

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”.

|  | For the year ended December 31,  |           |           |           |           |
|--|--|-----------|-----------|-----------|-----------|
|  | 2018   | 2017      | 2016      | 2015      | 2014      |
|  | R\$  | R\$       | R\$       | R\$       | R\$       |
|  | <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<br>(in millions of cubic meters)           |        |        |        |
| Water Billed Loss Index during period<br>(average) (in percent) <sup>(3)</sup>  | 19.5   | 20.1   | 20.8   |
| Water Metered Loss Index during period<br>(average) (in percent) <sup>(4)</sup> | 30.1   | 30.7   | 31.8   |
| Water loss per connection per day<br>(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.

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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,<br/>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.

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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<br>Water Program ( <i>Programa de Uso Racional da Água –<br/>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.

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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 (volume of water that flows into the reservoirs or natural inflow from the river basin), showing: (i) historical average and minimum flows; (ii) 1953, previously the driest year on record; (iii) inflow during the 2013-2014, 2014-2015, 2015-2016, 2016-2017 and 2017-2018 hydrological year; and (iv) inflow during the 2018-2019 hydrological year (through March 2019):

|                     | For the month of            |      |      |      |      |       |       |      |      |      |      |      |
|---------------------|-----------------------------|------|------|------|------|-------|-------|------|------|------|------|------|
|                     | Oct.                        | Nov. | Dec. | Jan. | Feb. | March | April | May  | June | July | Aug. | Sep. |
|                     | <i>(in m<sup>3</sup>/s)</i> |      |      |      |      |       |       |      |      |      |      |      |
| <b>Water Inflow</b> |                             |      |      |      |      |       |       |      |      |      |      |      |
| Historical Average  | 30.0                        | 34.4 | 52.1 | 69.4 | 72.3 | 65.9  | 47.3  | 37.7 | 35.0 | 28.2 | 24.0 | 25.0 |
| Historical          |                             |      |      |      |      |       |       |      |      |      |      |      |
| Minimum             | 14.0                        | 14.0 | 21.8 | 26.9 | 27.6 | 28.1  | 24.7  | 19.9 | 16.5 | 13.9 | 12.0 | 11.8 |
| Drought of 1953     | 17.5                        | 26.0 | 31.5 | 26.9 | 34.5 | 29.8  | 34.6  | 23.8 | 20.7 | 17.6 | 16.3 | 16.2 |
| 2013/14             | 25.1                        | 22.1 | 22.5 | 15.4 | 10.5 | 18.9  | 17.2  | 10.1 | 10.0 | 6.4  | 8.2  | 9.0  |
| 2014/15             | 5.2                         | 8.8  | 16.0 | 11.5 | 40.7 | 42.6  | 18.1  | 14.0 | 16.2 | 11.3 | 5.8  | 18.3 |
| 2015/16             | 14.8                        | 27.1 | 52.3 | 73.8 | 49.6 | 69.8  | 24.1  | 25.0 | 62.9 | 19.4 | 19.3 | 14.9 |
| 2016/17             | 24.2                        | 29.5 | 30.2 | 76.0 | 36.4 | 36.9  | 24.3  | 33.8 | 22.6 | 13.9 | 14.9 | 9.0  |
| 2017/18             | 13.7                        | 23.0 | 18.8 | 57.4 | 35.8 | 33.2  | 17.5  | 13.7 | 20.1 | 15.6 | 20.1 | 17.9 |
| 2018/19             | 30.9                        | 33.0 | 40.8 | 41.5 | 43.5 | 56.2  |       |      |      |      |      |      |

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

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, compared to 916.8 million m<sup>3</sup> (including the São Lourenço System – a new supply system with 59.0 million m<sup>3</sup>) available for treatment as of December 31, 2017. These figures do not include the Cantareira System's technical reserve of 287.5 million m<sup>3</sup>.

The following table shows the volume of water stored in the systems that serve the São Paulo metropolitan region as of March 2016, December 2016, March 2017, December 2017, March 2018, December 2018 and March 2019 at the end of the rainy season:

|              | For the month |               |            |               |            |               | Total Storage Capacity |                           |
|--------------|---------------|---------------|------------|---------------|------------|---------------|------------------------|---------------------------|
|              | March 2019    | December 2018 | March 2018 | December 2017 | March 2017 | December 2016 |                        |                           |
| Cantareira   | 542.4         | 387.8         | 532.3      | 405.2         | 931.9      | 740.1         | 641.9                  | 1,269.5 <sup>(1)(2)</sup> |
| Guarapiranga | 155.8         | 103.3         | 141.4      | 101.6         | 135.4      | 123.6         | 150.0                  | 171.2                     |
| Rio Grande   | 113.1         | 92.4          | 97.2       | 92.2          | 98.9       | 99.3          | 108.4                  | 112.2                     |
| Rio Claro    | 13.9          | 10.9          | 13.9       | 10.1          | 13.9       | 11.3          | 14.0                   | 13.7                      |
| Alto Tietê   | 511.9         | 282.6         | 362.8      | 294.8         | 314.6      | 248.1         | 247.9                  | 573.8                     |
| Cotia        | 16.8          | 7.1           | 15.2       | 12.9          | 16.4       | 16.2          | 16.5                   | 16.5                      |
| São Lourenço | 87.3          | 59.1          | -          | -             | -          | -             | -                      | -                         |

