

COMPANHIA DE SANEAMENTO BASICO DO ESTADO DE SAO PAULO-SABESP  
Form 20-F  
April 29, 2019

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

**FORM 20 F**

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

**OR**

**p ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2018**

**OR**

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

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

**OR**

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

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

**Commission file number 001 31317**

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

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

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

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

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

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

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

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

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

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

683,509,869 Shares of Common Stock (SBS)

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

Yes  No

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

Yes  No

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

Yes  No

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

Yes  No

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

Large Accelerated Filer   
Non-accelerated Filer

Accelerated Filer   
Emerging Growth Company

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

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

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

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

Item 17  Item 18

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

Yes  No

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

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## PRESENTATION OF FINANCIAL AND OTHER INFORMATION

### General

We maintain our books and records in *reais*. We prepare our financial statements in accordance with International Financial Reporting Standards, or “IFRS”, as issued by the International Accounting Standards Board, or the “IASB”. Our audited financial statements as of December 31, 2018 and 2017 and for each of the years in the three-year period ended December 31, 2018 and are included in this annual report on Form 20 F.

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

### Water Crisis

Our results and operational performance for the fiscal year ended December 31, 2018 were partially affected by the new consumption habits of our consumers that have impacted the volume of water billed. In the years 2014 and 2015, the drought was more intense in the northwest region of the State of São Paulo, resulting in the lowest stream flow measurements in over 80 years. With the return of the rainfall to historical levels for the rainy season that began in October 2015 and ended in March 2016, the level of water in the reservoirs that provide water to the population of the São Paulo metropolitan region returned to normal and the measures taken during the water crisis to continue to service consumers were gradually discontinued. However, heightened public awareness of the need to conserve water during the crisis resulted in our customers adopting lower water consumption practices during the water crisis and these practices have been partially integrated into our consumers’ daily habits. As a result, despite our reservoirs having a higher volume of water available for treatment, the total volume of water billed to our clients did not return to the volume of water billed in 2013, before the water crisis. As of December 31, 2018, the reservoirs in the São Paulo metropolitan region, where our largest market is located, contained 943.3 million m<sup>3</sup> of water storage for treatment (including the São Lourenço System, a new supply system which expands our production capacity by 6 m<sup>3</sup>/s and which commenced operation in July 2018), compared to 916.8 million m<sup>3</sup> available for treatment as of December 31, 2017. The measurements for these years do not include the so called “technical reserve” of 287.5 million m<sup>3</sup>. See “Item 4.B. Business Overview—The 2014-2015 Water Crisis”. Average monthly water production in 2018 for the São Paulo metropolitan region was 60.9 m<sup>3</sup>/s, compared to 69.1 m<sup>3</sup>/s in 2013, the year before the water crisis started. For more information, see “Item 3.D. Risk Factors—Risks Relating to Our Business—“The 2014-2015 water crisis impacted the water supply in the metropolitan region of São Paulo and affected the water consumption practices that have been influencing the volume of water billed” and “Item 4.B. Business Overview—The 2014-2015 Water Crisis”.

### Other Information

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

In addition, references to:

- “ANA” are to Water National Agency (*Agência Nacional de Águas*);
- “ARSESP” are to the São Paulo State Sanitation and Energy Regulatory Agency (*Agência Reguladora de Saneamento e Energia do Estado de São Paulo*);

- “ADR” or “ADRs” are to American Depositary Receipt or American Depositary Receipts, respectively;
- “ADS” or “ADSs” are to American Depositary Share or American Depositary Shares, respectively;
- “Brazil” are to the Federative Republic of Brazil;
- “Central Bank” are to the Central Bank of Brazil;
- “Coverage” indicators are to (a) the number of homes that are actually connected to the water network or sewage collection network, plus the number of homes for which the water and sewage networks are available for connection but which are not connected to those networks (referred to as “feasible” or “connectable” homes), as a portion of (b) the total number of homes within the urbanized service area covered by our contract with the municipality (i.e., the “serviceable area”);
- “CVM” are to the *Comissão de Valores Mobiliários*, the Brazilian securities and exchange commission;

- “federal government” and “Brazilian government” are to the federal government of the Federative Republic of Brazil and “state government” are to the state government of the State of São Paulo;
- “¥” or “Japanese yen” are the official currency of Japan;
- “real”, “reais” or “R\$” are to the Brazilian *real*, the official currency of Brazil;
- “Regional Systems” are to the area where the regional systems’ executive office operates, comprising 332 municipalities in the interior and coastline regions of the state of São Paulo;
- “São Paulo metropolitan region”, with respect to our operations, are to the area where the metropolitan executive office operates, comprising 38 municipalities, including the city of São Paulo;
- “Service” indicators are to (a) the number of homes that are actually connected to the water network or sewage collection network, as a portion of (b) the total number of homes within a given serviceable area;
- “Sewage Treatment Coverage” indicators are to the amount of consumer units connected to the sewage treatment system;
- “State” are to the State of São Paulo, which is also our controlling shareholder;
- “U.S. dollars” or “US\$” are to the United States dollar, the official currency of the United States; and
- “water crisis” are to the drought we experienced from late 2013 and throughout most of 2015. This drought, the most serious that our service region has experienced in more than 80 years, primarily affected the Cantareira System, our largest water production system.

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

### ***Market Information***

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

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

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

Throughout this document, we refer to the 369 municipalities we serve and to our 373 contracts. This difference results from the fact that we have two partial water contracts with the municipality of Mogi das Cruzes, where the



majority of population is serviced on a wholesale basis, though it has not been included in the total number of municipalities we serve. Additionally, we have a further two contracts, which we entered with the municipalities of Aguaí and Guarulhos, where the operations did not commence by the end of 2018. Most of our contracts with the municipalities we serve are program contracts which have a term of 30 years.

Throughout the report we mentioned that we serve five municipalities in our wholesale segment (Guarulhos, Mauá, Mogi das Cruzes, Santo André and São Caetano do Sul) since our revenue for the fiscal year 2018 is derived from 369 municipalities we serve as part of our retail operations and five municipalities we serve on a wholesale basis. However, in December 2018, we entered into an agreement with the municipality of Guarulhos and, as of January 2019, we started operations in the municipality as part of our retail operations. For further information on this agreement, see “Item 4.B. Business Overview—Wholesale Operations—Wholesale Water Services” and Note 9 to our 2018 financial statements included in this annual report.

## CAUTIONARY STATEMENTS ABOUT FORWARD LOOKING STATEMENTS

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

- general economic, political, demographical and other conditions in Brazil and in other emerging market countries;
- changes in applicable laws and regulations, as well as the enactment of new laws and regulations, including those relating to environmental, tax and employment matters in Brazil;
- availability of the water supply;
- the impact on our business of lower water consumption practices adopted by our customers during the water crisis, which we do not know if they will return to their prior standards despite the discontinuation of the measures adopted to serve the São Paulo metropolitan region during the water crisis;
- any measures that we may be required to take to ensure the provision of water to our customers;
- our exposure to probable increases in the frequency of extreme weather conditions, including droughts and intensive rain and other climatic events;
- fluctuations in inflation, interest rates and exchange rates in Brazil;
- the interests of our controlling shareholder;
- our potential corporate reorganization, as approved by State Law No. 16,525 on September 15, 2017, or any other type of reorganization that might be approved by the government that may include change in control;
- our ability to collect amounts owed to us by our controlling shareholder and by municipalities;
- our ability to continue to use certain reservoirs under current terms and conditions;
- our capital expenditure program and other liquidity and capital resources requirements;
- power shortages, rationing of energy supply or significant changes in energy tariffs;
- the effects of the agreement for provision of water and sewage services in the city of São Paulo, which we executed with the State and the city of São Paulo;
- the lack of formal agreements between our company and certain municipalities to which we provide water and sewage services, including cities comprising metropolitan regions, urban conurbations, and the fact that the State and

municipal governments share competency regarding these services;

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

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- the costs we incur in complying with environmental laws and any penalties for failure to comply with these laws;
- the outcome of our pending or future legal proceedings;
- the delay or postponement in investment in our sewage system;
- our management's expectations and estimates relating to our future financial performance;
- the regulations issued by ARSESP regarding several aspects of our business, including limitations on our ability to set and adjust our tariffs;
- the potential impacts of Provisional Measure No. 868/2018 on our business if it is converted into law;
- the possibility to be subject to a regulatory agency, other than ARSESP; and
- other risk factors as set forth under "Item 3.D. Risk Factors".

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

## Part I

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

Not applicable.

### ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

### ITEM 3. KEY INFORMATION

#### A. Selected Financial Data

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

The selected financial data as of December 31, 2018 and 2017 and for the years ended December 31, 2018, 2017 and 2016 have been derived from our audited financial statements, presented in accordance with IFRS, and included in this annual report. The selected financial data as of December 31, 2016, 2015 and 2014 and for the years ended December 31, 2015 and 2014 have been derived from our audited financial statements, presented in accordance with IFRS, which are not included in this annual report.

We have included information with respect to the dividends and/or interest attributable to shareholders’ equity paid to holders of our common shares since January 1, 2014 in *reais* and in U.S. dollars translated from *reais* at the commercial market selling rate in effect as of the payment date under the caption “Item 8.A. Financial Statements and Other Financial Information—Dividends and Dividend Policy—Payment of Dividends”.

	<b>For the year ended December 31,</b>				
	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
	<b>R\$</b>	<b>R\$</b>	<b>R\$</b>	<b>R\$</b>	<b>R\$</b>
	<i>(in millions, except per share and per ADS <sup>(1)</sup> data)</i>				
<b>Selected Income Statement Data:</b>					
Net operating revenue	16,085.1	14,608.2	14,098.2	11,711.6	11,213.2
Cost of services	(9,086.5)	(8,779.0)	(9,013.1)	(8,260.8)	(7,635.6)
Gross profit	6,998.6	5,829.2	5,085.1	3,450.8	3,577.6
Selling expenses	693.5	(686.0)	(730.0)	(598.1)	(736.6)
Allowance for doubtful accounts(*)	(166.7)	(82.7)	—	—	—
Administrative income (expenses)	(996.9)	(1,099.0)	(934.9)	45.0	(924.4)
Operating profit	5,176.6	3,961.7	3,429.6	3,044.0	1,910.7
Financial income (expenses), net	(1,264.3)	(458.1)	699.4	(2,456.5)	(635.9)
Profit for the year	2,835.1	2,519.3	2,947.1	536.3	903.0
Earnings per share – basic and diluted	4.15	3.69	4.31	0.78	1.32
Earnings per ADS – basic and diluted	4.15	3.69	4.31	0.78	1.32
	0.99	0.19	1.02	0.19	0.32

Dividends and interest on shareholders' equity per share					
Dividends and interest on shareholders' equity per ADS	0.99	0.19	1.02	0.19	0.32
Weighted average number of common shares outstanding	683,509,869	683,509,869	683,509,869	683,509,869	683,509,869

(\*) Starting January 1, 2018, we adopted IFRS 9. As a result, in 2018 and 2017 we now recorded our allowance for doubtful accounts in the income statements as a separate item. In 2016, 2015 and 2014, the amounts of allowance for doubtful accounts in the income statements were R\$90.5 million, R\$2.4 million and R\$139.6 million and were presented as part of our selling expenses.

(1) ADS-American Depositary Share.

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**Selected Statement of Financial Position Data**

	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
	<b>R\$</b>	<b>R\$</b>	<b>R\$</b>	<b>R\$</b>	<b>R\$</b>
Property, plant and equipment	267.6	255.1	302.4	325.1	304.8
Contract asset (*)	7,407.9	–	–	–	–
Intangible assets	29,012.5	33,466.1	31,246.8	28,513.6	25,979.5
Total assets	43,565.1	39,546.4	36,745.0	33,706.6	30,355.4
Current portion of long term loans and financing	2,103.6	1,746.8	1,246.6	1,526.3	1,207.1
Long term loans and financing	11,049.2	10,354.2	10,717.6	11,595.3	9,578.6
Interest on capital	673.8	598.6	700.0	127.4	214.5
Total liabilities	24,013.4	22,033.4	21,325.8	19,990.0	17,051.0
Equity	19,551.7	17,513.0	15,419.2	13,716.6	13,304.4
Capital stock	15,000.0	10,000.0	10,000.0	10,000.0	10,000.0

**Selected Statements of Cash Flows Data:**

Net cash generated from operating activities	3,842.9	3,301.9	3,003.6	2,641.4	2,480.3
Net cash used in investing activities	(2,189.3)	(1,971.4)	(2,130.7)	(2,459.5)	(2,757.7)
Net cash provided by (used in) financing activities	(907.5)	(933.6)	(625.9)	(265.7)	218.5
Purchases of intangible assets and property, plant and equipment as presented in our statement of cash flow	(2,183.2)	(1,976.7)	(2,135.8)	(2,452.1)	(2,748.3)

(\*) As of December 31, 2018, with the adoption of IFRS 15 - Revenue from contract with customer, since 1 January 2018, assets related to concessions under construction, registered under the scope of IFRIC 12 - Concession Contracts, have been classified as Contract Assets during the construction period and transferred to Intangible Assets only after completion of the works. For more information on this adoption, see Note 4.1 to our 2018 financial statements included in this annual report.

**Operating Data****Indicator**

	<b>2018</b>	<b>2017</b>	<b>2016</b>
Number of water connections (in thousands)	9,053	8,863	8,654
Number of sewage connections (in thousands)	7,495	7,302	7,091
Percentage of population with water connections (“service” indicator) (in percent) (1)	95	95	95
Percentage of population with sewer connections (“service” indicator) (in percent) (1)	83	83	82
Percentage of population covered by water network (“coverage” indicator) (in percent) (2)	98	98	98
Percentage of population covered by sewage network (“coverage” indicator) (in percent) (2)	90	90	89
Percentage of consumer units connected to the sewage treatment system (“sewage treatment coverage” indicator) (in percent)	76	75	74
	2,107.9	2,075.9	1,990.3

Volume of water billed during period (in millions of cubic meters)			
Water Billed Loss Index during period (average) (in percent) <sup>(3)</sup>	19.5	20.1	20.8
Water Metered Loss Index during period (average) (in percent) <sup>(4)</sup>	30.1	30.7	31.8
Water loss per connection per day (average) <sup>(5)</sup>	293	302	308
Number of employees	14,449	13,672	14,137

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

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

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

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

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

## B. Capitalization and Indebtedness

Not applicable.

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





Not applicable.

## **D. Risk Factors**

### **Risks Relating to Brazil**

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

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

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

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

Uncertainty over whether the Brazilian government will change policies or regulations affecting these or other factors may contribute to economic uncertainty in Brazil and to heightened volatility in Brazilian securities markets and securities issued abroad by Brazilian issuers. Brazil was downgraded below investment grade by Standard & Poor's Global Ratings, or S&P, on September 9, 2015, and received a further downgrade by the same rating agency on

February 17, 2016. In addition, Brazil was downgraded below investment grade by Fitch Ratings Inc., or Fitch, on December 16, 2015 and received a further downgrade by the same agency on May 5, 2016. Moody's Investors Service, Inc., or Moody's, also downgraded Brazil below investment grade on February 24, 2016. During the first months of 2018, Brazil received additional downgrades by S&P on January 11, 2018 and Fitch on February 23, 2018.

New and amended Brazilian policies and regulations could have a material adverse effect on our business, financial condition and results of operations. In addition, uncertainty over whether the acting Brazilian government will have the political power or will to implement other needed policies or regulations affecting the above or other factors in the future may also contribute to economic uncertainty in Brazil and to heightened volatility in the securities issued abroad by Brazilian companies.

Following the impeachment of former President Dilma Rousseff, the Vice-President Michel Temer formally took office on August 31, 2016. Following a divisive presidential race, Congressman Jair Bolsonaro defeated Mr. Fernando Haddad in the second round of elections held on October 28, 2018, and became Brazil's president on January 1, 2019.

We cannot assure you that the Brazilian government will continue with its current economic policies, or that these and other developments in Brazil's economy and government policies will not, directly or indirectly, adversely affect our business and results of operations.

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

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

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

President Dilma Rousseff was suspended from office on May 12, 2016, when the Brazilian Senate voted to hold a trial on impeachment charges against her. President Rousseff was replaced by Vice-President Michel Temer, who served as acting President until Ms. Rousseff was permanently removed from office by the Senate on August 31, 2016 for infringing budgetary laws. Michel Temer then became President for the remainder of the presidential term, which ended in December 2018. The Temer government was marked by significant political and economic turmoil, allegations of corruption, political deadlock, slow economic recovery, national transport strikes, low approval rates and foreign trade disputes, among other factors. Mr. Temer himself has recently been accused by the Federal Public Prosecutor of allegations of corruption. The potential result of the ongoing corruption scandals and their related investigations is uncertain. Following a divisive presidential race, Congressman Jair Bolsonaro defeated Mr. Fernando Haddad in the second round of elections held on October 28, 2018, and became Brazil's President on January 1, 2019. See "Item 3.D. Risk Factors—Risks Relating to Brazil—The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. This influence, as well as Brazilian political and economic conditions, could adversely affect us and the market price of our common shares and ADSs".

We cannot assure you that the newly elected federal government will continue with current economic policies, or that these and other developments in Brazil's economy and government policies will not, directly or indirectly, adversely affect our business and results of operations. It is also unclear what changes the newly elected government will make to our sector.

