates inflation accounting no longer commonly used in Brazil). We do not believe that these covenants will impose constraints on our ability to finance our capital expenditure program or, more generally, to develop our business and enhance our financial performance. As of June 30, 2004, our ratio of Indebtedness to Adjusted Capitalization was 0.28x and our Debt Service Coverage Ratio was 3.10x, in each case as calculated in accordance with the above-mentioned indentures.

Brazilian regulations provide that a state-owned company, such as ours, must, subject to some exceptions, use the proceeds of external credit operations (i.e., foreign currency borrowings) to refinance outstanding financial obligations. Until so used, these proceeds must be deposited as directed by the Central Bank. The deposit requirement does not apply in the case of import financing and financing transactions involving multilateral and official organizations, such as the Japan Bank for International Cooperation, the World Bank and the Inter-American Development Bank.

Capital Requirements

We have, and expect to continue to have, substantial liquidity and capital resource requirements. These requirements include debt-service obligations, capital expenditures to maintain, improve and expand our water and sewage systems, payment of pension plan and other employee benefits, including pension plan payments to certain of our former employees on behalf of the State of São Paulo, and dividend payments and other distributions to our shareholders, including the State of São Paulo.

Debt-Service Obligations. Our debt service obligations as of June 30, 2004 included approximately R$711.7 million for the remainder of 2004, approximately R$1,519.7 million due during 2005, approximately R$643.9 million due during 2006, approximately R$553.9 million due during 2007, approximately R$1,081.6 million due during 2008 and approximately R$2,807.7 million due during 2009 or thereafter.

Capital Expenditures. Our cash disbursements for purchases of property, plant and equipment under our capital expenditure program totaled approximately R$317.7 million in the six months ended June 30, 2004 and R$641.3 million in 2003, as compared with approximately R$586.0 million in 2002 and R$694.6 million in 2001. Our capital expenditure program will require total expenditures of approximately R$4.3 billion in the period from 2004 through 2008, including approximately R$883.0 million in 2004 and R$880.0 million in 2005. We spent approximately $300.0 million on our capital expenditure program during the six months ended June 30, 2004.

Pension Plan Payments and Employee Benefits. We have been making State-mandated special retirement and pension payments to certain former employees who were employed by our predecessor entities prior to May 1974. These special payments totaled R$36.6 million during the six months ended June 30, 2004, R$87.1 million in 2003, R$77.6 million in 2002 and R$72.8 million in 2001. The State of São Paulo is required to reimburse us for such amounts, but has generally not been paying us on a timely basis. The State of São Paulo s obligation to us for these amounts is recorded under reimbursement due from State Government for pensions paid on the balance sheet and totaled R$527.6 million as of June 30, 2004. In December 31, 2002 these receivables totaled R$403.9 million and were classified as current and non-current assets. In December 31, 2003 they reached R$491.0 million and were reclassified to non-current assets in our financial statements. The special payments to former employees made by us are not reflected in our statement of operations, but nonetheless represent a significant component of our liquidity requirements. Although we have had discussions with the State of São Paulo regarding more timely reimbursement for the special payments to former employees, we cannot assure you as to when or whether such payments will be made by the State of São Paulo. We may continue to be held responsible for these special payments to former employees, even if the State of São Paulo stops reimbursing us with respect to these payments.

Tax Financing Agreements. We did not make payments in respect of certain Brazilian federal income tax and social contribution liabilities during the period from 1991 to mid-1996 mainly because we were contesting certain assessments by the federal tax authorities and, in the case of 1993 and 1994, because we did not have sufficient funds to meet all of our then existing liquidity and capital resources requirements. Under the Programa de Recuperacão Fiscal REFIS tax recovery program, we entered into an agreement with the Brazilian tax authorities regarding these tax obligations and have agreed to make payments on them in monthly installments ending in 2005. We are also required to pay interest on the unpaid balance of this tax liability. However, in July 2003, we included the amounts due under the REFIS program in another program called PAES, which is an alternative payment plan for taxes owed. In accordance with this settlement agreement, we are paying amounts due, of approximately R$317.0 million, in 120 monthly installments, from July 2003. See note 12 to our financial statements. Payments in respect of this aggregate tax liability continue to constitute a liquidity and capital resource requirement that must be satisfied.