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

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

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

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

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

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

The rain levels and water inflows into the reservoirs that supply the metropolitan region of São Paulo during the October 2018-March 2019 rainy season were at the historical average, when taking into account the accumulated volume, the completion of the São Lourenço Project and the Jaguari-Atibainha interconnection, a greater capacity of water transfer between the water producing systems, and the lower level of water production due a lower average water consumption by the population, we believe that in terms of water security, the Metropolitan Region is prepared to face situations of similar magnitude as those observed in 2014 and 2015 in the future.

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

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

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

The Guarapiranga System, with a storage capacity of 171 billion liters, maintained favorable levels of water availability for the duration of the drought and was the system that supplied most water during the water crisis, serving an additional 1.4 million people in the south and southeast regions of the city of São Paulo who had previously been served by the Cantareira System. As a result, the number of people served by the Guarapiranga System increased from 3.8 million before the water crisis to 5.2 million during the crisis. As of December 31, 2018, the Guarapiranga System served a population of 4.6 million people.

Throughout 2014 and 2015, with the adoption of these measures, almost three million people who used to be served by the Cantareira System began to be served by other systems. As of December 31, 2018, the Cantareira System served 6.8 million people, compared to 8.9 million people before the drought in February 2014.

#### Bonus Program

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

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

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

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

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



On March 24, 2016, with the return of rainfall to historical levels and increased predictability of reservoir levels, we applied to ARSESP for cancellation our Water Consumption Reduction Incentive Program. ARSESP approved this request on March 31, 2016, with effect on water meter readings recorded as of May 1, 2016.

#### Contingency Tariff

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

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

On March 24, 2016, with the return of historical average rainfall and increased predictability of reservoir levels, we applied to ARSESP for cancellation of the Contingency Tariff. ARSESP approved this request on March 31, 2016, with effect on water meter readings recorded as of May 1, 2016.

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

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

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

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

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

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

#### Extracting Water from the Technical Reserve

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

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

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

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

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

The main projects include:

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- Alto Tietê System – transfer of an additional 1 m<sup>3</sup>/s from the Guaió River to the Taiaçupeba reservoir, in order to recover the reserve volume of the Alto Tietê System. This project was concluded in June 2015.
- Alto Tietê System – transfer of additional up to 4.0 m<sup>3</sup>/s from Rio Grande - Billings reservoirs to the Alto Tietê System. This project was concluded in September 2015.
- Guarapiranga System – transfer of an additional 1 m<sup>3</sup>/s of which results from the expansion of the transfer capacity of the Billings reservoir to the Guarapiranga reservoir. This project was concluded in December 2015.
- Interconnection of the Jaguari and Atibainha reservoirs – the purpose of this project is to recover water levels and increase the water security of the Cantareira System. The interconnection increases water availability in the Cantareira System by 5.13 m<sup>3</sup>/s (annual average) to 8.5 m<sup>3</sup>/s (maximum) by transferring water from the Jaguari reservoir to the Atibainha reservoir. Construction of the interconnection began in February 2016 and was completed in March 2018. Upon completion of construction, we began transferring water from the Jaguari reservoir (part of the Paraíba do Sul Basin) to the Atibainha reservoir (part of the PCJ River Basin). For more information, see “Item 4.A. History and Development of the Company—Capital Expenditures Program”.
- Alto Tietê System – transfer of an additional average 1.9 m<sup>3</sup>/s and up to 2.5 m<sup>3</sup>/s from the Itapanhaú river to the Biritiba reservoir, providing more volume to the Alto Tietê System. In 2017, we finalized the bidding process that selected the consortium that 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.
- Implementation of the São Lourenço Production System – this project was commenced in April 2014 and was completed in April 2018 and operations began in July 2018. This system has an average water treatment capacity of 6.0 m<sup>3</sup>/s. For more information, see “Item 4.A. History and Development of the Company—Capital Expenditures Program”.

#### *The Drought Committee*

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

The Drought Committee’s main purposes were exchanging information and planning joint actions between its members in relation to any drought affecting regions in the state. However, due to the end of the water crisis, this committee is not operating anymore.

#### **Marketing Channels**

As of December 31, 2018, we were the concessionaire for the provision of water supply and collection, treatment and disposal of sewage services directly to end consumers for 369 municipalities in the state of São Paulo. We also supplied water on a wholesale basis to five municipalities located in the São Paulo metropolitan region, including Guarulhos. It is the responsibility of these municipalities to then distribute the water to end consumers. We provide sewage services to four of these municipalities. Because of our distribution infrastructure, end consumers to whom we offer water services on a wholesale basis cannot alternatively acquire such services directly from us. For more information on service concessions, see “—Wholesale Operations”.