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

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

Inflation and the Brazilian government's measures to combat it have had and may in the future have significant effects on the Brazilian economy and our business. Tight monetary policies with high interest rates may restrict Brazil's growth, the availability of credit and our cost of funding. Conversely, other Brazilian governmental actions, including lowering interest rates, intervention in the foreign exchange market and actions to adjust or fix the value of the *real*, may trigger increases in inflation. The Special Clearing and Settlement System (*Sistema Especial de Liquidação e Custódia*), or SELIC, the official overnight interest rate in Brazil, equaled 6.40%, 6.90% and 13.65% at the end of 2018, 2017 and 2016, respectively, in line with the target rate set by the Brazilian Committee on Monetary Policy (*Comitê de Política Monetária*).

The Brazilian annual inflation rates, as measured by the Amplified Consumer Price Index (*Índice Nacional de Preços ao Consumidor Amplo*), or IPCA, were 3.75%, 2.95% and 6.29% during 2018, 2017 and 2016, respectively. If Brazil experiences increases in inflation, our costs and expenses may rise, we may be unable to increase our tariffs at the same rate to counter the effects of inflation, and our overall financial performance may be adversely affected. In addition, a substantial increase in inflation may weaken investors' confidence in Brazil, causing a decrease in the market price of our common shares or ADSs.

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

The Brazilian currency has experienced frequent and substantial devaluations in relation to the U.S. dollar and other foreign currencies during the decades leading up to the mid-1990s. Throughout this period, the Brazilian government implemented various economic plans and exchange rate policies, including sudden devaluations, periodic mini devaluations (during which the frequency of adjustments ranged from daily to monthly), floating exchange rate systems, exchange controls and dual exchange rate markets. From time to time since that period, there have continued to be significant fluctuations in the exchange rate between the Brazilian *real* and the U.S. dollar and other currencies. For example, the *real* appreciated 13.8%, 9.5% and 20.7% against the U.S. dollar in 2005, 2006 and 2007, respectively, reaching R\$1.634 in August 2008, although it depreciated by 32.0% against the U.S. dollar during full year 2008, closing the year at R\$2.337 per US\$1.00. The *real* strengthened again by 25.5% in 2009 and 4.3% in 2010, but depreciated against the U.S. dollar by 12.6% in 2011, 8.94% in 2012, 14.63% in 2013, 13.39% in 2014 and 47.01% in 2015, falling to R\$3.9048 against the U.S. dollar at December 31, 2015. The *real* fell further during the first months of 2016, reaching a low of R\$4.1558 against the U.S. dollar on January 21, 2016, but then regained some value, reaching R\$3.2591 per US\$1.00 at December 31, 2016. During 2017, the *real* remained relatively stable, depreciating only 1.5% against the U.S. dollar by year-end. During 2018, the *real* was very volatile and depreciated by 17.1% against the U.S. dollar by year-end. There can be no assurance that the *real* will not depreciate further against the U.S. dollar. As of April 17, 2019, the commercial selling rate as reported by the Central Bank was R\$3.9225 per US\$1.00.

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

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

In the event of a significant devaluation of the *real* in relation to the U.S. dollar or other currencies, our ability to meet our foreign currency denominated obligations could be adversely affected because our tariff revenue and other sources of income are denominated solely in *reais*. In addition, because we have debt denominated in foreign currencies, any significant devaluation of the *real* will increase our financial expenses as a result of foreign exchange losses that we must record. We had total foreign currency denominated debt of R\$6,669.4 million as of December 31, 2018 and we anticipate that we may incur additional amounts of foreign currency denominated debt in the future. In 2018, our results of operations were negatively affected by the 17.1% depreciation of the *real* against the U.S. dollar, and the depreciation of the *real* against the yen by 20.0%, which together led to a R\$915.9 million negative impact on our foreign exchange result, net. We do not currently have any derivative instruments in place to protect us against a devaluation of the *real* in relation to any foreign currency. A devaluation of the *real* may adversely affect us and the market price of our common shares or ADSs. For more information, see Note 5(a) to our 2018 financial statements.

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

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

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

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

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

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

As it owns the majority of our common shares, the State is able to determine our operating policies and strategy, control the election of a majority of the members of our board of directors and appoint our senior management. As of December 31, 2018, the State owned 50.3% of our outstanding common shares. Both through its control of our board of directors as well as by enacting State decrees, the State has in the past directed our company to engage in business activities and make expenditures that promoted political, economic or social goals, but that did not necessarily enhance our business and results of operations. The State may direct our company to act in this manner again in the future. These decisions by the State may not be in the interests of our non-controlling shareholders, including holders of ADSs. See “Item 5.A. Operating and Financial Review and Prospects—Certain Transactions with Controlling Shareholder”.

In January 2019, following the elections for State governor in 2018, Mr. João Doria, elected governor, appointed Mr. Benedito Pinto Ferreira Braga Junior as our Chief Executive Officer with a term expiring in June 2019. Additionally, pursuant to our bylaws, Mr. Benedito Pinto Ferreira Braga Junior is also a member of our board of directors while holding the position of Chief Executive Officer. The Board of Directors also elected as part of our executive officers, Mr. Adriano Candido Stringhini as Corporate Management Officer, and Mr. Ricardo Daruiz Borsari as Regional Systems Officer for a term expiring in June 2019. In March 2019, Monica Ferreira do Amaral Porto joined our board of directors. We cannot guarantee that there will not be further changes to our Board of Directors or Executive Officers and whether such further changes may have a material adverse effect on our business and results of operations.

In September 2017, the State of São Paulo obtained approval for State Law No. 16,525/2017, which authorizes the State of São Paulo to set up a controlling company to hold all of the shares that the State of São Paulo holds in our company. Once formed, this controlling company will control our company, pursuant to the provisions of Art. 116 of Law No. 6,404 of December 15, 1976, as amended, or the Brazilian Corporate Law. State Law No. 16,525/2017 allows other minority shareholders, including private companies and state companies, to hold shares of the controlling company, provided that the State of São Paulo holds the majority of the common shares of the controlling company. If and once formed, this controlling company may affect future shareholding in and the control of our company. Due to elections for state government in the second half of 2018, this operation was suspended, and we are currently awaiting guidance from the State Privatization Program’s Board (*Conselho Diretor do Programa Estadual de Desestatização - CDPED*), which has authority over our corporate reorganization plan, including the formation of the controlling company, or any other type of corporate reorganization, including a change of control. We cannot assure that any potential corporate reorganization, including a change of control, will not have a material adverse effect on our business.

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

Historically, the State and some State entities have delayed payment of substantial amounts owed to us related to water and sewage services. As of December 31, 2018, the State owed us R\$105.7 million for water and sewage services. Additionally, the State also owes us substantial amounts related to reimbursements of State mandated special retirement and pension payments that we make to some of our former employees for which the State is required to reimburse us. At the end of 2018 several lawsuits were filed against the Government of the State of São Paulo for the collection of such debts.

With respect to payment of pensions on behalf of the State, we had a contested credit amount of R\$1,107.1 million as of December 31, 2018. We do not record this contested amount as a reimbursement credit for actuarial liability due to



the uncertainty of payment by the State. In addition, as of December 31, 2018, we had a provision for an actuarial liability in the amount of R\$2,606.1 million with respect to future supplemental pension payments for which the State does not accept responsibility. On March 18, 2015, we, the State and the São Paulo State Department of Water and Energy (*Departamento de Águas e Energia Elétrica do Estado de São Paulo*), or “DAEE”, with the intervention of the Department of Sanitation and Water Resources, executed an agreement providing for payment of R\$1,012.3 million, of which R\$696.3 million refers to principal and R\$316.0 million refers to monetary adjustment of the principal through February 2015. For a detailed discussion of this agreement, see “Item 7.B. Related Party Transactions—Agreements with the State” and Note 10 of our 2018 financial statements.

We have entered into agreements with the State to settle the overdue amounts that relate to water and sewage services. For a detailed discussion of these agreements, see “Item 7.B. Related Party Transactions—Agreements with the State” and Note 10 of our 2018 financial statements.

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

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

***Our right to withdraw water from the Guarapiranga and Billings reservoirs is being challenged judicially by minority shareholders of EMAE.***

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

On April 11, 2016, we were also named in a separate lawsuit commenced by minority shareholders of EMAE against the State of São Paulo, as controlling shareholder of EMAE. The minority shareholders are seeking an order to require the State to stop us from withdrawing water from the reservoirs without paying compensation to EMAE, and to allow EMAE to pump water from the reservoirs for its hydroelectric facility. The plaintiffs allege that the State, in its capacity as controlling shareholder of EMAE, has acted unduly to EMAE’s detriment and in favor of our company. The case is in its initial phase.

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

The settlement agreement between EMAE and us does not necessarily put an end to the separate lawsuits.

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

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

***The 2014-2015 water crisis impacted the water supply in the metropolitan region of São Paulo and affected the water consumption practices that have been influencing the volume of water billed.***

When considering all the water sources that supplied the metropolitan region of São Paulo in the last five hydrological years (which runs from October to September), the level of rainfall has fallen below the expected historical average. In the hydrological year 2012/2013, rainfall was 101% of the average expected for the period. In the following years, rainfall has been below the historical average: for the hydrological years 2013/2014, 2014/2015, 2015/2016, 2016/2017, 2017/2018, the rainfall for those periods was 80%, 96%, 97%, 91% and 71% of the historical average, respectively.

For the years 2014 and 2015, we experienced a severe drought in the metropolitan region of São Paulo, which was more intense in the northwest region of the State of São Paulo, resulting in the lowest level of rainfall ever recorded in the Cantareira System, the largest production system in the metropolitan region of São Paulo, over the last 80 years of record. This drought severely affected the level of water sources that supply the metropolitan region of São Paulo, forcing us to adopt a series of measures to mitigate its impact and maintain the water supply for the 20.9 million inhabitants served in the metropolitan region of São Paulo.

In order to balance supply and demand despite the restricted water availability, we adopted a series of measures from 2014 to April 2016, including: (i) using treated water from other production systems to serve consumers originally supplied by the Cantareira system; (ii) offering discounts (bonus) to consumers that would use below average amounts of water, compared to average consumption; (iii) reducing pressure in the water distribution lines in order to decrease leakage; (iv) adjusting the volume of treated water sold to municipalities that operate their own distribution network; and (v) using pumps in order to extract water located below the intakes of the Cantareira system, from the so-called “technical reserve”, which had never before been used to serve the population. See “Item 4.B. Business Overview—The 2014-2015 Water Crisis”.

With the return of the rainfall to its historical average for the rainy season that began in October 2015 and ended in March 2016, the volume of water available to the population of the São Paulo metropolitan region returned to a normal level and the measures taken during the water crisis to continue to service consumers were gradually discontinued. However, heightened public awareness of the need to conserve water during the crisis resulted in our customers adopting lower water consumption practices during the water crisis and these practices were partially integrated in our consumers’ daily habits. As a result of this new behavior, despite us having a higher volume of water available for treatment, the volume of water billed to our clients did not return to the volume of water billed before the water crisis, in 2013. The average monthly water production in 2018 for the São Paulo metropolitan region was 60.9 cubic meters per second, or m<sup>3</sup>/s, compared to 60.6 m<sup>3</sup>/s in 2017, 58.5 m<sup>3</sup>/s in 2016, 52.0 m<sup>3</sup>/s in 2015, 62.2 m<sup>3</sup>/s in 2014 and 69.1 m<sup>3</sup>/s in 2013, the year before the water crisis started.

The drought prompted a reduction in the volume of water billed, impacting our revenue especially in 2014 and 2015.

In 2014, the water volume billed decreased 3.1% and the gross operational revenue fell by 6.7% compared to 2013.

In 2015, the water volume billed decreased 8.0% and our gross operational revenue increased slightly by 0.5% compared to 2014. In 2016, the volume of water billed increased 4%, and the gross operational revenue increased by 24.3% compared to 2015. In 2017, the volume of water billed increased 4.3% and the gross operational revenue increased by 9.9% compared to 2016. In 2018, the volume of water billed increased 1.5% and the gross operational revenue increased by 16.6% compared to 2017.

Although the investments we made since 2014 have brought improvements to the water security in the metropolitan region of São Paulo, there is still a risk that there might be further droughts similar or more severe to that of 2014-2015 in the future forcing us to adopt similar measures as those adopted in 2014-2015.

At the end of March 2019, the total volume of water stored in the reservoirs that supply the metropolitan region of São Paulo was 1,441.3 million m<sup>3</sup> (including the volume from São Lourenço System, the ninth system that commenced operations in March 2018) compared to 1,162.8 million m<sup>3</sup> at the end of March 2018, 1,223.9 million m<sup>3</sup> at the end of March 2017 and 1,178.8 million m<sup>3</sup> at the end of March 2016.

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

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

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

- We depend on a water right issued by Water National Agency (*Agência Nacional de Águas*, or ANA) and the São Paulo State Department of Water and Energy (*Departamento de Águas e Energia Elétrica do Estado de São Paulo*, or DAEE), in order to extract water from the Cantareira System. In May 2017, the concession that regulates the volume of water that may be extracted from the Cantareira System, the main water system we use to serve the São Paulo metropolitan region, based on the volume of water available in the reservoirs was renewed. Under the new terms, the water we are permitted to withdraw from the system is divided into five tranches: (i) if the volume of water available is higher than 60% of the reservoirs’ capacity, we can withdraw up to 33m<sup>3</sup>/s; (ii) if the volume of water is between 40% and 60% of the reservoirs’ capacity, we can withdraw up to 31m<sup>3</sup>/s; (iii) if the volume of water is between 30% and 40% of the reservoirs’ capacity, we can withdraw up to 27m<sup>3</sup>/s; (iv) if the volume of water is between 20% and 30% of the reservoirs’ capacity, we can withdraw up to 23m<sup>3</sup>/s; and (v) if the volume of water available is lower than 20% of the reservoirs’ capacity, we can withdraw up to 15.5m<sup>3</sup>/s.
- We are dependent upon energy supplies to conduct our business. Any shortages or rationing of energy may prevent us from providing water and sewage services and may also cause material damage to our water and sewage systems when we resume operations. The Electric Sector Monitoring Committee (*Comitê de Monitoramento do Setor Elétrico*—CMSE), has guaranteed the supply of electrical energy to the National Interconnection System (*Sistema Interligado Nacional*—SIN) in 2018. Thus, there is no forecast of any shortages or rationing of energy in 2019. See “Item 4.B. Business Overview—Energy Consumption”.
- We are exposed to various weather-related risks, since our financial performance is closely linked to climate patterns. The possible increase in the frequency of extreme weather conditions in the future may adversely affect the water available for abstraction, treatment, and supply. Droughts could adversely affect the water supply systems, resulting in a decrease in the volume of water distributed and billed as well as in the revenue derived from water supply services. An increase in heavy rainfall could impact the regular operation of water sources, including abstraction of water from our reservoirs due to increased soil erosion, silting, and runoff of pollutants that affect the aquatic ecosystems.

See “Item 4.B. Business Overview—Environmental Matters— Climate Change Regulations: Reduction of Greenhouse Gases (GHG) Emissions”.

- The increasing degradation of watershed areas (*Mananciais*) may affect the quantity and quality of water available to meet demand from our customers. See “Item 4.A. History and Development of the Company—Capital Expenditure Program” and “Item 4.A. History and Development of the Company —Main Projects of Our Capital Expenditure Program”.
- In addition to the risks discussed under “—The terms of our agreement to provide water and sewage services in the city of São Paulo could have a material adverse effect on us”, we may not be able to increase our tariffs on a timely basis, or at all, in order to pass on increases in inflation or operating expenses, including taxes, to our customers. These constraints may have an adverse effect on our ability to fund our capital expenditure program and financing activities and to meet our debt service requirements. See “Item 4.B. Business Overview—Tariffs—Second Ordinary Tariff Revision (2017-2020)” - Tariff Structure - Water and sewage services tariffs and “Item 5.A. Operating and Financial Review and Prospects—Factors Affecting Our Results of Operations—Effects of Tariff Increases”.

- The state and federal government agencies that manage water resources could impose substantial charges for the abstraction of water from bodies of water and the discharge of sewage. We may not be able to pass these charges on to our customers. See “Item 4.B. Business Overview—Environmental Matters—Water Usage”.
- Our water and sewage pipes are susceptible to degradation caused by factors such as age, intense traffic, population density and commercial and industrial development, which may provoke accidents in the networks and affect the regular provision of our services, impacting society and the environment. See “Item 4.B. Business Overview—Description of Our Activities—Water Operations—Water Distribution” and “Item 4.B. Business Overview—Description of Our Activities—Sewage Operations—Sewage System”.

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

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

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

Law No. 13,329/16 instituted a “Special Incentive Regime for the Development of Basic Sanitation” (*Regime Especial de Incentivos para o Desenvolvimento do Saneamento Básico – REISB*), seeking to incentivize companies that provide public basic sanitation services to invest more through tax credits, starting in 2018 and running until 2026. However, article 54-C, which set out the rules for the off-setting of tax credits, was vetoed by the President of Brazil and, accordingly, we cannot predict what benefits the Special Incentives for the Development of Basic Sanitation Regime will bring to us. In 2016, Law No. 13,312/2016 amended Law No. 11,445/2007 and now includes the obligation to adopt environmental criteria that include, among other measures, individual metering of water consumption per habitation unit in condominiums. However, since this change is still being implemented and shall only come into effect in 2021, we are not currently able to predict its impact on our business.