Dividend Distributions. We are required by our by-laws to make dividend distributions, which can be made as payments of interest on shareholders equity, to our shareholders in an amount equal to not less than 25% of the amounts available for distribution, to the extent amounts are available for distribution. The aggregate amount of distributions we made for 2001, 2002 and 2003 were R$489.8 million, R$108.2 million and R$504.1 million, respectively, or R$4.30, R$0.95 and R$4.42 per ADS.

On February 26, 2004, our Board of Directors approved the payment of dividends, in the form of interest on shareholders equity, in the amount of R$39.3 million, to be paid within 60 days after our 2005 shareholders meeting to shareholders of record as of March 15, 2004. We currently are unable to determine the amount, if any, of its portion of these declared dividends that the State will apply to current and future accounts receivable owed to us by the State or its controlled entities.

Off-Balance Sheet Arrangements

We do not have any material off-balance sheet arrangements.

Contractual Obligations and Commercial Commitments

The following table summarizes our significant contractual obligations and commercial commitments that affect our liquidity as of December 31, 2003:

	Payments due by period				
	Less than 1 year	1-3 years	3-5 years	More than 5 years	Total
	(in millions of *reais*)				
Contractual obligations:					
Long-term debt, including current portion(1)	997.0	2,060.0	1,546.0	2,661.3	7,264.3
Domestic	713.7	946.8	692.7	1,898.4	4,251.6
Foreign	283.3	1,113.2	853.3	762.9	3,012.7
Operating leases(2)	9.1	3.8	0.3		13.2
Pension plan obligations-Plan G1(3)	23.1	51.5	61.5	3,833.3	3,969.4

Pension plan obligations-Plan G0(3)	89.4	181.2	184.9	1,984.9	2,440.4
Tax Recovery Program (PAES)(4)	33.2	66.4	66.4	149.4	315.4
Capital expenditure commitments(5)	138.0	502.0	136.0		776.0
Take-or-pay contracts for electrical energy(6)	68.4	12.1	2.7	0.3	83.5
Total contractual cash obligations	1,358.2	2,877.0	1,997.8	8,629.2	14,862.2

(1) Long-term debt is presented in note 10 to our financial statements.
(2) Operating leases are presented in note 15 (b) to our financial statements.
(3) Pension plan obligations and actuarial amounts are presented in notes 26 (a) (i) and (iv) to our financial statements.

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(4) The REFIS/PAES Tax Recovery Program is presented in note 12 to our financial statements.
(5) Capital expenditure commitments are presented in note 15 (d) to our financial statements.
(6) Take-or-pay contracts for electrical energy are presented in note 15 (c) to our financial statements.

US GAAP Reconciliation

Our net income (loss) in accordance with the Brazilian Corporate Law Method was R$216.2 million in 2001, R$(650.5) million in 2002 and R$833.3 million in 2003; and R$504.5 million and R$42.2 million for the six months ended June 30, 2003 and 2004, respectively. Under US GAAP, we would have reported net income (loss) of R$16.7 million in 2001, R$(847.6) million in 2002 and R$642.6 million in 2003. Under US GAAP, net income for the six months ended June 30, 2003 would have been R$418.0 million and we would have recorded a loss of R$26.4 million for the six months ended June 30, 2004.

Our shareholders equity in accordance with the Brazilian Corporate Law Method totaled R$7,246.5 million as of December 31, 2002 and R$7,576.9 million as of December 31, 2003. Shareholders equity in accordance with the Brazilian Corporate Law Method as of June 30, 2004 was R$7,580.9 million. Under US GAAP, we would have reported shareholders equity of R$5,945.8 million at December 31, 2002, R$6,085.6 million at December 31, 2003 and R$6,021.1 million as of June 30, 2004.