#### **Energy Consumption**

Energy is essential to our operations, and as a result we are one of the largest users of energy in the state of São Paulo. In the year ended December 31, 2018, we used approximately 1.9% of the total energy consumption in the state of São Paulo. To date, we have not experienced any major disruptions in energy supply. Any significant disruption of energy to us could have a material adverse effect on our business, financial condition, results of operations or prospects. Energy prices have a significant impact on our results of operations. In 2018, we purchased

approximately 55% of our total energy consumption in the “free market”, where we can more efficiently negotiate the supply of energy; and the remainder of our energy consumption comes from the Regulated Market. This allowed us to save approximately R\$183 million in 2018, compared to what we expect we would have spent if we purchased all of our total energy consumption in the Regulated Market.

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

### **Insurance**

We maintain insurance covering, among other things, fire or other damage to our property and office buildings and third party liability. We also maintain insurance coverage for directors’ and officers’ liability (D&O insurance). We currently obtain our insurance policies by means of public bids involving major Brazilian and international insurance companies that operate in Brazil. As of December 31, 2018, we had paid a total aggregate amount of R\$5.0 million in premiums. In addition, we paid R\$1.6 million for a D&O insurance policy, covering R\$3.1 billion in assets, third party liabilities and D&O insurance. We do not have insurance coverage for business interruption risk because we do not believe that the high premiums for such insurance are justified by the low risk of major interruption of our activities. In addition, we do not have insurance coverage for liabilities arising from water contamination or other problems involving our water supply to customers and for environmental related liabilities and damages. We believe that we maintain insurance at levels customary in Brazil for our type of business.

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## Intellectual Property

### *Trademarks*

We have secured registration of our logo and composite trademark (“Sabesp”) at the Brazilian Institute of Industrial Property (*Instituto Nacional da Propriedade Industrial*), or INPI. In addition, we have registered with the INPI several other trademarks, such as: “Sabesp Soluções Ambientais”, “Projeto Tietê”, “Programa Córrego Limpo”, “Programa Onda Limpa”, “Prol – Programa de Reciclagem do Óleo de Fritura”, “Revista DAE”, “Ligação Sabesp”, “Agente da Gente – Sabesp Comunidade”, “PURA – Programa de Uso Racional da Água”, “Sabesp Inteligência Ambiental”, “Uso Racional da Água”, “Parque da Integração”, “Sabesp Semana do Meio Ambiente”, “Água Sabesp Aquífero Guarani”, “Água Sabesp Estação Cantareira”, “Contrato de Fidelização Sabesp”, “Esgoto não Domésticos Sabesp”, “PEA – Programa de Educação Ambiental – Sabesp”, “Sabesp Abraço Verde”, “Água de Reúso Sabesp”, “Eu Sou Guardião das Águas Sabesp Eu Não Desperdiço”, “Calculadora de Sonhos”, “Parque Sabesp Mooca”, “Parque Sabesp Butantã”, “Parque Sabesp Cangaíba”, “Programa Água Legal Sabesp”, “Signos Sistema de Informação Geográfica no Saneamento Sabesp”, “Sistema de Suporte a Decisões Sabesp” and “Clubinho Sabesp”, which is a tool for environmental education directed to children through our website, and of its characters: “SuperH2O”, “Gota Borrallheira”, “Gotucho”, “Ratantan”, “Dr. Gastão”, “Cauã”, “Denis”, “Gabi”, “Iara” and “Cadu”.

We have also filed applications with the INPI for registration of the following trademarks: “Acertando suas contas com a Sabesp”, “Fertilizante Sabesfértil Sabesp”, “Pitch Sabesp”, “Novos Negócios Sabesp”, “Centrais de Geração, Hidrelétrica Sabesp”, “Biogás Sabesp”, “Energia Fotovoltaica Sabesp”, “Energia Eólica Sabesp”, “Resíduos Sólidos Urbanos Sabesp”, “Fertilizantes Sabesp”, “Tocha de Plasma Sabesp”, “Serviços Técnicos Sabesp”, “Afinidades Sabesp”, “Fibra Ótica nas Redes Sabesp”, “Geosabesp Sabesp”, “Serviços Imobiliários Sabesp”, “Waste To Energy Sabesp”, “Esgoto não Doméstico Sabesp” and “Redução de Perdas Sabesp”.

### *Patents*

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

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

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

*Software*

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

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

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Among them, we highlight:

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

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

### ***Domain Names***

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

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

- [www.clubinhosabesp.com.br](http://www.clubinhosabesp.com.br); and
- [www.superh2o.com.br](http://www.superh2o.com.br).