The Basic Sanitation Law still requires that the federal government, states and municipalities establish independent regulators who monitor basic sanitation services and regulate tariffs. In compliance with this law, the state of São Paulo established ARSESP in 2007. Currently, our regional and local operations, including tariff regulation, are monitored and regulated by ARSESP, and the remainder of our operations is in the process of negotiating new contractual bases. Regulatory agencies determine tariff increases for our water and sewage services, on which our results of operations and financial condition are highly dependent. As a result, we cannot anticipate all the effects that the Basic Sanitation Law No. 11,445/2007 and the Federal Decree No. 7,217/2010 will have on our business and operations, if any.

In 2009, ARSESP enacted rules regarding the following: (i) general terms and conditions for water and sewage services; (ii) procedures for communication regarding any failure in our services; (iii) penalties for deficiencies in the provision of basic sanitation services; and (iv) procedures for confidential treatment of our customers’ private information. The implementation of these and other more recent rules will particularly impact our commercial and operational processes, and may adversely affect us in ways we cannot currently predict. Implementation of these rules

started in 2011 and is expected to continue for the next few years. For more information, see “Item 4.B. Business Overview—Government Regulations Applicable to Our Contracts—Rules Enacted by ARSESP”.

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

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

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

The State of São Paulo, pursuant to Article 25, Section 3 of the Brazilian Constitution, enacted the State Supplementary Law, or “LCE”, creating the metropolitan regions of São Paulo (LCE No. 94/1974), Baixada Santista (LCE No. 815/1996), Campinas (LCE No. 870/2000), Vale do Paraíba and Litoral Norte (LCE No. 1,166/2012), Sorocaba (LCE No. 1,241/2014), and Ribeirão Preto (LCE No. 1,290/2016), as well as the urban clusters of Jundiaí (LCE No. 1,146/2011), Piracicaba (LCE No. 1,178/2012) and Franca (LCE No. 1,323/2018). These areas incorporate independent municipalities that modify the exercise of their constitutional competencies, including those related to basic sanitation services, and increase the number of judicial disputes concerning the regulation and oversight of services in areas currently served by us and regulated by ARSESP. We cannot anticipate the result of these judicial disputes and the adverse material effects that may result from them, especially if the rules of regulation and monitoring of services issued by municipal agencies come to coexist with those already published by ARSESP and implemented into our operational and corporate processes since 2011.

In July 2018, Provisional Measure No. 844/2018 was issued in order to update Basic Sanitation Law No. 11.445/2007 and amend Law No. 9,984, of July 17, 2000, to assign to the National Water Agency competence to establish reference standards for sanitation services, among other aspects. This Provisional Measure expired in November 2018 without being converted into law.

On December 28, 2018, Provisional Measure No. 868/2018 was issued with the same purpose of Provisional Measure No. 844/2018, which aims to amend the Basic Sanitation Law No. 11,445/2007; Law No. 9,984/2000, to attribute to the National Water Agency the power to enact national reference rules about the sanitation service; Law No. 10,768/2003 to change the role of the Water Resources Specialist; and Law No. 13,529/2017 to authorize the Federal Government to participate in the fund with the exclusive purpose to provide financial support for specialized technical services. This Provisional Measure is valid until June 3, 2019 and its conversion into law is pending approval by the National Congress. Although this Provisional Measure has been in force since the date of its publication, it is not yet possible to predict how it will impact contracts that we may enter into while the measure is in force.

If the Provisional Measure No. 868/2018 is converted into law, it could have a material adverse effect on our business, results of operations and financial condition.

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

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

On March 6, 2013, the Brazilian Supreme Court decided a matter related to the shared management of basic sanitation services in the state of Rio de Janeiro. In its decision, the court ruled that the state of Rio de Janeiro must establish a



new entity, owned by both the state of Rio de Janeiro and the relevant municipalities, to oversee the planning, regulation and auditing of basic sanitation services in its metropolitan region with the non-partisan participation of all the municipalities located in the metropolitan region, creating a requirement that the state and the municipalities must participate jointly in the shared management of public services.

However, this decision is not yet fully effective, as a ruling on a motion for clarification is currently pending, and therefore does not yet alter the legislative framework regarding basic sanitation that is currently in effect for the State of São Paulo. The São Paulo metropolitan region (including the municipalities to which we provide water on a wholesale basis, but excluding the concession infrastructure construction revenue) accounted for 72.2% of our gross operating revenue from services in 2018.

In January 2015, the Federal Government issued the Metropolitan Bylaws (Law No. 13,089/2015), amended by Provisional Measure No. 818 of January 11, 2018, which was subsequently converted into Federal Law No. 13,683/2018 and by Provisional Measure No. 862 of December 4, 2018, establishing: (i) the general guidelines for the planning, management and performance of public interest initiatives in metropolitan regions and in urban clusters instituted by the states; (ii) the general planning standards for integrated urban development and other interfederal governance instruments; and (iii) the criteria to receive federal loans related to urban development. In addition, the Metropolitan Bylaws foresees mechanisms for integrated management and interfederal governance as well as the sharing of decisions by regional entities.

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

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

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

The provision of water and sewage services in the city of São Paulo accounted for 47.0% of our gross operating revenues (excluding revenues relating to the construction of concession infrastructure) in the year ended December 31, 2018.

On June 23, 2010, the State and the city of São Paulo executed an agreement in the form of a *convênio* with our and ARSESP’s consent, under which they agreed to manage the planning and investment for the basic sanitation system of the city of São Paulo on a joint basis. In application of the *convênio*, we executed a separate contract dated June 23, 2010 with the State and the city of São Paulo, to regulate the provision of these services for the following 30 years. Among other principal terms of this separate agreement, we must transfer 7.5% of the gross revenues we derive under the *convênio* and subtract (i) COFINS and PASEP taxes and (ii) unpaid bills of publicly owned properties in the city of São Paulo, to the Municipal Fund for Environmental Sanitation and Infrastructure (*Fundo Municipal de Saneamento Ambiental e Infraestrutura*), established by Municipal Law No. 14,934/2009. See “Item 7.B. Related Party Transactions—Agreement with the State and the city of São Paulo” for further discussion of the principal terms of the *convênio* and principal terms of the separate contract we executed in application of the *convênio*.

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

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

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

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

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

On May 9, 2018, ARSESP announced the final result of the Second Ordinary Tariff Revision. Following this revision cycle, ARSESP will pass-through to the tariffs up to 4% of the municipal revenue that is transferred by us to a legally established municipal infrastructure fund. Our only contract that provides for this and complies with ARSESP’s

requirements is with the municipality of São Paulo and, accordingly, today 4% of the funds transferred to the São Paulo Municipal Fund for Environmental Sanitation and Infrastructure are being passed through to our tariffs.

Although ARSESP is required to ensure that the tariffs will adequately compensate us for the services we provide, which includes the above mentioned pass-through to tariffs, until May 2018 our existing tariff had never included any pass-through to tariffs related to the transfer of 7.5% of the gross revenues obtained from providing sanitation services in the municipality of São Paulo to the São Paulo Municipal Fund for Environmental Sanitation and Infrastructure.

Considering that ARSESP has limited to 4% the pass-through to tariff of values transferred to municipal infrastructure funds, the mandatory transfer of 7.5% of the gross revenues to the Municipal Fund for Environmental Sanitation and Infrastructure, will not be passed through to customers in full and we cannot assure you when this will happen.

As of December 31, 2018, since 2010 we have transferred approximately R\$3.1 billion to the São Paulo Municipal Fund for Environmental Sanitation and Infrastructure. For additional information on ARSESP regulations, see “Item 4.B. Business Overview—Tariffs” and “Item 4.B. Business Overview—Government Regulations Applicable to Our Contracts—Rules Enacted by ARSESP”.

On May 24, 2018, as a result of the final result of the Second Ordinary Tariff Revision, we filed a reconsideration request as well as a clarification and revision request with ARSESP. As part of the clarification and revision request, we requested that ARSESP provide a revision of the calculation of the financial component related to municipal funds. On February 28, 2019, ARSESP rejected our reconsideration request and maintained their original calculation of the financial component related to municipal funds. See Item “Item 4.B. Business Overview—Tariffs—Second Ordinary Tariff Revision (2017-2020).”

***We currently lack formal agreements or concessions with 35 of the municipalities to which we provide service, and 31 of our existing concession agreements will expire between 2019 and 2030. We may face difficulties in continuing to provide water and sewage services in return for payment in these and other municipalities, and we cannot assure you that they will continue to purchase services from us on the same terms or at all.***

As of December 31, 2018, we held formal 30-year agreements with 307 municipalities (including the city of São Paulo) of the 369 municipalities we serve. We entered into twenty of these agreements during 2018. The 307 municipalities with which we had formal agreements at year-end accounted for 81.1% of our total revenues for the year ended December 31, 2018, and 80.2% of our intangible assets and contract asset as of December 31, 2018. Of the 35 served municipalities for which we lacked formal agreements at year-end, we were in the process of actively renegotiating with all municipalities. Together, these 35 municipalities accounted for 6.1% of our total revenues for the year ended December 31, 2018 and 12.3% of our intangible assets and contract asset as of that same date. Between 2019 and 2030, 31 of our existing concession agreements will expire. These 31 concession agreements accounted for 6.3% of our total revenues for the year ended December 31, 2018 and 5.3% of our intangible assets and contract asset as of that same date.

We may not be able to continue providing service on current terms, or at all, in the municipalities for which we do not have formal agreements, including the 35 for which we are renegotiating expired agreements. In particular, the lack of formal concessions or contractual rights in these municipalities means that we may not be able to enforce our right to continue to provide services and we may face difficulties in being paid on a timely basis, or at all, for the unamortized assets. If we are successful in renegotiating the expired agreements, or executing formal agreements with the municipalities for which we have never had agreements, those agreements may not contain terms that are as favorable as those under which we currently operate. We cannot make any such assumption because the Basic Sanitation Law prevents us from planning, regulating and monitoring our services and it requires more stringent control by the municipalities or by ARSESP. The municipalities for which we do not have formal agreements may choose to start providing water and sewage services directly themselves, or may run public tenders to select another provider. They may set eligibility requirements for which we do not qualify and, if we do qualify and participate in these tenders, we may not win.

Changes in the Basic Sanitation Law and in other laws related to it could have adverse effects on our negotiation with the municipalities and we cannot evaluate these impacts since Provisionary Measure No. 868 is still under discussion. For further information, see Item “3.D. Risk Factors—Current regulatory uncertainty, especially with regard to implementation and interpretation of the Brazilian Basic Sanitation Law, may have an adverse effect on our business”.

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

In the municipalities with which we did not have formal agreements by December 31, 2018, we continued operating with municipal approval or with judicial support.

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

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

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

With regard to our operations that lack contracts or have indefinite or overdue timeframes, the Basic Sanitation Law No. 11,445/2007 reduced the maximum time period for payment of indemnification in such cases to four years. This provision applies to concession agreements entered into prior to the enactment of the Basic Sanitation Law only to the extent that the concession agreement does not contain a contractual indemnification provision, or we have not otherwise entered into an agreement with the municipality with regard to such early termination. These provisions have not yet been tested by the courts and we are therefore unable to predict the effect of the Basic Sanitation Law on our rights to indemnification for the early termination of any particular concession.

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We have been, and are currently, party to concession-related proceedings related to indemnification issues regarding the resumption of water supply and sewage collection services by some municipalities. For more information, see Note 20 to our 2018 financial statements included in this annual report. Other municipalities may seek to terminate their concession agreements before the contractual expiration date. If this occurs and we do not receive adequate indemnification for our investments, or the indemnification is paid over an extended period, we may suffer material harm to our financial position.

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

As of December 31, 2018, our total accounts receivable was R\$5,157.0 million. Of this amount, certain municipalities to which we provide water on a wholesale basis owed us R\$1,994.9 million, and certain municipal government entities owed us R\$850.6 million. Of the total amount owed by municipalities, R\$171.1 million was overdue by between 30 and 360 days and R\$1,802.3 million was overdue by over 360 days.

The Brazilian courts could oblige us to continue to supply water to these municipalities, even when we have not received payments due to us. We have no way of ensuring that negotiations with these municipalities or legal action taken against the municipalities will result in payments being made.

Since 2012, we have intensified negotiations with municipalities in order to find alternative ways of receiving these sums and restoring normal commercial relations with them. In 2014 we entered into an agreement with the municipality of Diadema. More recently, in December 2018, we entered into an agreement with the municipality of Guarulhos for the direct supply of water and sewage services for 40 years, subject to regulation and oversight of ARSESP.

With respect to the municipality of Mauá, on April 19, 2018 we published a press release stating that we have been in contact with the municipality of Mauá regarding directly supplying water to four neighborhoods that have been affected by a water shortage, and, to date, no agreement to supply water to these neighborhoods was concluded.

With respect to the municipality of Santo André, we signed a protocol of intention on May 11, 2017 but efforts did not culminate in any agreement. In March 2019, we signed a new Protocol of Intentions with this municipality.

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

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

Our capital expenditure program will require resources of approximately R\$18.7 billion in the period from 2019 through 2023. In 2018 we recorded R\$4.2 billion in capital expenditures.

In addition to cash generated by our operations, we have funded and intend to continue funding these capital expenditures with issuances of debt securities in the domestic and international capital markets as well as borrowings in Brazilian *reais* and foreign currencies. A significant portion of our financing needs is obtained through long term financing at attractive interest rates from Brazilian federal public banks, multilateral agencies and international governmental development banks. If the Brazilian government changes its policies regarding the financing of water

and sewage services, or if we fail to obtain long term financing at attractive interest rates from domestic and international multilateral agencies and development banks in the future, we may not be able to meet our obligations or finance our capital expenditure program, which could have a material adverse effect on our business and financial condition.

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

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

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

We are subject to extensive Brazilian federal, state and municipal laws and regulations relating to the protection of human health and the environment. These laws and regulations set, among others, potable water standards and limit or prohibit the discharge or spillage of effluent produced in our operations, particularly raw sewage. We occasionally suffer accidents such as leakages or breaks in pipes that could lead to liability for damages under environmental law. We could be subject to various types of criminal, administrative and civil proceedings for non-compliance with environmental laws and regulations that could expose us to penalties and criminal sanctions, such as fines, closure orders and significant indemnification obligations. The scope and enforcement of environmental laws in Brazil are becoming more stringent, and our capital expenditures and environmental compliance costs may increase substantially as a result. These expenses may lead us to reduce expenditure on strategic investments, which could harm our business. In addition, Brazilian courts are enforcing environmental laws more stringently than in the past, which may result in fines or liability for damages that are significantly higher than those we currently anticipate. We are party to various environmental proceedings that could have a material adverse impact on us, including civil processes and investigations relating, among others, to the release of untreated sewage into waterways or the disposal of sludge generated by treatment plants. We are also involved in proceedings challenging the water withdrawing in the face of the 2014-2015 water crisis. Any unfavorable judgment in relation to these proceedings, or any material environmental liabilities, may have a material adverse effect on us. For further information on these proceedings, see "Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings". For further information on investments in environmental programs, see "Item 4.A. History and Development of the Company—Main Projects of our Capital Expenditure Program", "Item 4.B. Business Overview—Description of our Activities—Sewage Operations—Sewage Treatment and Disposal", "Item 4.B Business Overview—Environmental Matters" and "Item 4.B. Business Overview— Environmental Matters—Environmental Regulation". For further information on the Water Crisis, see "Item 4.B. Business Overview—The 2014-2015 Water Crisis.

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

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

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

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

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

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

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

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

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

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

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



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

We are party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among others, civil, tax, labor, corporate and environmental issues. As of December 31, 2018, the estimated total claims asserted amounted to R\$57,498.4 million (net of R\$258.6 million in escrow deposits), including contingent liabilities. A substantial monetary judgment against us in one or more of these legal proceedings may have a material adverse effect on our financial condition. We have recognized provisions totaling R\$892.9 million (net of escrow deposits) as of December 31, 2018. For more information, see Note 20 to our 2018 financial statements included in this annual report. These provisions do not cover all legal proceedings involving monetary claims filed against us and it may be insufficient to cover the ultimate resolution of these claims. Any unfavorable judgment in relation to these proceedings may have a material adverse effect on us. For more information, see “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”.

***We are subject to anti-corruption, anti-bribery, anti-money laundering, sanctions and antitrust laws and regulations. Our violation of any such laws or regulations could have a material adverse effect on our reputation, our results of operations and our financial condition.***

We are subject to anti-corruption, anti-bribery, anti-money laundering, sanctions, antitrust and other similar laws and regulations. We are required to comply with the applicable laws and regulations of Brazil, and we may become subject to such laws and regulations in other jurisdictions. There can be no assurance that our internal policies and procedures will be sufficient to prevent or detect any inappropriate practices, fraud or violations of these laws or regulations by our employees, officers, executives, partners, agents and service providers, nor that any such persons will not take actions in violation of our policies and procedures. Any violations, whether actual or perceived, by us or any of our employees, directors, officers, partners, agents and service providers of these laws or regulations or our internal policies or procedures could have a material adverse effect on our business, reputation, our ability to obtain financing, results of operations and financial condition.

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

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

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

We have established an Information Security Committee with members appointed by our executive officers. The mission of this committee is to undertake projects and actions related to the protection or mitigation of the vulnerabilities and risks of our information technology assets. Although we have developed systems and processes,

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

In this regard, the Internet Act (Law No. 12,965 of 2014) applies only to personal data collected through the Internet, and establishes other principles and rules with respect to the privacy and protection of the personal and behavioral data of internet users. The Internet Act guarantees, among others, the privacy of internet and privately stored communications. Any data processing activity is subject to the data subject's informed, free and express consent. If we fail to comply with the provisions of the Internet Act, we may be subject to sanctions and penalties, including damages, which will be assessed based on the nature and degree of our non-compliance, among other factors.