The principal differences between the Brazilian Corporate Law Method and US GAAP that affect our net income (loss) in 2001, 2002 and 2003 and during the six months ended June 30, 2004, as well as shareholders equity as of December 31, 2002 and 2003 and June 30, 2004, relate to the treatment of the following items:

- additional inflation restatements and related depreciation which would be mandated by US GAAP (but which are not permitted under the Brazilian Corporate Law Method) for 1996 and 1997 in recognition of Brazil s status as a highly inflationary country in those years;

- revaluations of property, plant and equipment recorded in 1990 and 1991 under the Brazilian Corporate Law Method, which would be reversed and partially replaced by supplemental inflation restatements based upon a general price index (IGP-M) for periods prior to 1990 under US GAAP;

- pension plan (Plan G0) payments and other employee benefits for former employees of our predecessor companies which are obligations of the State of São Paulo and which are not treated as our expenses under the Brazilian Corporate Law Method, but which would be required to be treated as our expense on an actuarial basis under US GAAP;

- pension plan (Plan G1) expenses which, through December 31, 2001, were recognized on an accrual basis only to the extent of required contributions for the relevant year or financial period under Brazilian Corporate Law Method, but which would be required to be fully recorded on an actuarial basis under US GAAP. Since January 1, 2002 under the Brazilian Corporate Law Method, recognition on an actuarial basis is required. There are some differences as compared with US GAAP, basically regarding the calculation method, amortization period and recognition rules, resulting in different pension cost obligation; and

- additional accounting items, including, among others, capitalized interest, expensing of deferred charges and deferred taxes and the voluntary redundancy plan.

See note 24 to our financial statements for a description of these differences as they relate to us and a reconciliation of net income (loss) and total shareholders equity from the Brazilian Corporate Law Method to US GAAP.

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BUSINESS

General

We believe we are the largest water and sewage company in Latin America based on net revenue and customers in 2003. We operate water and sewage systems in the State of São Paulo in which the City of São Paulo, Brazil s largest city, is located. According to the Brazilian Institute of Geography and Statistics, or IBGE, the State of São Paulo is Brazil s most populous and economically productive state. We had net revenue from sales and services of R$4,130.8 million (US$1,329.3 million) and net income of R$833.3 million (US$268.2 million) for 2003 and net revenue from sales and services of R$2,126.3 million (US$684.2 million) and net income of R$42.2 million (US$13.6 million) for the six months ended June 30, 2004. We had total assets of R$16,441.5 million (US$5,290.9 million) and shareholders equity of R$7,580.9 million (US$2,439.5 million) as of June 30, 2004.

We provide 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. We also supply water on a wholesale basis to six municipalities in the São Paulo Metropolitan Region in which we do not operate water systems. Until December 2002 we divided our service territories into three regions: the São Paulo Metropolitan Region, the Interior Region and the Coastal Region. During 2003 we reorganized our corporate management structure by consolidating the municipalities which we serve in the interior and coastal regions into a single management unit we call Regional Systems. Under this new structure, the São Paulo Metropolitan Region and the Regional Systems accounted for 74.0% and 26.0% of our net revenue from sales and services for the six months ended June 30, 2004, respectively.

As of June 30, 2004, we distributed water to approximately 22.2 million people, which we believe includes approximately 60.0% of the urban population of the State of São Paulo, through approximately 57,976 kilometers of water pipes and mains to more than 6.3 million water connections. As of June 30, 2004, we provided sewage services to approximately 18.0 million people, and a sewage coverage ratio of 78%, through 35,692 kilometers of sewer lines to approximately 4.7 million sewage connections. We currently sell water on a wholesale basis to six other municipalities having an estimated population of approximately 3.1 million in the aggregate.

The State of São Paulo, our controlling shareholder, is required by our by-laws and State law to own at least one-half plus one of our common (voting) shares. After giving effect to the ADS and Brazilian offerings, the State of São Paulo will own 55.7% of our outstanding common shares assuming the over-allotment option is exercised in full. As a state-controlled company, we are an integral part of the governmental structure of the State of São Paulo. Our strategy and major policy decisions are formulated in conjunction with the Energy, Water Resources and Sanitation Secretariat of the State of São Paulo as part of the overall strategic planning for the State of São Paulo. The majority of the members of our Board of Directors and our Executive Committee are nominated by the State Council for Protection of Capital of the State of São Paulo (*Conselho de Defesa de Capitais do Estado de São Paulo CODEC*), a State agency presided over by the Secretary of the State Treasury and reporting directly to the Governor.

In addition, our capital expenditure budget is subject to approval by the legislature of the State of São Paulo and is approved in conjunction with the budget of the Energy, Water Resources and Sanitation Secretariat and of the State of São Paulo as a whole. However, the Governor of the State of São Paulo has the power to modify our capital expenditure budget after it has been approved. 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 of São Paulo.

State of São Paulo