### **Environmental Matters**

Our environmental management, which is guided by the directives established in our environmental policy, is inherent to the provision of our services and the essence of our business. In order to consolidate our environmental culture, we have an Environmental Corporate Management Department and Environmental Management Teams allocated in our business units. Our environment management is based in two pillars of action: (i) environmental compliance and (ii) change of environmental culture. We prioritize the internal and external dissemination of knowledge and experience on the best environmental practices. There are actions of our environmental management corporate program that rely on the involvement of collaborators, the communities we service and partnerships with non-governmental organizations.

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We have the following ongoing environmental management programs:

- development of the Corporate Greenhouse Gas Management Program (*Programa Corporativo de Gestão de Emissões de Gases de Efeito Estufa*), in line with the guidelines from the São Paulo State Climate Change Policy (PEMC), including the preparation of inventories of greenhouse gases, totaling 11 inventories concluded since 2007;
- continuation of the actions set forth in the corporate programs for obtaining and maintaining environmental licenses and grants for the right to use water;
- the Environmental Education Program (*PEA-SABESP*), an important tool for strengthening the effectiveness of our sanitation activities, which propitiates connections with the communities we service through over several environmental education projects. The activities developed by the PEA are organized with the following objectives: increment the intrinsic value of water; protect the environment; preserve the streams; improve the quality of the environment; valorize sanitation activities; valorize the conscious use of water; direct capacitation and production of guiding material;
- Management of our institutional representation in the State and National Systems of Water Resources, including training of company representatives to participate in: (i) the creation of criteria for water usage charges, (ii) preparation and review of river basin plans (*Planos de Bacias*), (iii) review of water bodies' classifications, and (iv) analysis of legislations regarding the protection of water sources;
- the SABESP 3 Rs Program (*Programa SABESP 3Rs*) for the reduction, re use and recycling of waste from administrative activities, in partnership with waste and recycling collecting cooperatives and which includes employee training enabling them to act as multipliers in the roll-out of the program;
- the progressive implementation and maintenance of the Environmental Management System (EMS) in our water and sewage treatment plants. Since 2015, we have been working on the EMS with a mixed model, whereby the ISO 14001 standard is applied to a limited number of certified plants, while the other stations adopt their own environmental management model (named SGA-SABESP), without aiming certification. The EMS is currently in place in 271 treatment plants, 35 of which are ISO 14001 certified. We expect to implement the EMS in all stations by 2024, which may expand the scope of ISO 14001 certifications according to the strategy of the Business Units; and
- implementation of the Regularization of the Terms of Commitment for Environmental Recovery Corporate Program, based on obligations of forest restoration with environmental compensation purposes, when necessary, for the environmental licensing of new enterprises. This program includes the planting and maintenance of 1 million seedlings of native species in the period of ten years, in order to deal with current obligations, as well as to new environmental compensations for the implementation of new projects. The action is part of the Springs Program (*Programa Nascentes*) created by the Government of the State of São Paulo. Currently 416 thousand seedlings have been planted and are being maintained in the Cantareira System, in the surroundings of the Cachoeira Reservoir, additionally to other 58 thousand in the municipality of Igaratá, located in Paraíba Valley. The planting and maintenance of other 150 thousand more seedlings around Cachoeira Reservoir and 110 thousand more in the municipality of Mirante do Paranapanema have all been contracted.

In addition to corporate environmental management initiatives, we have several projects and initiatives underway to benefit the environment by engaging the population at large.

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

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

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

In 2018, we concluded the corporate inventory of greenhouse gases for 2017, thus totaling 11 inventories since 2007. We noted that the trend observed in the previous inventories persists, specifically that activities regarding sewage collection and treatment remain our largest sources of greenhouse gas release, representing approximately 89.3% of total greenhouse gas release. Electric energy represents approximately 9.1% and other activities represent approximately 1.6%.

We have projects in the research and development stages that entail using biogas generated in the treatment of sewage and recycling sewage sludge as a possible way to reduce the gases released in the treatment processes, among other technological resources to reduce the amount of sludge disposed in landfills. We also have initiatives to reduce our emission of greenhouse gases, such as the coverage of stabilization ponds and drying of sludge by solar irradiation and the processing of biogas for vehicular use.

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

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

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

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

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

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

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

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

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

***Public Bidding Procedures***

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

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

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

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

On June 30, 2016, Federal Law No. 13,303/16 came into force in Brazil. This law sets new corporate governance standards for Brazilian government-owned and mixed capital companies like our company, as well as their subsidiaries. Federal Law No. 13,303/16 also sets new rules that these companies must follow in public bidding procedures and when contracting third parties. These requirements were implemented by June 30, 2018.

#### ***Water Usage***

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

- rational utilization of water resources, ensuring that their primary use is to supply water to the population;
- optimizing the economic and social benefits resulting from the use of water resources;
- protection of water resources against actions which could compromise current and future use;
- defense against critical hydrological events which could cause risk to the health and safety of the population or economic and social losses;
- development of hydro transportation for economic benefit;
- development of permanent programs of conservation and protection of underground water against pollution and excessive exploitation; and
- prevention of soil erosion in urban and rural areas, with a view to protecting against physical pollution and silting of water resources.