On August 15, 2018, the Brazilian General Law for Data Protection ("LGPD") was published with a term of 18 months to take effect. Subsequently, on December 28, 2018, Provisional Measure No. 869/2018 was published, which, in summary, created the National Data Protection Authority (ANPD), linked to the Brazilian Presidency, effective since the date of publication of this Provisional Measure, and extending the initial term of validity regarding the obligations set out in the other articles to 24 months. The LGPD regulates the use of personal data in Brazil. The LGPD significantly transformed the data protection system in Brazil and is in line with recent European legislation (the General Data Protection Regulation – "GDPR"). The LGPD establishes detailed rules for the collection, use, processing and storage of personal data. It will affect all economic sectors, including the relationship between customers and suppliers of goods and services, employees and employers and other relationships in which personal data is collected, both in the digital and physical environment.

Failure by us to adhere to the LGPD and any additional privacy laws or regulations enacted or approved in Brazil or in other jurisdictions in which we operate could adversely affect our reputation, business, financial condition or results of operations.

***Industrial accidents, equipment failure, environmental hazards or other natural phenomena may adversely affect our operations, assets and reputation and might not be covered by our insurance policies.***

As of December 31, 2018, we provided water and sewage services to 369 municipalities in the state of São Paulo. We currently substantially withdraw all of our water supply from surface sources from rivers and reservoirs, with a small portion being withdrawn from groundwater. Our reservoirs are filled by impounding water from rivers and streams, by diverting the flow from nearby rivers, or by a combination of both methods. We have 229 dams for water supply purpose. Although we comply with all legal requirements and best practices for the management of dams, invest in security inspections, monitoring and maintenance of all structures under our responsibility, our operations may be hampered by numerous factors, including unexpected or unusual geological and/or geotechnical operating conditions, industrial accidents, floods or droughts or other environmental occurrences that could result in structural damages and eventually rupture our reservoirs, dams and other facilities or equipment. The occurrence of any of these events could lead to personal injury or death, adverse social impacts on the communities located near our facilities, monetary losses and possible legal liability, other environmental damages, the loss of prime materials and damage to our reputation. See "Item 4.B. Business Overview—Water Operations—Water Resources".

It is not always possible to obtain insurance against all such risks due to the high premiums associated with insuring against them or for other reasons. Moreover, insurance against risks such as water contamination or other problems involving our water supply to customers and for environmental related liabilities and damages as a result of our activities is not generally available to us or to other companies in our industry on acceptable terms. Our insurance will not cover all potential risks associated with our operations and insurance coverage may not continue to be available or may not be adequate to cover any resulting liability. Losses from these events may cause us to incur significant costs that could have a material adverse effect on our financial performance and results of operations. To the extent that we incur losses not covered by our insurance policies, the funds available for sustaining our current operations and for our expansion activities will be reduced. See also "—Risks Relating to Our Business—Compliance with environmental laws and environmental liability payments could have a material adverse effect on us" and "Item 4.B. Business Overview—Insurance".

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

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

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

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

Investing in securities from emerging markets such as Brazil involves greater risk than investing in securities of issuers in major securities markets, and these investments are often considered to be more speculative in nature. The Brazilian securities market is substantially smaller, less liquid, more concentrated and can be more volatile than major securities markets. Accordingly, although you are entitled to withdraw the common shares underlying the ADSs from the depositary at any time, your ability to sell the common shares underlying the ADSs at a price and time at which you wish to do so may be substantially limited. There is also significantly greater concentration in the Brazilian securities market than in major securities markets. The ten largest companies in terms of market capitalization represented approximately 52.9% of the aggregate market capitalization of the B3 as of December 31, 2018.

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

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

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

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

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

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

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

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

U.S. holders of common shares and ADSs may not be able to exercise the preemptive rights and tag along rights relating to common shares unless a registration statement under the U.S. Securities Act of 1933, as amended, or the Securities Act, is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file a registration statement with respect to our common shares relating to these rights, and we cannot assure you that we will file any such registration statement. Unless we file a registration statement or an exemption from registration is available, an ADR holder may receive only the net

proceeds from the sale of his or her preemptive rights and tag along rights or, if these rights cannot be sold, they will lapse and the ADR holder will receive no value for them.

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

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

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*If we issue new shares or our shareholders sell shares in the future, the market price of your ADS may be reduced.*

Sales of a substantial number of shares, or the belief that this may occur, could decrease the prevailing market price of our common and preferred shares and ADS by diluting the shares' value. If we issue new shares or our existing shareholders sell shares they hold, the market price of our common and preferred shares, and of the ADS, may decrease significantly. Such issuances and sales also might make it more difficult for us to issue shares or ADS in the future at a time and a price that we deem appropriate and for you to sell your securities at or above the price you paid for them. Our controlling shareholder, the Brazilian Government, may decide to capitalize us for a variety of reasons therefore diluting existing shareholders and ADS holders.

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

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

###### **Overview**

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

We believe we are one of the largest water and sewage service providers in the world (based on the number of customers in 2014, according to the inDepth Water Yearbook 2014-2015). We operate water and sewage systems in the state of São Paulo, which includes the city of São Paulo, Brazil's largest city. According to the IBGE, the state of São Paulo is Brazil's most populous state and the state with the highest gross domestic product, or GDP, in Brazil. For the year ended December 31, 2018, we generated net revenue of R\$16,085.1 million and net income of R\$2,835.1 million. Our total assets amounted to R\$43,565.1 million and our total shareholders' equity amounted to R\$19,551.7 million as of December 31, 2018.

As of December 31, 2018, we provided water and sewage services to a broad range of residential, commercial, industrial and governmental customers in 369 of the 645 municipalities in the state of São Paulo, including the city of São Paulo. Substantially all of our concessions or program agreements have 30 year terms. As of December 31, 2018, we lacked formal agreements for 35 of the municipalities we serve, each of which we are currently in the process of renegotiating. From January 1, 2019 through 2030, 31 further concessions will expire, and we will seek to replace them with program agreements. In addition to the 369 municipalities we served, we also provided water services to the municipality of Mogi das Cruzes, pursuant to two partial water contracts under which we service only certain neighborhoods in that municipality. See “Presentation of Financial and Other Information—Other Information—Our Contracts and the Municipalities We Serve”.

We also supplied water on a wholesale basis to five municipalities in the São Paulo metropolitan region, including Guarulhos, in which we did not operate water distribution systems (together covering a total estimated urban population of approximately 3.1 million residents). Four of these municipalities also utilized our sewage treatment services. For the year ended December 31, 2018, the São Paulo metropolitan region (including the municipalities to

which we provide water on a wholesale basis) accounted for 72.2% of our gross operating revenue (excluding revenues relating to the construction of concession infrastructure), while the Regional Systems accounted for 27.8%. In December 2018, we entered into an agreement with the municipality of Guarulhos for the direct supply of water and sewage services to the municipality. Operations commenced in January 2019.

As of December 31, 2018, we provided water services through 9.1 million water connections to approximately 25.1 million people, representing approximately 57% of the total population of the state of São Paulo, and had a water coverage ratio of 98% with respect to all regions. As of that date, we provided sewage services through 7.5 million sewage connections to approximately 21.7 million people and had an effective sewage service ratio of 83%. As of December 31, 2018, we operated using 75,519 kilometers of water pipes and water transmission lines and 51,788 kilometers of sewer lines.

We also provide water and/or sewage services to four other municipalities through special purpose companies. In addition, we have three partnerships with private companies: Aquapolo Ambiental S.A., Attend Ambiental S.A. and Paulista Geradora de Energia S.A. Aquapolo Ambiental S.A. commenced operations in the second half of 2012 and operates the largest water recycling facility in the southern hemisphere. Aquapolo Ambiental S.A. has the capacity to supply up to 1,000 liters per second to industries in the Capuava petrochemical cluster of the São Paulo metropolitan region, but is currently only providing approximately 650 liters per second as a result of demand. Attend Ambiental S.A. commenced operations in the second half of 2014 to operate a pre-treatment plant for non-domestic effluent in the São Paulo metropolitan region. Paulista Geradora de Energia S.A., which was formed in 2015, focuses on the implementation and commercial exploration of water potential in small hydroelectric power plants, located at Vertedouro Cascata and the Guaraú Water Treatment Plant, with a total capacity of 7 MW. Until the date of this annual report, we had not yet started construction. See “Note 12 to the Financial Statements - Investments”. In addition, we provide consulting services regarding the rational use of water, the updating of institutional models, and commercial and operational management in Panama, through a consortium.



The State of São Paulo, our controlling shareholder, is required by State Law No. 11,454/2003 to own at least 50% plus one of our common shares. As of December 31, 2018, the State owned 50.3% of our outstanding common shares. As a mixed capital company, we are an integral part of the State governmental structure. Our strategy and major policy decisions are formulated in conjunction with the State Secretariat for Infrastructure and Environment as part of the State's overall strategic planning. The majority of the members of our board of directors and our board of executive officers are nominated by the State government.

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

Our results of operations and financial condition are generally affected (i) by our ability to raise tariffs, control costs and improve productivity; (ii) the general economic conditions in Brazil and abroad; and (iii) climate conditions. In order to supply water to the São Paulo metropolitan region, we use water from nine systems, most of which were affected by the most severe drought in our service region in over 80 years, which occurred during 2014 and 2015. Of those, the Cantareira System, our largest water system, was the most affected. In order to balance supply and demand despite the restricted water availability, we adopted a series of initiatives throughout 2014 and 2015, including the Water Consumption Reduction Incentive Program. In March 2016, as a result of the increased level of rainfall and increased predictability of the level of water in our reservoirs, we cancelled the Water Consumption Reduction Incentive Program and disappplied the Contingency Tariff to water meter readings recorded as of May 1, 2016. For further information on the water crisis, see "Item 3.D. Risk Factors—The 2014-2015 water crisis impacted the water supply in the metropolitan region of São Paulo and affected the water consumption practices that have been influencing the volume of water billed" and "Item 4.B Business Overview—The 2014-2015 Water Crisis".

## **Our Strengths**

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

***Well established business with significant size, scale and know how to operate in complex urban settings.*** We believe we are one of the largest water and sewage service providers in the world. We provide water services directly to approximately 25.1 million people and supply water on a wholesale basis to an additional urban population of approximately 3.1 million people, including the population of Guarulhos. As of December 31, 2018, we had an effective water coverage ratio of 98% in respect of all regions in which we operate. We also provide sewage services directly to approximately 21.7 million people, achieving an effective sewage service ratio of 83% in respect of all regions in which we operate as of December 31, 2018. Our significant size and scale have required us to operate in complex urban settings such as shantytowns (*favelas*) and environments without urban planning, thereby enabling us to develop well trained personnel, skills for operating in adverse conditions that we believe our competitors lack.

***Operations in Brazil's most populous and wealthy state.*** The state of São Paulo, which is located in the most developed and economically active region of Brazil, is the most populous state in Brazil, with an estimated total population of 44.2 million as of December 31, 2018. The city of São Paulo had an estimated total population of 11.8 million as of the same date, while the São Paulo metropolitan region had a total population of 20.9 million. Based on its GDP, the state of São Paulo is the wealthiest state and has the largest economy of any state in Brazil. The GDP of the state of São Paulo was approximately R\$2.0 trillion representing approximately 32.5% of Brazil's total GDP, according to the most recent data collected by the IBGE in 2016. The state of São Paulo generates more revenue from water and sewage services than any other Brazilian state.

***Strong Base of Contracted Business.*** Between January 1, 2008 and December 31, 2018, we executed 30-year agreements with 307 of the 369 municipalities we serve, including an agreement with the city of São Paulo, in June 2010, and Santos in September 2015. In December 2018, we entered into an agreement with the municipality of Guarulhos, the second largest municipality in the State of São Paulo where we started the operation in January 2019, with a population of 1.3 million. For the year ended December 31, 2018, income from these 30-year agreements accounted for 81.1% of our gross operating revenues (including revenues relating to the construction of concession infrastructure).

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

***Strong corporate governance practices.*** In 2002, we joined the *Novo Mercado* segment of the B3, which is the listing segment in Brazil with the highest corporate governance requirements. As a result, we are committed to certain corporate governance standards that are not otherwise required by Brazilian law, which provides heightened protection to our shareholders and enhances the quality of information we disclose to the market.

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

### **Our Strategy**

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

**Secure water availability in the areas where we operate.** Our goal is to secure the availability of water in the areas where we operate, as well as to promote a rational and integrated use of water resources, respecting demand and critical levels of water for each region, and allocating resources in the short, medium and long run in order to guarantee access to water. Our goal is to consistently meet the needs of our consumers with our services. Furthermore, specifically during 2015 to 2018, we implemented a series of short-term and medium-term initiatives that improved the water security for the Metropolitan region of São Paulo. For more information, see “Item 4.B. Business Overview—The 2014-2015 Water Crisis” and “—Capital Expenditure Program”.

**Ensure the quality and availability of our services in our existing service area through excellence in service provision and improving our operating efficiency.** Our goal is to maintain the water coverage ratio, coupled with a high standard of quality and availability of our services, and meet the expected growth in our operations. We also intend to increase our sewage coverage by adding 1.2 million sewage connections by 2023. In addition, we seek to reduce both physical and non physical water loss. See “—Capital Expenditure Program”.

We also seek to improve our processes by implementing: (i) a new management model based on the Management Excellence Model of the National Quality Foundation (*Modelo de Excelência na Gestão da Fundação Nacional da Qualidade*) that seeks to improve the alignment of management processes and the dissemination of best practices within the company; (ii) an enterprise resourcing planning system, or “ERP system” (SAP), and a customer relationship management system, or “CRM system” (Net@suite), to replace our commercial and management information systems. The ERP system was implemented in April 2017. The first stage of Net@suite was implemented in August 2018 and we expect to complete the implementation of the Net@ suite by 2020.

Through these projects we intend to increase our speed and productivity in responding to regulatory changes; to strengthen and streamline our financial, commercial and administrative structure; to provide a solid and integral base

of information to support the decision-making process; and to increase the efficiency of our operations while also reducing costs.

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

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

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

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

***Maintain and expand our operating base.*** We intend to maintain and expand our operating base by executing new agreements. To this end, we are actively seeking to develop closer relationships with the municipal governments that we currently serve in order to increase customer loyalty, allowing us to renew all or substantially all of our concession agreements as they expire. We also regularly explore the possibility of executing agreements for the provision of water and sewage services in municipalities in the state of São Paulo in which we currently have no operations or to which we currently supply water and provide sewage treatment solely on a wholesale basis, which on aggregate represent a total population of approximately 16.7 million, including the population of Guarulhos and Aguaí. We evaluate possible expansion opportunities in terms of proximity to our existing service areas to maximize return on investment and improve our financial performance. In June 2010, we entered into a 30 year agreement with the State and city of São Paulo for the provision of water and sewage services in the city of São Paulo, which in the year ended December 31, 2018 accounted for 47.0% of our gross operating revenues (excluding revenues relating to the construction of concession infrastructure). Between January 1, 2007 and December 31, 2018, we entered into agreements with 307 municipalities (including our services agreement with the city of São Paulo), of which twenty were entered into in 2018. These 307 municipalities accounted for 81.1% of our total revenues for the year ended December 31, 2018 and 80.2% of our intangible assets as of the same date. As of December 31, 2018, 35 of our concessions had expired and are currently being renegotiated. These 35 municipalities accounted for 6.1% of our total revenues for the year ended December 31, 2018 and 12.3% of our intangible assets as of the same date. From January 1, 2019 through 2030, 31 concession agreements, accounting for 6.3% of our revenues for the year ended December 31, 2018 and 5.3% of our intangible assets as of the same date, will expire.

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

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

***Expand our sewage treatment coverage.*** Our goal is to progress in the implementation of sewage collection and treatment structures in an economically and technologically viable way. We had an effective sewage coverage ratio of 90% as of December 31, 2018 and plan to increase this ratio to 93% by 2023 by adding over 1.2 million sewage connections and the indicator of consumer units connected to the sewage treatment system from 76% to 84% by 2023. These investments are necessary to restore the quality of the rivers and lakes, providing new sources for water

supply. In addition, there are municipalities in the state of São Paulo representing a total population of approximately 16.7 million (including the municipality of Guarulhos and Aguai) to which we currently do not provide water or sewage services, or to which we currently supply water solely on a wholesale basis. Our strong presence in the State and experience in providing water and sewage services places us in a privileged position to expand our sewage services to these additional municipalities in the state of São Paulo as well as to other Brazilian states and abroad. For more information, see “Item 4.B. Business Overview—Description of our Activities—Sewage Operations” and “Item 4.B. Business Overview—Competition” and “Item 4.B. Business Overview—Tariffs”.

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

In 2018 we invested R\$4.2 billion and between 2019 and 2023 we plan to invest an additional R\$18.7 billion to improve and expand our water and sewage systems, increase water security, and meet the growing demand for water and sewage services in the state of São Paulo, thereby encouraging these customers to continue using our services.