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

In conducting our principal activities, we have the majority of grants for the rights to use water, and there is a multi-annual corporate program in place to obtain and maintain the rights to use water to comply with current regulations. There are requests to obtain grants under analysis by DAEE and ANA.

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

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

Charging for the use of water is under gradual implementation by the State of São Paulo, where the largest individual contributors are located, and it is a management tool of the Policy on Water Resources to promote the rational use of water and finance programs and actions established by the basin plans. In 2018, we paid approximately R\$78.7 million for the use of water resources.

Charging for the use of water from rivers of federal domain began in 2003 in the Paraíba do Sul basin, and charging for the use of water from rivers of state domain began in 2007 in the Paraíba do Sul, Piracicaba, Capivari and Jundiá basins. Subsequently, charges were implemented for the use of water from the Sorocaba and Médio Tietê, Baixo Tietê and Baixada Santista river basins. In 2014, charges were implemented for the use of water from the Alto Tietê river basin, and in 2016, from the Tietê / Batalha, Tietê / Jacaré and Ribeira de Iguape river basins. In 2017, charges were implemented for the use of water from the Sapucaí Mirim/Grande, Baixo Pardo/Grade, Mogi Guaçu and Pardo river basins. In 2018, the charge of the Turvo Grande/Médio Paranapanema/Pontal do Paranapanema committees was implemented, and the implementation of the charge in the Litoral Norte, São José dos Dourados e Alto Paranapanema river basins is expected for 2019.

### ***Water Quality***

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

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

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

### ***Environmental Regulation***

The implementation and operation of water and sewage systems are subject to strict federal, state and municipal laws and regulations on environmental and water resource protection. The National Environmental Council (*Conselho Nacional de Meio Ambiente*), or the CONAMA, is the federal agency responsible for the regulation of potentially polluting activities. In the state of São Paulo, CETESB is the governmental entity responsible for the control, supervision, monitoring and licensing of polluting activities, pursuant to State Law No. 997/1976, as amended by State Decree No. 62,973/2017 and State Law No. 13,542/2009.

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

water and interfere in water resources on the State and federal level, respectively.

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

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

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

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

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

#### *Sewage Requirements*

State law sets forth regulations regarding pollution control and environmental preservation in the state of São Paulo. According to this law, in areas in which there is a public sewage system, all effluents of a “polluting source” must be discharged to such system, as is the case for industrial enterprises. It is the responsibility of the polluting source to connect itself to the public sewage system. All effluents to be discharged are required to meet the standards and conditions established by the applicable environmental law, which allows such effluents to be treated by our treatment facilities and discharged in an environmentally safe manner. Effluents that do not comply with such criteria are prohibited from being discharged into the public sewage system. State legislation also establishes that liquid effluents, except those related to basic sanitation, be subjected to pre treatment so that they meet the required mandatory levels before being discharged into the public sewage system. Effluents from our treatment facilities must comply with effluent limitation guidelines and meet the water quality standards of the receiving water bodies established by federal and state legislation. See “—Sewage Operations—Sewage System”.

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

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

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

CMN Resolution No. 4,589/17 dated as of June 29, 2017, which replaced CMN Resolution No. 2,827/2001 dated as of March 30, 2001, as amended, limits the amount that Brazilian financial institutions may lend to public sector companies, such as us. Financing of projects which are put up for international bid and any financing in *reais* provided to the Brazilian counterpart of such international bids are excluded from these limits.

#### *Scope of Business*

State Law No. 12,292/2006, dated as of March 2, 2006, and amended State Law No. 119/1973, dated as of June 29, 1973, which created our Company, authorizes us to provide water and sewage services outside the state of São Paulo (in other states of Brazil and other countries). This law also authorizes us to own interests in other public or private public companies and Brazilian or international consortia. In addition, this law permits us to incorporate subsidiaries and enter into a partnership with or acquire interests in a private company with a corporate purpose related to the sanitation business.

### **C. Organizational Structure**

Not applicable.

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

Our principal property, plant and equipment comprise administrative facilities which are stated at historical costs less depreciation. The reservoirs, water treatment facilities, water distribution networks consisting of water pipes, water transmission lines, water connections and water meters, sewage treatment facilities, and sewage collection networks consisting of sewer lines and sewage connections are recorded as intangible assets (concession assets). As of December 31, 2018, we operated through 75,519 kilometers of water pipes and water transmission lines and 51,788 kilometers of sewer lines. As of the same date, we operated 247 water treatment facilities and 565 sewage treatment facilities (including nine ocean outfalls), as well as 16 water quality control laboratories.

As of December 31, 2018, the total net book value of our property, plant and equipment, intangible assets (including concession assets) and contract assets was R\$36,688.0 million.

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

**ITEM 4A. UNRESOLVED STAFF COMMENTS**

Not applicable.