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

### **State of São Paulo**

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

The state of São Paulo occupies approximately 3.0% of Brazil's land mass and encompasses an area amounting to approximately 96,000 square miles. According to the SEADE, the state of São Paulo had an estimated total population of 44.2 million as of December 31, 2018. The city of São Paulo, capital of the state of São Paulo, had an estimated total population of 11.8 million, with a total population of 20.9 million inhabitants in the São Paulo metropolitan region, as of December 31, 2018. The São Paulo metropolitan region encompasses 39 municipalities and is the largest metropolitan region in the Americas and the fourth largest metropolitan region in the world, according to the United Nations' Data Booklet "The World's Cities in 2018", with approximately 47% of the total population of the state of São Paulo as of December 31, 2018. According to the 2016, the most recent data collected by the IBGE, the GDP of the state of São Paulo was approximately R\$2.0 trillion, representing approximately 32.5% of Brazil's total GDP, and making it the largest economy of any state in Brazil based on GDP. According to the IBGE, the state of São Paulo is also the leading Brazilian state in terms of manufacturing and industrial activity, with a strong position in car manufacturing, pharmaceuticals, computer manufacturing, steel making and plastics, among other activities, as well as a leading position in the banking and financial services industries. The state of São Paulo is the leading export state in Brazil, according to the Brazilian Ministry of Development, Industry and Foreign Trade (*Ministério do Desenvolvimento, Indústria e Comércio Exterior*), currently Ministry of Economy (*Ministério da Economia*).

## History

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

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

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

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

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



As of December 31, 2018, we provided water and sewage services directly to a large number of residential, commercial and industrial private consumers, as well as to a variety of public entities, in 369 of the 645 municipalities in the State, including in the city of São Paulo. We also supplied water on a wholesale basis to five municipalities in the São Paulo metropolitan region, including Guarulhos, in which we did not operate water distribution systems, and four of these municipalities also utilize our sewage treatment services. In December 2018, we entered into an agreement with the municipality of Guarulhos for the direct supply of water and sewage services. This operation began in January 2019. According to the inDepth Water Yearbook 2014-2015, we are the fourth largest water and sewage service company in the world in terms of number of clients.

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

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

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

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

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

In September 2017, the State of São Paulo obtained approval for State Law No. 16,525/2017, which authorizes the State of São Paulo to set up a controlling company to hold all of the shares that the State of São Paulo holds in our company. Once formed, this controlling company will control our company, pursuant to the provisions of Art. 116 of Law No. 6,404 of December 15, 1976, as amended, or the Brazilian Corporate Law. State Law No. 16,525/2017 allows other minority shareholders, including private companies and state companies, to hold shares of the controlling company, provided that the State of São Paulo holds the majority of the common shares of the controlling company. If and once formed, this controlling company may affect future shareholding in and the control of our company. Due to elections for state government in the second half of 2018, this operation was suspended, and we are currently awaiting guidance from the State Privatization Program's Board (*Conselho Diretor do Programa Estadual de Desestatização - CDPED*), which has authority over our corporate reorganization plan, including the formation of the controlling company, or any other type of corporate reorganization, including a change of control. We cannot assure that any potential corporate reorganization, including a change of control, will not have a material adverse effect on our business.

## Corporate Organization

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

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

- the Corporate Management Officer, who is responsible for marketing (commercial processes), human resources and social responsibility, legal affairs, information technology, asset management, supplies and contracts;
- the Chief Financial Officer and Investor Relations Officer, who is responsible for financial planning, collection of revenues, allocating financial resources to divisions of our company, conducting capital markets and other debt incurrence transactions and managing debt levels, controller, accounting, costs and tariffs, corporate governance and investor relations;

- the Technology, Enterprises and Environment Officer is responsible for environmental management, technological and operational development, quality control of water and sewage, the development, coordination and execution of special investment programs, projects, research innovation and new business ventures; and
- the Chief Operating Officer for the São Paulo metropolitan region Division and the Chief Operating Officer for the Regional Systems Division, who are responsible for managing the operation, maintenance, execution of works for water and sewage supply systems (including for the services that we provide on a wholesale basis), sales and call center services, and have overall responsibility for the financial and operational performance of their divisions. The Chief Operating Officers are also responsible for sanitation advisory services to independent municipalities and for mediation and negotiation with communities and local governments, aimed at aligning our interests with the interests of our clients.

### Capital Expenditure Program

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

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

We have budgeted investments in the total amount of R\$18.7 billion from 2019 through 2023. We invested R\$4.2 billion, R\$3.4 billion and R\$3.9 billion in 2018, 2017 and 2016, respectively.

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

	Planned Capital Expenditures					Total
	2019	2020	2021	2022	2023	
	<i>(in millions of reais)</i>					
Water	1,669	1,492	1,636	1,507	1,453	7,757
Sewage Collection	1,366	1,524	1,777	1,766	1,878	8,311
Sewage Treatment	470	607	471	576	539	2,663
<b>Total</b>	<b>3,505</b>	<b>3,623</b>	<b>3,884</b>	<b>3,849</b>	<b>3,870</b>	<b>18,731</b>

Our capital expenditure program from 2019 through 2023 will continue to focus on achieving our targets by making regular investments to maintain and expand our infrastructure and to reduce water losses in the 369 municipalities we served as of December 31, 2018. The recent drought has prompted a reduction in the volume of water billed, particularly in 2014 and 2015, and thus a reduction in revenue. Due to the drought and the need to prioritize construction to mitigate the effects of the water crisis and increase water security in the Metropolitan Region of São Paulo, we were required to adjust our investment programs commencing in 2014. These adjustments are expected to continue in 2019 due to the priority given since 2014 to emergency investments in water.

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

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

**Investments in Water** – We have a series of ongoing and scheduled projects involving water production and distribution. For the period from 2019 through 2023, we plan to spend R\$7.7 billion in water-related investments. The main programs are:

#### *Metropolitan Water Program*

Demand for our water services has grown steadily over the years in the São Paulo metropolitan region and has at times exceeded the capacity of our water systems. On account of the high demand, prior to September 1998, a portion of our customers in this region received water only on alternate days of the week. We refer to this as “water rotation”. In order to address this situation, we implemented the Metropolitan Water Program (*Programa Metropolitano de Água*) to improve regular water supply to the entire São Paulo metropolitan region. This program terminated in 2000 and the water rotation measure was eliminated, but we have nevertheless maintained our investment plans for the region. In 2018, we invested approximately R\$165 million in the Metropolitan Water Program.

Since 2000, the Metropolitan Water Program has increased the production capacity by 13.1 m<sup>3</sup>/s, 5 m<sup>3</sup>/s of which can be attributed to the Public Private Partnership, or “PPP”, conducted in the Alto do Tietê concluded in 2011, 2.1 m<sup>3</sup>/s of which can be attributed to increased production in the Guarapiranga System, concluded in 2015, and 6 m<sup>3</sup>/s due to the implementation of the new São Lourenço water supply system.

#### São Lourenço Project

The metropolitan region lacks water sources, which requires us to obtain water from increasingly distant sources. In order to address this situation, we developed, under a PPP contract, a new supply system called São Lourenço, which expands our production capacity by 6.4 m<sup>3</sup>/s and should be able to benefit a population of almost 1.5 million people. The PPP contract was executed in August 2013 and construction began in April 2014. The project was undertaken by Sistema Produtor São Lourenço S.A., which is a special purpose company controlled by the construction companies Camargo Corrêa Construtora S.A. and Andrade Gutierrez S.A. The construction was completed in April 2018 and operations began in July 2018. In May 2018, Camargo Corrêa Construtora S.A. and Andrade Gutierrez S.A. sold their shares of Sistema Produtor São Lourenço S.A. to CGGC Construtora do Brasil Ltda., a Chinese-owned company.

As of December 31, 2018, the estimated amount of the PPP contract was R\$6.0 billion (including R\$2.2 billion in construction and maintenance and operation of the system). After monetary adjustment, the contract amounts to approximately R\$7.9 billion and has a 25-year term, four years of which was dedicated to the construction, while the other 21 years will be dedicated to service delivery. These services include the operation and maintenance of the sludge treatment system of the water treatment plant and disposal of the waste thus generated; electromechanic and civil maintenance of the untreated water pumping stations, of the water treatment plant and the untreated water pipeline; preservation and cleaning, surveillance and property security.

#### Interconnection of Jaguari and Atibainha Reservoirs

In February 2016, we began the construction work on the interconnection of Jaguari (part of the Paraíba do Sul Basin) and Atibainha reservoirs (part of the PCJ River Basin, Cantareira System), which is a strategic and priority project to guarantee secure access to water for the metropolitan region of São Paulo. This project was completed during March 2018, when we also began transferring 5.13 m<sup>3</sup>/s of water from the first to the other.

Since May 2018, the transfer of water also works in the opposite direction, from the Atibainha reservoir to the Jaguari reservoir, enabling to reverse up to 12.2 m<sup>3</sup>/s and optimize the reservation capacity of both reservoirs, while benefiting the population of the Paraíba Valley.

#### Reversal of the Itapanhaú River

The Itapanhaú River system is expected to have the capacity to pump an average of 2 m<sup>3</sup>/s (maximum of 2.5 m<sup>3</sup>/s) of water to Biritiba-Mirim reservoir, part of the Alto Tietê system. The project aims to improve water security in the São Paulo metropolitan region and is expected to directly benefit approximately 4.5 million residents that receive water from the Alto Tietê system as well as indirectly benefit 20.9 million people in the greater São Paulo region. In 2017, we finalized the bidding process that selected the consortium which will execute the project. The investment will be of R\$91.7 million and the start of works is conditional on obtaining the installation license expected for the second half of 2019.

#### *Corporate Program for Reduction of Water Loss*

The objective of the Corporate Program for Reduction of Water Loss (*Programa Corporativo de Redução de Perdas de Água*) is to reduce water loss by efficiently integrating and expanding existing initiatives in our business units. This program has a 12 year term that began in 2009. We anticipate total investments of approximately R\$6.2 billion (current value) throughout the term of the program. Funding for the program will come from our own resources as well as from credit facilities provided by the Japan International Cooperation Agency, or JICA and BNDES.

The program aims to reduce the rate of water loss from 436 liters per connection per day in December 2008 to 267 liters per connection per day by 2021, which is equivalent to reducing the Water Metered Loss Index (based on measured consumption) from 34.1% in December 2008 to 28.5% in 2021. In 2018, we invested approximately R\$645.6 million in this program and our water loss measured 293 liters per connection per day and our Water Metered Loss Index averaged 30.1%.

#### *Coastal Water Program*

The Coastal Water Program (*Programa Água no Litoral*) combines various long term activities to expand water production capacity in the Baixada Santista metropolitan region and the southern coast of the state of São Paulo. The program aims to benefit approximately three million people, including both the local population and tourists. It aims to increase the level of reliability of the local systems, eliminating existing and potential deficiencies and irregularities in the water supply.

In order to reach this goal, we built two water treatment plants, which started operations in 2013: Mambu/Branco, with water treatment capacity of 1.6 m<sup>3</sup>/s, and Jurubatuba, with water treatment capacity of 2 m<sup>3</sup>/s. We have also begun constructing two additional water treatment plants in the municipality of Peruíbe, and in 2018, we started to enlarge the treatment capacity of the water treatment station Mambu Branco, from 1.6m<sup>3</sup>/s to 3.2m<sup>3</sup>/s, which we estimate to conclude by 2021.

In 2016, the integrated system of the Baixada Santista metropolitan region was reinforced with the commencement of operations at the Melvi Treated Water Reserve Center, located in Praia Grande. The Center's reserves went from 20 million to 45 million liters. The infrastructure is part of the Mambu-Branco production center (inaugurated in 2013 in Itanhaém) and will serve residents and tourists in two municipalities of the Baixada Santista region (Praia Grande and São Vicente). The program is supported by funds from the Caixa Econômica Federal as well as our own funds. In 2018, we invested R\$33.6 million in the Coastal Water Program.

**Investments in Sewage**—We have a series of ongoing and scheduled projects involving the collection, removal and treatment of sewage. For the period from 2019 through 2023, we plan to invest R\$11.0 billion in sewage collection and treatment. The main programs are:

#### *Tietê Project*

We have been working in the metropolitan region of São Paulo in sanitation programs that aim to contribute to the revitalization of rivers and streams, and its main program is the Tietê Project.

Established in 1992, the project aims to contribute to the progressive revitalization of the Tietê river and its tributaries, in the Alto Tietê basin, where the metropolitan region of São Paulo is located, through the expansion and optimization of the sewage collection, transportation and treatment system.

Considering the complexity and challenges faced to implement infrastructure projects in crowded and disorderly urbanized areas such as São Paulo, it was necessary to structure the project in stages.

From 1992 to the end of 2018, the investments totaled US\$2.9 billion, of which R\$441.9 million were disbursed in 2018. Part of the resources allocated to the program are our own capital and the remainder comes from financings granted by the Inter-American Development Bank - IDB, BNDES and *Caixa Econômica Federal - CEF*.

During this period, 1.77 million domestic sewage connections were built and 4.45 thousand km of interceptors, trunk collectors and collection networks were built to collect and transport the sewage to treatment in our plants, whose installed capacity for treatment almost tripled.

As a result, the treated sewage outflow at the metropolitan region of São Paulo increased from four thousand liters per second in 1992 to the current 18.7 thousand liters per second. This increase, of 14.7 thousand liters per second, is equivalent to the sewage generated by approximately ten million people. As a result, sewage collection that served 70% of the urbanized area of the metropolitan region of São Paulo in 1992 increased to 87% by the end of 2018. Sewage treatment increased from 24% to 70% of the volume collected.

The program aims to increase by 2024 the coverage rate with the sewage network in the metropolitan region of São Paulo to 92% and the treatment index to 90% of the total collected, with the conclusion of the third stage, now under way with a 70% progress, and the works already planned for the fourth stage, with priority interventions currently in

concurrent execution.

In 2018, the completion of the second phase of the expansion of Sewage Treatment Plant Barueri, the largest treatment plant in South America, allowed us to increase from 12 thousand liters per second (reached in 2017) to 16 thousand liters per second currently.

It is also worth mentioning the implementation of the ITi-7 sewage interceptor under the Marginal Tietê, a highway that runs through the city of São Paulo along with the Tietê River, expected to be completed by the beginning of 2020, benefiting approximately 2 million people living in the central and southern regions of the city of São Paulo, highly verticalized, with collector piping operating close to its limit.

#### *Clean Stream Program*

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

Since 2007, 151 urban streams have been decontaminated, benefiting approximately 2.5 million people. In 2018, we invested R\$9 million in the Clean Stream Program. The program is supported by funds from the *Caixa Econômica Federal* as well as our own funds. Part of the investment related to the Tietê Project benefits the Clean Stream Program.

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In 2018, through certain actions for the regularization of the sewage systems through the Clean Stream Program, complementary to the Tietê Project, we were able to clean up an extensive stream in the city of São Paulo, named Traição, benefiting more than 210 thousand people, in addition to the advances in sanitation works in sub-basins of the streams in conclusive phases. Throughout the year, we also continue to inspect and monitor the water quality of previously decontaminated streams.

However, despite our constant monitoring of pollution levels, the municipality of São Paulo's difficulties in moving low-income families who live in risky areas has led to a slowdown in progress under the program. We have renewed the partnership with the municipality and the objectives for 2019 are under discussion.

### *Clean Wave Program*

The Clean Wave Program (*Programa Onda Limpa*) is the largest environmental sanitation program on the Brazilian coast. Its main goal is to improve and expand the sewage systems in the municipalities that cover the metropolitan region of Baixada Santista, seeking the universalization of sewage services in the region. The program will improve the condition of 82 beaches and will benefit approximately 4 million people, including locals and tourists who visit the coast, especially in the summer months.

Due to the complexity and challenges involved in the implementation of infrastructure projects in coastal regions, the Program was structured in stages. In the first phase, started in 2007, 1,263 km of sewage collection networks, 4.5 km of submarine emissaries, two sewage pre-conditioning stations, seven sewage treatment stations and approximately 110 thousand sewage connections were implemented, resulting in the increase of the collected sewage index from 53% to 81% in 2018, reaching 100% treatment of the sewage collected. We invested R\$1.9 billion in this phase, with our own resources and financing from JICA and BNDES.

The second phase of the Program began in 2018 and aims to implement two sewage preconditioning stations, each with a treatment capacity of 1.4 m<sup>3</sup>/s of sewage and replacing the diffuser sections of two submarine emissaries in the city of Praia Grande. This stage also includes the implementation of approximately 450 km of collecting networks, 48 thousand new connections, three new sewage treatment plants and eleven additions and improvements to existing sewage treatment plants. We expect to complete this step in 2025, with 92% sewage collection and maintenance of sewage treatment index collected.

The third stage of the Program is under planning, with execution estimated between 2025 and 2030, and a forecast of 95% sewage collection and treatment of all sewage collected.

### *Other Policies and Programs*

#### *Nossa Guarapiranga*

The Nossa Guarapiranga Project launched in December 2011 is still running. Its main objective is to improve the water quality in the Guarapiranga basin, an urban water source for the São Paulo metropolitan region. The basin serves one million people directly in the areas near Guarapiranga reservoir and indirectly serves a further three million people who consume the water from this water basin. We carried out actions on three fronts as part of this project: (i) we installed ecobarriers at the bottom of the reservoir's main affluents in order to retain solid residue and installed drains to collect residue from rivers in the Guarapiranga basin; (ii) we developed diagnosis and control services for the removal of plants that obstruct water extraction; and (iii) we removed and disposed of solid residue that had accumulated at the bottom of the dam in the river basin. Two vessels were built specifically for this purpose. We work as a collaborative team with the municipal government of São Paulo in the Nossa Guarapiranga Project, with

the municipal government of São Paulo transporting all of the residue collected through these fronts to a sanitary landfill. In 2018, we removed an average of 200 m<sup>3</sup>/month of solid residue and approximately 1,370 m<sup>3</sup>/month of water plants from this basin.