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

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

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

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

#### **Overview**

As of December 31, 2018, we operated water and sewage systems in the state of São Paulo, including in the city of São Paulo, Brazil’s largest city. Our operations extended into a total of 369 municipalities, or 57% of all municipalities in the state. We also provided water services on a wholesale basis to five municipalities located in the São Paulo metropolitan region in which we did not operate water distribution systems. In December 2018, we entered into an agreement with the municipality of Guarulhos, previously served on a wholesale basis, for the direct supply of water and sewage services to the municipality of Guarulhos. The operation began in January 2019.

The São Paulo metropolitan region, which includes the city of São Paulo, is our most important service region. With a total population of approximately 20.9 million, the São Paulo metropolitan region accounted for 72.2%, 70.7% and 69.7% of our gross operating revenue in 2018, 2017 and 2016 (excluding revenues relating to the construction of concession infrastructure), respectively. As of December 31, 2018, 64.2% of the concession intangible assets reflected on our balance sheet were located in this region. In an effort to respond to demand in the São Paulo metropolitan region, we have concentrated a major portion of our capital expenditure program to expand the water and sewage systems and to increase and protect water sources in this region. Our capital expenditure program is our most significant liquidity and capital resource requirement.

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

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

In 2015, our business was significantly affected by the most severe drought recorded in our service area in over 80 years. During the rainy season that began in October 2015 and ended in March 2016, rainfall returned to its historical average, resulting in the level of water in the reservoirs that provide water to the population of the São Paulo metropolitan region returned to normal and the measures taken during the water crisis to continue to services consumers were gradually discontinued. However, heightened public awareness of the need to conserve water during the crisis resulted in our customers adopting lower water consumption practices during the water crisis and these practices have been partially integrated into our consumers’ daily habits. In 2017 and 2018, consumption levels largely recovered in the residential category, while consumption in the industrial category continued to decline mainly due to the low level of growth in the Brazilian economy. As a result of this new behavior, despite our reservoirs having a higher volume of water available for treatment, the volume of water billed to our clients has not returned to the 2013 pre-water crisis levels.

*Effects of Tariff Increases*

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

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

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

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

|   | <b>Year ended December 31,</b> |             |             |
|---|--------------------------------|-------------|-------------|
|   | <b>2018</b>                    | <b>2017</b> | <b>2016</b> |
| Increase in average tariff <sup>(1)</sup> | 3.51%                          | 7.89%       | 8.45%       |
| Inflation – IPC – FIPE                    | 3.02%                          | 2.27%       | 6.54%       |
| Inflation – IPCA                          | 3.75%                          | 2.95%       | 6.29%       |
| Inflation – IGP M                         | 7.54%                          | (0.52)%     | 7.17%       |

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

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

### ***Effects of Brazilian Economic Conditions***

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

#### *General Economic Conditions*

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

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

In 2018, Brazilian GDP increased 1.1% in comparison with 2017. Brazil’s trade surplus in 2018 was US\$58 billion and at year-end the country had US\$374.7 billion in currency reserves. The average unemployment rate in Brazil in 2018 was 12.3%.

#### *Interest Rates*

As a political monetary instrument of the federal government, the SELIC rate influences the behavior of other interest rates in the country, including the rates related indebtedness denominated in local currency. In 2011, until the month of August, the Central Bank continued increasing the SELIC rate, reaching 12.50% in July. In the month of August, the Central Bank started decreasing the SELIC, closing 2011 at 11.00%. This downward trend was maintained in 2012, with the SELIC rate closing the year of 2012 at 7.25%. In 2013, the SELIC rate was kept at 7.25% until April, after which the Central Bank started to gradually raise it. The SELIC rate was 11.65% at December 31, 2014 and increased to 14.15% at December 31, 2015. The SELIC rate increased to 13.65% at December 31, 2016. A series of rate reductions in 2017, brought the SELIC rate down to 6.90% as of December 7, 2017, where it remained at year-end 2017. In 2018 the SELIC rate decreased to 6.40%.

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

### *Inflation*

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

Inflation adjustments derive from collections from or payment to third parties, as contractually required by law or court decision, and are recognized on an accrual basis. Inflation adjustments included in these agreements and decisions are not considered embedded derivatives, since they are deemed as inflation adjustments for us. See Notes 3.20, 5.1 and 30 of the financial statements for the impacts of inflation adjustments on our financial performance and debt.

### *Currency Exchange Rates*

We had total foreign currency denominated indebtedness of R\$6,669.4 million as of December 31, 2018, of which R\$738.5 million relates to the current portion of our long-term foreign currency denominated obligations. In the event of significant devaluations of the *real* in relation to the U.S. dollar or other currencies, the cost of servicing our foreign currency denominated obligations would increase as measured in *reais*, particularly as our tariff and other revenue is based solely in *reais*. In addition, any significant devaluation of the *real* will increase our financial expenses as a result of foreign exchange losses that we must record. In 2016, the 16.54% appreciation of the *real* against the U.S. dollar and the 13.89% appreciation of the *real* against the yen led to a foreign exchange gain of R\$1,090.5 million. In 2017, the 1.50% depreciation of the *real* against the dollar and the 5.38% depreciation of the *real* against the yen led to a foreign exchange loss of R\$96.3 million. In 2018, the 17.1% depreciation of the *real* against the dollar and the 20.0% depreciation of the *real* against the yen led to a foreign exchange loss of R\$915.9 million. However, since most of our debt denominated in foreign currencies is long-term debt with a long amortization schedule, a devaluation of the *real* would principally impact cash flows regarding the current portion of our long-term debt.

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

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

|  | <b>Year ended December 31,</b>        |             |             |
|--|---------------------------------------|-------------|-------------|
|  | <b>2018</b>                           | <b>2017</b> | <b>2016</b> |
|  | <i>(in reais, except percentages)</i> |             |             |
| Depreciation (appreciation) of the <i>real</i> versus U.S. dollar <sup>(1)</sup> | 17.13%                                | 1.50%       | (16.54)%    |
| Period end exchange rate – US\$1.00  | 3,8748                                | 3.3080      | 3.2591      |
| Average exchange rate – US\$1.00 <sup>(2)</sup>                                  | 3.6558                                | 3.1925      | 3.3523      |

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

(2) Represents the average for period indicated.

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

|  | <b>Year ended December 31,</b>        |             |             |
|--|---------------------------------------|-------------|-------------|
|  | <b>2018</b>                           | <b>2017</b> | <b>2016</b> |
|  | <i>(in reais, except percentages)</i> |             |             |
| Depreciation (appreciation) of the <i>real</i> versus yen <sup>(1)</sup> | 19.97%                                | 5.38%       | (13.89)%    |
| Period end exchange rate – ¥1.00   | 0.0353                                | 0.0294      | 0.0279      |
| Average exchange rate – ¥1.00 <sup>(2)</sup>                             | 0.0331                                | 0.0291      | 0.0289      |

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

(2) Represents the average for period indicated.

During the years ended December 31, 2018, 2017 and 2016 we had no forward exchange transactions.

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

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

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

partial restoration of the water levels of the Cantareira system.

As of December 31, 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, 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 technical reserve of 287.5 million m<sup>3</sup>. In December 2018, this system served 6.8 million residents, compared to 8.9 million in February 2014, the last month before the water crisis started.

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

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## **Critical Accounting Estimates and Judgments**

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

### ***Allowance for Doubtful Accounts***

We establish an allowance for doubtful accounts in an amount that our management considers sufficient to cover expected losses, based on an analysis of customer accounts receivable, in accordance with the accounting policy stated in Note 3.4 to our financial statements as of December 31, 2018 and 2017 and for the years ended December 31, 2018, 2017 and 2016. Bad debt expense, net of recoveries, is included in selling expenses, and was R\$166.7 million, R\$82.7 million and R\$90.5 million for the years ended December 31, 2018, 2017 and 2016, respectively. In 2018, the transactions with wholesale customers generated a reversal of wholesale sales losses, amounting to a revenue of R\$529.1 million, mainly due to the agreement with the municipality of Guarulhos (for more information on this agreement, see Note 9 to our 2018 financial statements included in this annual report). In 2017 and 2016, we recorded wholesale losses amounting to R\$203.5 million and R\$328.7 million respectively, were recorded as a reduction of revenue.

The methodology for determining the allowance for doubtful accounts requires significant estimates, considering a number of factors, including historical collection experience, current economic trends, expected future losses, the aging of the accounts receivable portfolio, recoveries of previously written off receivables and other factors. Actual results could differ from those estimates.

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

As of December 31, 2018, we had intangible assets of R\$29,012.5 million and contract asset of R\$7,407.9 million.

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

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

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

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

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

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

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

We are a party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among other types, disputes with customers and suppliers and tax, labor, civil, environmental and other proceedings. For a more detailed discussion of these legal proceedings, see Note 20 to our financial statements included in this annual report. We recognize provisions for legal proceedings in which our company has a present obligation as a result of past events (either due to an explicit agreement or duty, known as a legal obligation; or due to our past actions, known as a constructive obligation), it is probable that an outflow of resources embodying economic benefits will be necessary to settle the obligation and the amount of obligation can be estimated reliably. Therefore, we are required to make judgments regarding future events for which we often seek the advice of legal counsel. As a result of the significant judgment required in assessing and estimating these provisions, actual losses realized in future periods could differ significantly from our estimates and could exceed the amounts which we have provisioned.

As of December 31, 2018, we were party to judicial and administrative proceedings, relating to civil, environmental and tax matters, amounting to R\$892.9 million (after deducting court escrow deposits in the amount of R\$100.8 million) with respect to which we recognized provisions based on the criteria described above, as shown in Note 3.15 to our financial statements included in this annual report. As of the same date, the proceedings with respect to which we have contingent liabilities (i.e., no provisions have been recognized) totaled R\$56,605.5 million, of which we believe R\$47,812.4 million of those have a remote probability of an outflow of resources embodying economic benefits exists.