*Pró Conexão*

In 2012, the State of São Paulo approved a project to subsidize connections to the sewage system for low income families. Initially intended to last eight years, the project involves capital expenditures of up to R\$349.5 million of which 80% will be provided by the State government and 20% by us. In this period, we expect that this program will create 192 thousand new sewage connections benefiting approximately 800 thousand people. As of December 2018, we completed approximately 25.5 thousand sewage connections under the *Pró-Conexão* program.

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

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

## **B. Business Overview**

### **Our Operations**

As of December 31, 2018, we provided water and sewage services to 369 municipalities in the state of São Paulo under concession agreements, program agreements, other forms of legal arrangements or without formal agreements. We also supplied treated water on a wholesale basis to five municipalities located in the São Paulo metropolitan region and urban conurbations, including Guarulhos. The majority of these concessions have 30 year terms. Due to court orders, we temporarily suspended our services in two other municipalities (Cajobi and Macatuba). For more information, see “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”. Between January 1, 2007 and December 31, 2018, we entered into agreements with 307 municipalities (including our services agreement with the city of São Paulo) in accordance with the Basic Sanitation Law, of which twenty were entered into in 2018. As of December 31, 2018, these 307 municipalities accounted for 81.1% of our gross operating revenues (including revenues relating to the construction of concession infrastructure). In addition to the contracts that have 30 year terms, the municipalities entered into cooperation contracts with the State of São Paulo, delegating the regulation and monitoring of the provision of services to ARSESP. As of December 31, 2018, 35 of our agreements or concessions had expired but we continued to provide water and sewage services to these municipalities and were in negotiations with these municipalities to execute program agreements to substitute the expired concessions. From January 1, 2019 through 2030, 31 concessions will expire.

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

### **Description of Our Activities**

As set forth in Article 2 of our bylaws, we are permitted to render basic sanitation services with the goal of providing basic sanitation services to the entire population in the municipalities where we conduct our activities without harming our long term financial sustainability. Our activities comprise water supply, sanitary sewage services, urban rainwater management and drainage services, urban cleaning services, solid waste management services and related activities, including the planning, operation, maintenance and commercialization of energy, and the commercialization of services, products, benefits and rights that directly or indirectly arise from our assets, operations and activities. We are allowed to act in a subsidiary form in other Brazilian locations and abroad. See “—Government Regulations Applicable to Our Contracts—Establishment of ARSESP”. For a description of our operating segments please see Note 26 to our financial statements as of and for the year ended December 31, 2018.

Operating segments are presented in our annual report in a manner consistent with the internal reporting provided to our chief operating decision maker, which is the board of directors and the board of executive officers, as determined under IFRS 8. Under Brazilian GAAP, prior to our conversion to IFRS, the financial information for construction services was not separately presented and construction costs related to concessions were capitalized within property, plant and equipment. As a result, our chief operating decision maker did not review the results of this business. Following our conversion to IFRS, our chief operating decision maker decided to continue to exclude the construction results from the internal reporting of our revenues and expenses, thus not basing their decisions on discrete financial information for that business. Consequently, the business did not qualify as an operating segment under IFRS 8. Nonetheless, after our conversion to IFRS and for IFRS financial statement purposes only, we started to record such results separately as construction revenue and costs under IFRIC 12. Although such information is available discretely, it is not analyzed by our chief operating decision maker as such and is not the basis for operational decisions.

We set forth below a description of our activities.

### ***Wholesale Operations***

#### *Wholesale Water Services*

Until the end of 2018, we provided water services on a wholesale basis to five municipalities located in the São Paulo metropolitan region (Guarulhos, Mauá, Mogi das Cruzes, Santo André and São Caetano do Sul). However, in December 2018 we entered into an agreement with the municipality of Guarulhos to provide water and sewage services on a retail basis as from January 2019, replacing water services on a wholesale basis. Agreements to provide water services on a wholesale basis must comply with the Basic Sanitation Law, which designates these services as “interdependent activities” and regulates each stage of the service. The law requires that the service be supervised by an independent agency, stipulates registration of the cost of the service, and requires assurance of payment among the several service providers in order to continue the provision of the services, in accordance with the rules to be published by ARSESP. Our agreements currently comply with the provisions of the Basic Sanitation Law No. 11.445/2007. In 2018, the revenues from wholesales water services were R\$1,117.4 million (including the amount of R\$928.0 million related to agreement with the municipality of Guarulhos. For more information on this agreement, see Note 9 to our 2018 financial statements).

The Brazilian courts could oblige us to continue to supply water to these municipalities, even when we have not received payments due to us. If they do not pay, we have no way of ensuring that negotiations with these municipalities or legal action taken against them will result in payments being made. For example, the municipalities of Santo André and Mauá still owe us significant sums in respect of water that we have been providing to them on a wholesale basis. For more information, see “Item 3.D. Risk Factors—Risks Relating to Our Business—We may face difficulties in collecting overdue amounts owed to us by municipalities to which we provide water on a wholesale basis and municipal government entities”. We have intensified the process of collecting these sums and other amounts using the Single Registry of Debtors of São Paulo (*Cadastro Único de Devedores de São Paulo*), or State CADIN, and we executed Protocols of Intentions with Santo André and Mauá, in 2015 and 2016, respectively, seeking to resolve the outstanding amounts and restore normal commercial relations with them but the negotiations were not successful. Accordingly, we signed a new Protocol of Intentions with the municipality of Santo André in March 2019.

*Wholesale Sewage Services*

Currently, we provide sewage services on a wholesale basis to the municipalities of Mauá, Mogi das Cruzes, Santo André and São Caetano do Sul. Our agreement with Santo André for these services was executed with the intervention of the Public Prosecution Office. Our agreements with the other municipalities resulted from our environmental efforts and municipal authorities' awareness of environmental issues. Through these agreements, in 2018 we invoiced approximately 31.1 million cubic meters of sewage collected from these municipalities. We believe this illustrates our commitment to social and environmental responsibility. In 2018, our revenues from wholesale sewage services were R\$46.9 million.

In December 2018, we entered into an agreement with the municipality of Guarulhos to direct supply water and sewage services to the municipality for 40 years. The municipality of Guarulhos holds a PPP contract entitled part of the sewage services and we hold an interdependent contract with the SPE that holds the PPP contract. We are responsible for all commercial and billing services.

*Water Operations*

Our supply of water to our customers generally involves abstraction of water from various sources, subsequent treatment and distribution to our customers' premises. In 2018, we produced approximately 2,799.7 million of cubic meters of water. The São Paulo metropolitan region (including the municipalities to which we supply water on a wholesale basis) currently is, and has historically been, our core market, accounting for approximately 69.1% of water invoiced by volume in 2018.

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

	<b>2018</b>	<b>Year ended December 31, 2017</b>	<b>2016</b>
	<i>(in millions of cubic meters)</i>		
Produced:			
São Paulo metropolitan region	1,959.6	1,952.3	1,888.8
Regional Systems	840.1	830.9	807.4
<b>Total</b>	<b>2,799.7</b>	<b>2,783.2</b>	<b>2,696.2</b>
Invoiced:			
São Paulo metropolitan region	1,194.5	1,175.8	1,136.7
Wholesale	262.7	256.7	227.4
Regional Systems	650.7	643.4	626.2
<b>Total</b>	<b>2,107.9</b>	<b>2,075.9</b>	<b>1,990.3</b>

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

- water discharged for periodic maintenance of water transmission lines and water storage tanks;
- water supplied for municipal uses such as firefighting;
- water consumed in our own facilities; and

- estimated water loss associated with water we supply to shantytowns (*favelas*).

*Seasonality*

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

*Water Resources*

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

In order to supply water to the São Paulo metropolitan region, we rely on 20 reservoirs of non treated water and 231 reservoirs of treated water, which are located in the areas under the influence of the nine water producing systems (including the São Lourenço water supply system) comprising the interconnected water system of the São Paulo metropolitan region. The total capacity of the water sources available for treatment in this area is 82.1 m<sup>3</sup>/s, not including an additional 5.5 m<sup>3</sup>/s resulting from the emergency construction work conducted by us in 2014 and 2015. Total current installed capacity is 80.9 m<sup>3</sup>/s and can be distributed to the São Paulo metropolitan region. Average verified production for the interconnected water system of the São Paulo metropolitan region was 60.9 m<sup>3</sup>/s during 2018. The Cantareira, Guarapiranga and Alto Tietê systems produce 82% of the water we distributed in the São Paulo metropolitan region in 2018.

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

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

In 2018, the Cantareira system accounted for 39% of the water that we supplied to the São Paulo metropolitan region (including the municipalities to which we supplied water on a wholesale basis), which represented 72.2% of our gross operating revenues (excluding revenues relating to the construction of concession infrastructure) for the year. For more information, see “Item 3.D. Risk Factors—Risks Relating to Our Business—We are exposed to risks associated with the provision of water and sewage services”.

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

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

	Production Rate <sup>(1)</sup>		
	2018	2017	2016
	<i>(in cubic meters per second)</i>		
<b>Water production system:</b>			
Cantareira	23.9	25.0	22.0
Guarapiranga	13.4	13.3	13.9
Alto Tietê	12.9	11.8	11.7
Rio Claro	3.4	3.9	3.8
Rio Grande (Billings reservoir)	4.3	4.5	4.9
Alto Cotia	1.1	1.2	1.2

Baixo Cotia <sup>(2)</sup>	0.2	0.8	0.9
Ribeirão da Estiva	0.1	0.1	0.1
São Lourenço	1.6	-	-
<b>Total</b>	<b>60.9</b>	<b>60.6</b>	<b>58.5</b>

(1) Average of the twelve months ended December 31, 2018, 2017 and 2016.

(2) At the beginning of 2018, the region served by the Baixo Cotia system began to be supplied by the São Lourenço system.

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

Statewide, we estimate that we are able to supply nearly all of the demand for water in all of the areas where we operate, subject to droughts and extraordinary climate events. We installed 199.1, 207.3 and 200.2 thousand new water connections in 2018, 2017 and 2016, respectively. The interconnected water system of the São Paulo metropolitan region serves 30 municipalities, of which 25 are operated directly by us under this system. Through this system, we serve the other five municipalities on a wholesale basis, including Guarulhos, whereas distribution is the responsibility of other companies or departments related to each municipality.



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

To ensure the continuous provision of regular water supply in the São Paulo metropolitan region, we intend to invest R\$18.7 billion from 2019 to 2023 to increase our water production and distribution capacities as well as to improve the water supply systems. In 2018, our total investment in water supply systems amounted to R\$2.3 billion, of which R\$2.0 billion were invested in the São Paulo metropolitan region.

#### *Water Treatment*

We treat all water at our water treatment facilities prior to dispatching it to our water distribution network. We operate 247 treatment facilities, of which nine are a part of the Metropolitan Production System—located in the São Paulo metropolitan region and account for approximately 70.0% of all water we produced in 2018. The type of treatment used depends on the nature of the source and quality of the untreated water. For example, water abstracted from rivers requires more treatment than water withdrawn from groundwater sources. All of the water we treat receives fluoridation treatment.

#### *Water Distribution*

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

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

	<b>As of December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Water distribution pipes and water transmission lines (in kilometers)	75,519	74,396	73,015
Number of connections (in thousands)	9,053	8,863	8,654

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

As of December 31, 2018, our water distribution pipes and water transmission lines included: (i) 38,858 kilometers in the São Paulo metropolitan region; and (ii) 36,661 kilometers in the Regional Systems.

As of that date, we had 375 storage tanks in the São Paulo metropolitan region with a total capacity of 2.3 million cubic meters, and 2,056 storage tanks in the Regional Systems. Furthermore, we had 462 treated water pumping stations in the São Paulo metropolitan region aqueduct system, including stations at treatment facilities, intermediate trunk transfer pumping stations and small booster stations serving local areas.

Water transmission lines that require maintenance are cleaned and their lining is replaced. We are typically notified of water main fractures or breaks by the public through a toll free number maintained by us. We consider the condition of the water pipes and water transmission lines in the São Paulo metropolitan region to be adequate as of the date of this

annual report. Due to age, external factors such as traffic, the dense population, and commercial and industrial development, water pipes and water transmission lines in the São Paulo metropolitan region are somewhat more susceptible to degradation than those in the Regional Systems. To counter these effects, we have a maintenance program in place for water pipes and water transmission lines that is intended to address anticipated fractures and clogs due to brittleness and encrustation, and to help ensure water quality in the region.

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

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

	<b>in thousands</b>					
	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2019 – 2023</b>
São Paulo metropolitan region	124	127	127	127	127	632
Regional Systems	62	65	65	65	65	322
<b>Total</b>	186	192	192	192	192	954

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*Water Loss*

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

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

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

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

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

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

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

These indicators are calculated by applying the following formulas:

$$\begin{aligned}
 \text{WBLI} &= \frac{V_{\text{produced}} (V_{\text{invoiced}} + V_{\text{used}})}{V_{\text{produced}}} \\
 \text{WMLI} &= \frac{V_{\text{produced}} - (V_{\text{measured}} + V_{\text{used}})}{V_{\text{produced}}} \\
 \text{TLDC} &= \frac{V_{\text{produced}} - (V_{\text{measured}} + V_{\text{used}})}{N_{\text{connection}} \times \text{No. of days of a given period}}
 \end{aligned}$$

Where:

**V<sub>produced</sub>**: corresponds to the volume of water produced at a given period;

**V<sub>billed</sub>**: corresponds to the volume of water billed at a given period;

**V<sub>measured</sub>**: corresponds to the volume of water measured at a given period;

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

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

Using this calculation method, as of December 31, 2018, we experienced 337 liter/connection per day of water loss in the São Paulo metropolitan region and 226 liter/connection per day of water loss in the Regional Systems, averaging 293 liter/connection of water loss per day. We have a Corporate Program for Reduction of Water Loss in place that aims to reduce total water loss to around 267 liters/connection per day, and the Water Metered Loss Index to 28.5% by 2021.

In order to continue to supply water to the population despite its low availability, one of the measures that we adopted was to further reduce water pressure across our network of operation. Inasmuch as the utilization of water sources, real water loss (water physically lost) fell from 22.2% in December 2008 to 19.9% in December 2018.

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For more information on the measure we have adopted to confront the water crisis, see “—The 2014-2015 Water Crisis”.

Our strategy to reduce water loss has two approaches:

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

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

- the introduction of technically advanced valves to regulate water pressure throughout our water transmission lines in order to maintain appropriate water pressure downstream. These valves are programmed to respond automatically to variations in demand. During peak usage, the flow of water in the pipes is at its highest point; however, when demand decreases, pressure builds up in the water transmission lines and the resulting stress on the network can cause significant water loss through cracks and an increase in ruptures of the pipes. The technically advanced valves are equipped with probes programmed to feed data to the valve in order to reduce or increase pressure to the water transmission lines as water usage fluctuates; the reconfiguration of interconnected water distribution to permit the distribution of water at lower pressure;
- the implementation of routine operational leak detection surveys to reduce overall water loss;
- the monitoring of and improved accounting with respect to water connections, especially for large volume customers;
- regular checking on inactive customers and monitoring non residential customers that are accounted for as residential customers and, therefore, billed at a lower rate;
- preventing fraud with the use of new, more sophisticated water meters that are more accurate and less prone to tampering;
- installing water meters where none are present; and
- conducting preventive maintenance of existing and newly installed water meters.

### *Water Quality*

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

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

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

All chemical products used for water treatment are analyzed and follow strict specifications set out in recommendations made by the National Health Foundation (*Fundação Nacional de Saúde*), or NHF, ABNT, and the National Standard Foundation, or NSF, and the American Water Works Association, or AWWA, to eliminate toxic substances that are harmful to human health. From time to time, we face problems with the proliferation of algae, which may cause an unpleasant taste and odor in the water. In order to mitigate this problem, we work on: (i) fighting algae growth at the water source and (ii) using advanced treatment processes at the water treatment facilities that involve the use of powdered activated carbon and oxidation by potassium permanganate. The algae growth creates significant additional costs for water treatment because of the higher volumes of chemicals used to treat the water. We also participate in the Clean Stream Program to clean important streams in the city of São Paulo. Other initiatives also aimed at improving the water quality in the water sources located in the of São Paulo metropolitan region are *Nossa Guarapiranga* and *Pró Conexão*. See “—Main Projects of Our Capital Expenditure Program—Clean Stream Program”, and “—Other Policies and Programs—Nossa Guarapiranga”.

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

#### *Fluoridation*

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

#### *Sewage Operations*

We are responsible for the collection, removal, treatment and final disposal of sewage. As of December 31, 2018, we collected approximately 82% and 85% of all the sewage produced in the municipalities in which we operate in the São Paulo metropolitan region and in the Regional Systems, respectively. During 2018, we collected approximately 83% of all the sewage produced in the municipalities in which we operated in the state of São Paulo. We installed 215.3 thousand, 221.8 thousand and 236.6 thousand new sewage connections in 2018, 2017 and 2016, respectively.

#### *Sewage System*

The purpose of our sewage system is to collect and treat sewage and to adequately dispose of the treated sewage. As of December 31, 2018, we were responsible for the operation and maintenance of 51,788 kilometers of sewage lines, of which approximately 27,036 kilometers are located in the São Paulo metropolitan region and 24,752 kilometers are located in the Regional Systems, respectively.

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

	<b>As of December 31,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Sewage lines (in kilometers)	51,788	50,991	50,097
Sewage connections (in thousands)	7,495	7,302	7,091

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

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

Before the discharge is permitted, we carry out acceptance studies that assess the capacity of the public sewage system to receive it as well as the compliance with regulations. Upon the conclusion of these studies, the technical and commercial conditions for receiving the discharge are established, which are then formalized in a document signed by us and the effluent producer. Failure to comply with these conditions can lead to the application of penalties by us. In extreme cases, the State of São Paulo Environmental Company (*Companhia Ambiental do Estado de São Paulo*), or CETESB, is notified in order for the applicable measures to be taken. Effluents from our treatment facilities must comply with limitation guidelines for release of effluents into receiving water bodies. Additionally, the quality of the water in the receiving water body must not be impaired by the release of such effluents, as established by State Law No. 997/1976 regulated by State Decree No. 8,468/1976 and Conama Resolution No. 357/2005, as amended by Conama Resolution No. 430/2011.

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



Unlike the São Paulo metropolitan region, the interior region of São Paulo State does not generally suffer obstructions caused by sewage system overload. The coastal region, however, experiences obstructions in its sewage lines primarily due to infiltration of sand, especially during the rainy season in the summer months. In addition, the sewage coverage ratio in the coastal region is lower than in the other regions served by us, at approximately 80% as of December 31, 2018.

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

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

	2019	2020	2021	2022	2023	2019	2023
	<i>in thousands</i>						
São Paulo metropolitan region	147	154	154	155	155		765
Regional Systems	80	86	92	92	85		435
<b>Total</b>	<b>227</b>	<b>240</b>	<b>246</b>	<b>247</b>	<b>240</b>		<b>1,200</b>

#### *Sewage Treatment and Disposal*

In 2018, approximately 64% and 99% of the consumer units of the sewage services used our sewage treatment system in the São Paulo metropolitan region and the Regional Systems, respectively, or 76% of the consumer units of our sewage services in the state of São Paulo, was connected at our treatment facilities and afterwards discharged into receiving water bodies such as rivers and the Atlantic Ocean, in accordance with applicable legislation. Though we have not yet reached full coverage of sewage collection and treatment services in the regions where we operate, we are making efforts to reach this goal.

We currently operate nine ocean outfalls and 556 sewage treatment facilities, of which the five largest, located in the São Paulo metropolitan region, have a treatment capacity of approximately 24.5 cubic meters of sewage per second.

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

Sewage treatment in the Regional Systems will vary according to the particularities of each area. In the interior region of São Paulo State, treatment consists largely of stabilization ponds. There are 489 secondary treatment facilities in the interior region of São Paulo State that have treatment capacity of approximately 16.9 cubic meters of sewage per second. Similar to our disposal process for treated sewage collected in the São Paulo metropolitan region, the majority of sewage collected in the coastal region receives treatment and disinfection and is then discharged into rivers and also into the Atlantic Ocean through our ocean outfalls, in accordance with applicable legislation. We have 43 sewage treatment facilities in the coastal region.

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

Requirements”.

*Sludge Disposal*

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

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

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

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

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

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

### Principal Markets in Which We Operate

As of December 31, 2018, we operated water and sewage systems in 369 of the 645 municipalities in the state of São Paulo. In addition, we supplied water on a wholesale basis to five municipalities located in the São Paulo metropolitan region, including Guarulhos, with a total population of approximately 3.1 million people.

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

	Year ended December 31,		
	2018	2017	2016
	<i>(in millions of R\$)</i>		
São Paulo metropolitan region	10,295.5	8,636.9	7,749.7
Regional Systems	3,958.1	3,586.8	3,372.5
<b>Total</b>	<b>14,253.6</b>	<b>12,223.7</b>	<b>11,122.2</b>

### Competition

In 2018, there were 276 municipalities operating their own water and sewage systems with a total population of approximately 16.7 million, or approximately 38% of the population of the state of São Paulo.

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

In recent years, we have also experienced an increasing level of competition in the market of water supply to industrial customers. Several large industrial customers located in municipalities we serve use their own wells to meet their water needs. In addition, competition for the disposal of non residential, commercial and industrial sludge in the São Paulo metropolitan region has increased in recent years as private companies offer stand alone water treatment solutions inside the facilities of their customers. We have also established new tariff schedules for commercial and industrial customers in order to assist us in retaining these customers. Since these fixed demand agreements

(take-or-pay contracts) with certain of our industrial customers were not covered by our bonus program, until April 2016, we suspended the fixed demand requirement in order to encourage lower water consumption. In May 2016, we reinitiated the fixed demand requirement, and the volumes of those contracts were revised according to clients' new consumption profiles. We started 2018 with 482 formal contracts and ended the year with 531 contracts. For more information about the water crisis, see “—The 2014-2015 Water Crisis”. For more information on Take-or-pay Contracts see “—Tariff Structure—Fixed Demand Agreements (Take-or Pay)”.

### **Billing Procedures**

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

The majority of the bills for water and sewage services are delivered to our customers in person, mainly through independent contractors who are also responsible for reading water meters, although a proportion of clients elected, for convenience purposes, to receive their bill through regular mail. Water and sewage bills can be paid at some banks and other locations in the state of São Paulo. These funds are paid over to us after deducting average banking fees ranging from R\$0.29 to R\$1.34 per transaction for collection and remittance of these payments. Customers must pay their water and sewage bills by the due date if they wish to avoid paying a fine. We generally charge a penalty fee and interest on late bill payments. In 2018, 2017 and 2016, we received payment of 93.8%, 94.1% and 93.0%, respectively, of the amount billed to our retail customers, and 93.8%, 94.1% and 93.0%, respectively, of the amount billed to those customers other than State entities, within 30 days after the due date. In 2018, 2017 and 2016, we received 99.4%, 99.2% and 97.2%, respectively, of the amount billed to the State entities. With respect to wholesale supply, in 2018, 2017 and 2016, we received payment of 38.5%, 60.1% and 74.1%, respectively, of the amount billed within 30 days.

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

## **Tariffs**

Tariff adjustments follow the guidelines established by the Basic Sanitation Law and ARSESP. The guidelines also establish procedural steps and the terms for the annual adjustments. The adjustments have to be announced 30 days prior to the effective date of the new tariffs, which previously would take effect in September. Pursuant to the most recent tariff revision, both the base date and future adjustments take place in April.

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

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

In regard to municipalities that have not explicitly selected ARSESP as their regulator, the Basic Sanitation Law allows the municipality to create other regulatory agencies of their own. In 2007, the municipality of Lins decided to create its own regulatory authority, although it revised this decision in 2010, transferring to ARSESP the regulation of the water activities performed in Lins, including for the setting of tariffs. The municipality of Lins has, however, reserved the power to ultimately approve the tariff set by ARSESP.

In addition, in 2011, the municipalities located in the hydrographic basins of the Piracicaba, Capivari and Jundiá rivers created a consortium known as ARES/PCJ to regulate and supervise our activities in those areas, and for similar purposes, in November 2013 the Regulatory Agency of São Bernardo do Campo (AR/SBC) was created. As a result of the creation of the ARES/PCJ, we are currently involved in legal proceedings in which ARES/PCJ is claiming that it has jurisdiction over the regulation and supervision of our activities in four municipalities (Piracaia, Mombuca, Santa Maria da Serra and Aguas de São Pedro). In 2016 we obtained a definitive favorable decision in the Piracaia proceeding and in 2018, we obtained a definitive favorable decision in the Mombuca and Santa Maria da Serra proceedings. However, as the debate continues in the Aguas de São Pedro proceeding, we cannot predict the outcome of this case or how it may affect our business. Furthermore, regional and municipal agencies may continue to be created and may dispute with ARSESP regarding the regulation and oversight of our services. See “Item 3.D. Risk Factor—Risks Relating to Our Business—Current regulatory uncertainty, especially with regard to implementation and interpretation of the Brazilian Basic Sanitation Law, may have an adverse effect on our business”.

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

consultation, proposing a preliminary initial maximum average tariff (P0) and X Factor, based on a preliminary evaluation of assets held by us.

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

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

On November 1, 2013, ARSESP issued Resolution No. 435/2013 which authorized us to implement a linear tariff adjustment increase of 3.1451% for tariffs beginning December 11, 2013.

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In April 2014, ARSESP issued Resolution No. 484/2014 (further ratified by ARSESP Resolution No. 520/2014). Considering the provisions of Resolution No. 484/2014, we decided to postpone the application of the repositioning index to an opportune date no later than the end of December 2014.

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

Taking into account the unusual situation in our industry as a result of the lack of rainfall and our measures to encourage water savings in order to ensure supply, we had to implement a series of measures, including the following:

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

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

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

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

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

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

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

(2) Resolution No. 615/2015, also published in December 2015, authorized the extension of the Water Consumption Reduction Incentive Program until December 31, 2016, or until hydrological conditions become more predictable, and updated of the reference consumption value used to determine when discounts should be offered to our customers.

Prior to this resolution, the reference consumption value by which we calculated the discounts was the average consumption of our customers in the period between February 2013 and January 2014. As of December 2015, we modified the reference consumption value, which was set at 78% of the prior reference consumption value. The updated reference consumption value began to be applied to our customers' bills as of February 1, 2016. The bonus ranges of 10%, 20% and 30%, were maintained, following the rules of our discount (bonus) program which established that if a client consumes 10% less water during a certain period compared to his reference consumption value, he will obtain a discount of 20% in his water bill, and if the client consumes 20% less water, he obtains a discount of 30%.

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

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

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



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

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

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

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

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

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

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

#### *Second Ordinary Tariff Revision (2017-2020)*

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

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

On October 6, 2017, ARSESP published the Final Technical Note NT/F/004/2017 and the Detailed Report on the first part of the Second Ordinary Tariff Revision. These publications set the initial regulatory remuneration asset base at

R\$40.3 billion (although this value was not final), increased the annual rate (WACC) from 8.06% to 8.11% and set the preliminary tariff revision (Preliminary P0) at R\$3.6386/m<sup>3</sup> using the April 2017 price. On October 10, 2017, ARESPP approved Resolution No. 753/2017, authorizing us to apply the tariff repositioning index of 7.8888%, effective on November 10, 2017.

On November 10, 2017, ARSESP authorized us to charge our customers for the Regulatory, Control and Inspection Fee (*Taxa de Regulação, Controle e Fiscalização*, or TRCF) by 0.5% including it in customer bills in the municipalities regulated by ARSESP, pursuant to Paragraph 2 of Article 2 of ARSESP Resolution No. 406/2013. This fee was initially established by the State Supplementary Law No. 1.025/2007.

With respect to the second stage of the Second Ordinary Tariff Revision, on March 26, 2018, ARSESP released Preliminary Technical Note NT/F/0004-2018 with the proposed calculation of the maximum average tariff (P0) and the X Factor. This technical note established a final regulatory asset base of R\$38.4 billion, a WACC of 8.11%, an X Factor of 0.9287%, a P0 of R\$3.8207/m<sup>3</sup> and a tariff repositioning index of 4.7744%. After Public Consultation and Public Hearings on the Final P0 proposal, ARSESP released, on May 9, 2018, Final Technical Note NT/F/0006/2018 and Resolution No. 794/2018, establishing a final regulatory asset base of R\$39 billion, a WACC of 8.11%, an X Factor of 0.8885%, a P0 of R\$3.7702/m<sup>3</sup> and a tariff repositioning index of 3.5070% effective on June 9, 2018.

On May 24, 2018, as a result of the final result of the Second Ordinary Tariff Revision, we filed: (i) an administrative appeal questioning the methodology utilized for applying the compensatory adjustment to revenue, electricity costs and investments made during the first tariff cycle; (ii) a request for clarification of the reasons leading to a significant reduction in OPEX projections for the period 2017-2020; (iii) a request to review estimates for the X Factor calculations of the compensatory adjustment for the delay in the application of the Second Ordinary Tariff Review; and (iv) a request to review the calculation of the financial component related to municipal funds, this one related to the contract with the municipality of São Paulo.

On February 28, 2019, ARSESP published the result of the applications filed on May 24, 2018 (described above). With regard to the administrative appeal, ARSESP decided not to accept its merits. Regarding the request for clarification and estimate review; ARSESP partially accepted our arguments and determined: (i) the correction of the X factor, reducing it from 0.8885% to 0.6920%; and (ii) to apply a compensatory adjustment of 0.8408% to the upcoming tariff adjustment to cover: a) the delay in the application of the Tariff Revision in the second cycle, specifically related to the capitalization of revenue differences after June 2018; and b) an adjustment in the reference price dates adopted in the OPEX calculation, from December 2017 to April 2017. The final results of an index of 0,8408%, to be applied at the same time as the annual tariff adjustment in May 2019.

On April 10, 2019, ARSESP issued Resolution No. 859/2019 which authorizes us to implement a tariff readjustment of 4.7242% to the current tariffs, comprised of: (i) IPCA variation in the period of 4.5754% effective (ii) efficiency factor (X Factor) of 0.6920%; and (iii) Compensatory adjustment of 0.8408%. This tariff readjustment will be effective on May 11, 2019.

#### *Regulatory Agenda*

On November 1, 2018, ARSESP opened public consultation No. 09/2018 with the objective of collecting contributions and opinions related to the proposal of the Regulatory Agenda ARSESP 2019-2020. The purpose of this Regulatory Agenda is to ensure transparency and participation by the society in the regulatory process and to give users of regulated public services, economic agents and other interested parties the opportunity to express their opinion, as well as to obtain subsidies that may provide a greater degree of reliability, clarity and security to the agency's decision-making process. On January 31, 2019, ARSESP announced the result of this public consultation (No. 09/2018) and among the subjects that were discussed are the regulatory criteria for the recognition as part of the tariffs of the transfers made to all municipal funds for environmental sanitation and infrastructure, expected to be concluded in the first half of 2019.

On February 8, 2019, ARSESP published the Public Consultation No. 02/2019, which aims to obtain contributions on the Regulatory Criteria for the recognition of the tariffs for the transfers to municipal funds for environmental sanitation and infrastructure. Our contributions to this Public Consultation were forwarded on March 11, 2019.

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

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

- In March 2013, ARSESP issued Resolution No. 407/2013, authorizing us to pass on to our consumers the 7.5% transfer to the Municipal Fund for Environmental Sanitation and Infrastructure, as defined by municipal legislation. Pursuant to the Sewage and Water Supply Service Contracts, this charge must be considered in the tariff revision.
- In April 2013, ARSESP issued Resolution No. 413/2013, which effectively suspended Resolution No. 407/2013 until the first tariff revision process is concluded, thereby postponing our authorization to pass on to our consumers' service bill the charge for the Municipal Fund for Environmental Sanitation and Infrastructure. The postponement of Resolution No. 407 was due to a request from the Government of the State of São Paulo to analyze, among other matters, methods of reducing the impact on consumers.

- In May 2014, ARSESP issued Resolution No. 488/2014, which maintained the suspension of ARSESP Resolution No. 407/2013 until the outcome of the revision of the contract signed between us, the city of São Paulo and the State of the São Paulo is known, thereby delaying the authorization to pass on to our consumers' service bill the charge for the Municipal Fund for Environmental Sanitation and Infrastructure. We cannot be certain when the contract will be revised or when we will be able to pass the 7.5% charge on to consumers through the service bill.
- In December 2016, we concluded the first four-year revision of our contract with the city of São Paulo, which altered our service quality, investment and investment tracking targets. However, the issue of the 7.5% charge was not discussed.
- In January 2018, the second step of our Second Ordinary Tariff Revision was initiated. In this review, the possibility of including the average tariff in the portion related to transfers to municipal funds, as is the case with the 7.5% that we transfer to the São Paulo Municipal Fund for Environmental Sanitation and Infrastructure, was discussed.
- On May 9, 2018 ARSESP announced the final results of the Second Ordinary Tariff Revision. Following this revision cycle, ARSESP will pass-through to the tariffs up to 4% of the municipal revenue that is transferred by us to a legally established municipal infrastructure fund. Our only contract that provides for this and complies with ARSESP's requirements is with the municipality of São Paulo and, accordingly, today 4% of the funds transferred to the São Paulo Municipal Fund for Environmental Sanitation and Infrastructure are being passed through to our tariffs.

- On May 24, 2018, as a result of the final result of the Second Ordinary Tariff Revision, we filed a reconsideration request as well as a clarification and revision request with ARSESP. As part of the clarification and revision request, we requested that ARSESP provide a revision of the calculation of the financial component related to municipal funds. On February 28, 2019, ARSESP rejected our reconsideration request and maintained their original calculation of the financial component related to municipal funds. For more information, see “Item 4.B. Business Overview—Tariffs—Second Ordinary Tariff Revision (2017-2020).”
- Considering the final results of the Second Ordinary Tariff Revision released on May 9, 2018, in the current tariff cycle (2017-2020) this 7.5% charge will not be passed in full through to customers.

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

### **Tariff Structure**

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

However, in the Public Consultation No. 09/2018, one of the topics included in the Regulatory Agenda 2019-2020 proposed by ARSESP is the preparation of studies and proposals for a review of our tariff structure and respective implementation plan. This subject is expected to be concluded in the first half of 2020.

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

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

We established a new tariff schedule, effective May 2002, for commercial and industrial customers that consume at least 5 thousand cubic meters of water per month and that enter into fixed demand agreements (take or pay) with us for at least one year terms, with the aim of retaining these industrial and commercial customers. In October 2007, the minimum volume for entering into these agreements was reduced from 5 thousand cubic meters per month to 3 thousand cubic meters per month. We believe this tariff schedule will help prevent our commercial and industrial customers from switching to the use of private wells. Since 2008, we have been authorized by ARSESP to establish

tariffs for non residential customers, such as industrial and commercial customers, that consume more than 3 thousand cubic meters per month, with a maximum tariff equal to the tariffs applicable to non residential customers that consume more than 50 cubic meters per month. In 2010, ARSESP authorized a reduction in the minimum volume of consumption for customers that enter into fixed demand agreements with us to a minimum of 500 cubic meters per month.

In May 2016, we reinitiated the fixed demand requirement, and the volumes of those contracts were revised according to clients' new consumption profiles. We started 2018 with 482 formal contracts and ended the year with 531 contracts. For more information about the water crisis, see “—The 2014-2015 Water Crisis”.

On November 2, 2018, ARSESP published Resolution No. 818/2018 which provides the criteria for the execution and inspection of contracts for the supply of water and sewage services for large users of non-residential use categories, governing the conclusion of new contracts and adjusting existing contracts to the new rules.

The ARSESP Resolution No. 818/2018 consolidates all the regulatory guidelines for the execution of contracts with large users, as well as establishing a system for the homologation of standard contracts setting out the transition rules for contracts already in force and determines the minimum and maximum limits for the fees that may be charged. Additionally, this resolution allows ARSESP to amend such contracts, in case of a restriction of the water supply, and require mandatory disclosure of the contracts, as well as the results of their inspections, on the website of the provider.

*Water and sewage services tariffs*

We establish separate tariff schedules for our services in each of the São Paulo metropolitan regions and each of the interior region of São Paulo State and coastal regions which comprise our Regional Systems, depending upon whether a customer is located in the São Paulo metropolitan region or the Regional Systems. Each tariff schedule incorporates regional cross subsidies, taking into account the customers' type and volume of consumption. Tariffs paid by customers with high monthly water consumption rates exceed our costs of providing water service. We use the excess tariff billed to high volume customers to compensate for the lower tariffs paid by low volume customers. Similarly, tariffs for non residential customers are established at levels that subsidize residential customers. In addition, the tariffs for the São Paulo metropolitan region generally are higher than tariffs in the interior region of São Paulo State and coastal regions. In 2018, 2017 and 2016, the average tariff calculated for the Regional Systems was approximately 25% below the average tariff of the São Paulo metropolitan region. Considering the current tariff structure this is also expected for 2019.

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

Customer Category Consumption	As of May 11,	As of June 9,	As of Nov 10,	As of May 12,
	2019	2018	2017	2016
Residential				
Standard Residential:				
0 10	2.62	2.50	2.42	2.24
11 20	4.10	3.91	3.78	3.50
21 50	10.23	9.77	9.44	8.75
Above 50	11.27	10.76	10.40	9.64
Social:				
0 10	0.89	0.85	0.82	0.76
11 20	1.53	1.46	1.41	1.31
21 30	5.43	5.19	5.01	4.64
31 50	7.74	7.39	7.14	6.62
Above 50	8.55	8.17	7.89	7.31
Shantytown ( <i>favela</i> ):				
0 10	0.68	0.65	0.63	0.58
11 20	0.77	0.73	0.71	0.66
21 30	2.56	2.44	2.36	2.19
31 50	7.74	7.39	7.14	6.62

Above 50	8.55	8.17	7.89	7.31
Non Residential				
Commercial/Industrial/Governmental:				
0 10 <sup>(1)</sup>	5.26	50.20	4.85	4.50
11 20	10.23	9.77	9.44	8.75
21 50	19.60	18.71	18.08	16.76
Above 50	20.42	19.50	18.84	17.46
Social Welfare Entities:				
0 10 <sup>(1)</sup>	2.63	2.51	2.42	2.25
11 20	5.11	4.88	4.71	4.37
21 50	9.84	9.40	9.08	8.42
Above 50	10.22	9.76	9.43	8.74
Government entities that employ the Rational Use of Water Program ( <i>Programa de Uso Racional da Água – PURA</i> ), with reduction agreement:				
0 10 <sup>(1)</sup>	3.94	3.76	3.63	3.37
11 20	7.66	7.32	7.07	6.55
21 50	14.74	14.08	13.60	12.61
Above 50	15.32	14.63	14.13	13.10

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

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

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



On November 10, 2017, ARSESP authorized us to charge our customers for the Regulatory, Control and Inspection Fee (*Taxa de Regulação, Controle e Fiscalização*, or TRCF) by 0.5% including it in customer bills in the municipalities regulated by ARSESP, pursuant to Paragraph 2 of Article 2 of ARSESP Resolution No. 406/2013. This fee was initially established by the State Supplementary Law No. 1.025/2007.

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

On April 10, 2019, ARSESP issued Resolution No. 859/2019 which authorizes us to implement a tariff readjustment of 4.7242% to the current tariffs, comprised of: (i) IPCA variation in the period of 4.5754% effective (ii) efficiency factor (X Factor) of 0.6920%; and (iii) Compensatory adjustment of 0.8408%. This tariff readjustment will be effective on May 11, 2019.

### **Government Regulations Applicable to our Contracts**

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

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

### **PLANASA**

The National Plan of Basic Sanitation (*Plano Nacional de Saneamento Básico*), or “PLANASA” was created in 1971, aiming to provide universal access to sanitation services in urban areas and to establish an adequate tariff policy, among other things. Afterwards, SABESP was created under State Law No. 119/1973 as a mixed capital company to provide basic sanitation services in the state of São Paulo while also acknowledging the autonomy of the municipalities within the State.

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

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

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

### ***The Basic Sanitation Law***

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

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

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

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

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

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

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

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

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

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

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

On December 28, 2018, Provisional Measure No. 868/2018 was issued with the same purpose of Provisional Measure No. 844/2018, which aims to amend the Basic Sanitation Law No. 11,445/2017; Law No. 9,984/2000, to attribute to the National Water Agency the power to enact national reference rules about the sanitation service; Law No. 10,768/2003 to change the role of the Water Resources Specialist; and Law No. 13,529/2017 to authorize the Federal Government to participate in the fund with the exclusive purpose to provide financial support for specialized technical services. This Provisional Measure is valid until June 3, 2019 and its conversion into law is pending approval by the National Congress. Although this Provisional Measure has been in force since the date of its publication, it is not yet possible to predict how it will impact contracts that we may enter into while the measure is in force.

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

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

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

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

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

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

Concessions for providing water and sewage services are formalized by agreements executed between the state or municipality, as the case may be, and a concessionaire to which the performance of these services is granted in a given municipality or region. Our concessions normally have a contractual term of up to 30 years. However, our concessions in general can be revoked unilaterally at any time if certain standards of quality and safety are not met, in the event of default of the terms of the concession agreement, or due to changes in public interest since the concession was granted.

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

### ***Program Agreements***

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

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

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

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

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

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

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

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

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

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

The state of São Paulo, pursuant to Article No. 25, Paragraph 3 of the Brazilian Constitution, enacted the State Supplementary Law, or “LCE”, to create the metropolitan regions of São Paulo (LCE No. 94/1974), Baixada Santista (LCE No. 815/1996), Campinas (LCE No. 870/2000), Vale do Paraíba and Litoral Norte (LCE No. 1,166/2012), Sorocaba No. (LCE No. 1,241/2014) and Ribeirão Preto (LCE 1,290/2016), and the urban clusters of Jundiaí (LCE No. 1,146/2011), Piracicaba (LCE No. 1,178/2012) and Franca (LCE No. 1,323/2018).

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

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



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

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

In January 2015, the Federal Government issued the Metropolitan Bylaws (Law No. 13,089/2015), amended by Provisional Measure No. 818 of January 11, 2018, which was subsequently converted into Federal Law No. 13,683/2018 and by Provisional Measure No. 862 of December 4, 2018, establishing within the term of five years, counted from the date of the institution of the metropolitan region or urban cluster: (i) the general guidelines for the planning, management and performance of public initiatives in metropolitan regions and in urban clusters instituted by the states; (ii) the general planning standards for integrated urban development and other intergovernmental instruments; and (iii) the criteria to receive federal loans related to urban development. In addition, the Metropolitan Bylaws foresees mechanisms for integrated management and intergovernmental governance as well as the sharing of decisions by regional entities.

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

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

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

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

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

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

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

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

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

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

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

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

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

In 2009, ARSESP enacted rules regarding the following:

- general terms and conditions for water and sewage services;
- procedures for communication regarding any failure in our services;
- penalties for deficiencies in the provision of basic sanitation services; and
- procedures for confidential treatment of our customers' private information.

The implementation of these and other more recent rules will particularly impact our commercial and operational processes and may adversely affect us in ways we cannot currently predict. Implementation of these rules started in 2011 and is expected to continue for the next few years.

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

In 2011, ARSESP altered the standard contract that we are required to use in our relationships with retail customers. This alteration requires that invoices be sent to the user of the service rather than the owner of the property connected to the public water supply and sewage systems. Since 2011, we have implemented several measures and instituted new rules to update our client registry. Currently, more than 90% of our water and sewage connections are billed to the user of our services, as foreseen under current regulations. Related to the collection of debt, we are also faced with

the challenge of collecting customers' taxpayer identification numbers, which are required to register for our services and are needed for the judicial collection of outstanding fees in the event of nonpayment. We continuously update our customers' registration information, but we face difficulties in updating this information in areas with high concentrations of social vulnerability and noncompliance.

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

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

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

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

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

### *Our Current Concession Agreements*

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

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

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

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

- the book value of the assets; or

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

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

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

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

As of December 31, 2018, we provided water and sewage services to 369 municipalities. The majority of these concessions have 30-year terms. Due to court orders, we temporarily suspended our services in two other municipalities (Macatuba and Cajobi). For more information, see “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”. Between January 1, 2007 and December 31, 2018, we entered into agreements with 307 municipalities (including our services agreement with the city of São Paulo) in accordance with the Basic Sanitation Law, of which twenty were entered into in 2018. As of December 31, 2018, these 307 municipalities accounted for 81.1% of our gross operating revenues (including revenues relating to the construction of concession infrastructure). In addition to the contracts that have 30-year terms, the municipalities entered into cooperation contracts with the State of São Paulo, delegating the regulation and monitoring of the provision of services to ARSESP. As of December 31, 2018, 35 of our agreements or concessions had expired but we continued to provide water and sewage services to these municipalities and were in negotiations to execute program agreements to substitute the expired concessions. From December 30, 2019 through 2030, 31 concessions will expire.

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

The receivables owed to us by Mauá, due to the termination of the concession, total R\$85.9 million and have not been recognized in our financial statements due to the uncertainty of our ability to collect them as of December 31, 2018. Despite these developments, we currently supply water on a wholesale basis to Mauá. In January 2016, the municipality of Mauá executed a Protocol of Intentions with us for the preparation of studies and evaluations aiming to resolve commercial relations and existing debts between the municipality and us. However, the negotiations with Mauá ended June 2016. On April 19, 2018, we published a press release stating that we have been in contact with the municipality of Mauá regarding directly supplying water to four neighborhoods that have been affected by a water shortage and to date no agreement was entered into to supply water to those neighborhoods.

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

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

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

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

The state of São Paulo, pursuant to Article No. 25, Paragraph 3 of the Brazilian Constitution, enacted the State Supplementary Law, or “LCE”, to create the metropolitan regions of São Paulo (LCE No. 94/1974), Baixada Santista (LCE No. 815/1996), Campinas (LCE No. 870/2000), Vale do Paraíba and Litoral Norte (LCE No. 1,166/2012), Sorocaba No. (LCE No. 1,241/2014) and Ribeirão Preto (LCE 1,290/2016), and the urban clusters of Jundiaí (LCE No. 1,146/2011), Piracicaba (LCE No. 1,178/2012) and Franca (LCE No. 1,323/2018).

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

In January 2015, the Federal Government issued the Metropolitan Bylaws (Law No. 13,089/2015), amended by Provisional Measure No. 818 of January 11, 2018, which was subsequently converted into Federal Law No. 13,683/2018 and by Provisional Measure No. 862 of December 4, 2018, establishing within the term of five years, counted from the date of the institution of the metropolitan region or urban cluster: (i) the general guidelines for the planning, management and performance of public interest initiatives in metropolitan regions and in urban clusters instituted by the states; (ii) the general planning standards for integrated urban development and other interfederal governance instruments; and (iii) the criteria to receive federal loans related to urban development. However, this provision was repealed by Federal Law No. 1,368/2000.



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

However, this decision is not yet fully effective, as a ruling on a motion for clarification is currently pending, and therefore does not yet alter the legislative framework regarding basic sanitation that is currently in effect for the State of São Paulo. The São Paulo metropolitan region (including the municipalities to which we provide water on a wholesale basis, but excluding the concession infrastructure construction revenue) accounted for 72.2% of our gross operating revenue from services in 2018.

We cannot predict how the shared management of these operations will be carried out in the São Paulo metropolitan region and other metropolitan regions we operate in or what effect it may have on our business, financial condition or results of operations. See “Item 3.D. Risk Factors—Risks Relating to Our Business—Current regulatory uncertainty, especially with regard to implementation and interpretation of the Brazilian Basic Sanitation Law, may have an adverse effect on our business”.

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

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

On December 16, 1996, the Governor of the State of São Paulo issued the decree No. 41,446/1996, which updated the existing tariff system and allowed us to continue to set our own tariffs. Our tariffs are based on the general objectives of maintaining our financial condition and preserving “social equality” in terms of the provision of water and sewage services to the population while providing a return on investment. The governor’s decree also directs us to apply the following criteria in determining our tariffs:

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

With the enactment of the Basic Sanitation Law and Federal Consortium Law, we are prohibited from planning, overseeing and regulating services, which includes determining the tariff policy to be adopted. Such activities are to be exercised by the owner of the concession. Except for the responsibility for planning, the remaining activities may be delegated.

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

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

The municipalities in which the hydrographic basins of the Piracicaba, Capivari and Jundiá rivers are located created a consortium known as the Regulatory Agency of Sanitation Services for the Piracicaba, Capivari and Jundiá River Basin (*Agência Reguladora dos Serviços de Saneamento das Bacias dos Rios Piracicaba, Capivari e Jundiá*), or ARES-PCJ, in 2011 to regulate and supervise our activities in those areas, and for similar purposes, in November 2013 the Regulatory Agency of São Bernardo do Campo (AR/SBC) was created. As a result of the creation of ARES/PCJ, we are currently involved in legal proceedings in which ARES/PCJ is claiming that it has jurisdiction over the regulation and supervision of our activities in four municipalities (Piracaia, Mombuca, Santa Maria da Serra and Aguas de São Pedro). In 2016 we obtained a definitive favorable decision in the Piracaia proceeding and in 2018, we obtained a definitive favorable decision in the Mombuca and Santa Maria da Serra proceedings. However, as the debate continues in the Aguas de São Pedro proceeding, we cannot predict the outcome of this case or how it may affect our business. See “Item 3.D. Risk Factors—Risks Relating to Our Business—Current regulatory uncertainty, especially with regard to implementation and interpretation of the Brazilian Basic Sanitation Law, may have an adverse effect on our business”.

### **The 2014-2015 Water Crisis**

Prior to 2014, we planned our supply of water to the São Paulo metropolitan region based on the water supply during the driest period on record, which was from 1953 to 1954. However, water inflow to the Cantareira reservoirs throughout 2014 and most of 2015 was less than half the inflow recorded in 1953, the previous most critical year. Consequently, the volume of water stored in the reservoirs in 2014 and 2015 declined significantly until September 2015, when the reservoirs once again held more water than 12 months previously for the first time since the beginning of the water crisis. In the rainy season from October 2015 to March 2016 rainfall returned to historical levels and water levels in the reservoirs that provide water to the São Paulo metropolitan region, our largest market, increased. With the return of rainfall to the level of water in the reservoirs that provide water to the population of the São Paulo metropolitan region at normal levels, the measures taken during the water crisis to continue services to consumers were gradually discontinued. As of December 31, 2018, the reservoirs in the São Paulo metropolitan region contained 943.3 million m<sup>3</sup> of water storage for treatment (including the São Lourenço System – a new supply system which expands our production capacity by 6 m<sup>3</sup>/s, and which commenced operations in July 2018), compared to 916.8 million m<sup>3</sup> available for treatment as of December 31, 2017 not including the technical reserve of 287.5 million m<sup>3</sup>. The average monthly water production in 2018 for the São Paulo metropolitan region was 60.9 cubic meters per second, or m<sup>3</sup>/s, compared to 60.6 m<sup>3</sup>/s in 2017 and 58.5 m<sup>3</sup>/s in 2016.

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

#### *Cantareira System*

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

Prior to February 2014 and the water crisis, this system supplied water to approximately 8.9 million people, with an average extraction of up to 33 m<sup>3</sup>/s to serve the São Paulo metropolitan region. After the water crisis, when conditions returned to normal levels, this system supplies water to approximately 6.8 million people, with an annual average

water production of up to 23.9 m<sup>3</sup>/s in 2018 in order to serve the São Paulo metropolitan region. The volume of water that may be extracted from the Cantareira System is now based on the volume of water available in the reservoirs. A minimum of 10 m<sup>3</sup>/s of water may be released to serve the metropolitan region of Campinas and Jundiaí, which is located downstream from the reservoirs. This flow is defined in Joint Resolution Nos. 926/2017 and 925/2017, both dated May 29, 2017. See “Item 3.D. Risk Factors—Risks Relating to Our Business”.

*Water Inflow to the Cantareira System*

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

The table below sets forth water inflow (