### ***Pension Benefits***

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

We determine the appropriate discount rates at the end of each year, which is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. The discount rate was decreased from 5.30% in 2017 to 4.84% in 2018 under Plan G0 and from 5.35% in 2017 to 4.91% in 2018 under Plan G1 in order to follow the decrease in the rates applicable to the Brazilian Government NTN – B, long term notes, which term is similar to the duration of the pension benefits, as described in Notes 3.19 (a) and 21 (b) to our financial statements included in this annual report.

Other key assumptions for pension obligations are based in part on current market conditions. Additional information on the pension plans under Plan G0 and G1 is disclosed in Note 21 to our financial statements included in this annual report.

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

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

We regularly review the recoverability of deferred tax assets and do not recognize deferred tax assets if it is probable that these assets will not be realized, based on historic taxable income, the projection of future taxable income and the estimated period to reverse temporary differences. This process requires the use of estimates and assumptions. The use of different estimates and assumptions could result in the non-recognition of a significant amount of deferred tax assets.

As of December 31, 2018 and 2017, we have recognized R\$261.2 million and R\$36.8 million as deferred income tax liabilities and deferred income tax assets, respectively, in each case, net of the deferred tax assets and liabilities, as disclosed in Note 19] to our financial statements included in this annual report.

### **Certain Transactions with Controlling Shareholder**

#### ***Reimbursement Due from the State***

Reimbursement due from the State for pensions paid represent supplementary pensions (Plan G0) that we pay, on behalf of the State, to former employees of State owned companies which merged to form our company. These

amounts must be reimbursed to us by the State, as primary obligor.

In November 2008, we entered into the third amendment to the agreement with the State relating to payments of pension benefits made by us on its behalf. The State acknowledged that it owed us an outstanding balance of R\$915.3 million as of September 30, 2008, relating to payments of pension benefits made by us on its behalf. We provisionally accepted, but it is not recognized in our books, the reservoirs in the Alto Tietê System as partial payment in the amount of R\$696.3 million, subject to the transfer of the property rights of these reservoirs to us. Since November 2008, the State has been paying the remaining balance in the amount of R\$219.0 million in 114 successive monthly installments. See Note 10 to our financial statements included in this annual report and “Item 7. Major Shareholders and Related Party Transactions”.

On March 18, 2015, we, the State and DAEE, with the intervention of the Department of Sanitation and Water Resources, executed an agreement in the amount of R\$1,012.3 million, consisting of R\$696.3 million in principal amount and R\$316.0 million in monetary adjustment of the principal through February 2015. For detailed information on this agreement, see “Item 7.B. Related Party Transactions—Agreements with the State” and Note 10(a)(iv) to our financial statements included in this annual report.

As of December 31, 2018 and 2017, the amounts not recognized related to pension benefits paid by us on behalf of the State totaled R\$1,107.1 million and R\$1,021.7 million respectively. As a result, we also recognized the obligation related to pension benefits, maintained with the beneficiaries and pensioners of Plan G0. As of December 31, 2018 and 2017, the pension benefit obligations of Plan G0 totaled R\$2,606.1 million and R\$2,543.9 million, respectively. For detailed information on the pension benefit obligations refer to Note 21 to our financial statements included in this annual report.

***Accounts Receivable from the State for Water and Sewage Services Rendered***

Certain of these accounts receivable have been overdue for a long period. We have entered into agreements with the State with respect to these accounts receivable. For further information on these agreements, see Note 10 to our financial statements included in this annual report and “Item 7. Major Shareholders and Related Party Transactions”.

***Use of Guarapiranga and Billings reservoirs***

We withdraw water for use in the São Paulo metropolitan area from the Guarapiranga and Billings reservoirs. EMAE, a company that is also controlled by the State of São Paulo, has a concession to produce hydroelectric energy using water from the same reservoirs. EMAE commenced various lawsuits against us in the past seeking compensation for the water we withdraw from these reservoirs. Those lawsuits have now been settled, by way of an agreement between EMAE and our company.

The settlement agreement requires us to make certain installment payments to EMAE in settlement of the claim for compensation for our capture and use of the water, as well as apportionment of the maintenance, operation and monitoring costs for the reservoirs. See “Item 7. Major Shareholders and Related Party Transactions” and See Note 10(b) to our financial statements included in this annual report.

**Results of Operations**

The following table sets forth, for the years indicated, certain items from our income statements of operations, each expressed as a percentage of net operating revenue:

|  | <b>Year ended December 31,</b>                    |         |             |         |             |         |
|--|---|---------|-------------|---------|-------------|---------|
|  | <b>2018</b>                                       |         | <b>2017</b> |         | <b>2016</b> |         |
|  | <i>(in millions of reais, except percentages)</i> |         |             |         |             |         |
| Net operating revenue  | 16,085.1  | 100.0%  | 14,608.2    | 100.0%  | 14,098.2    | 100.0%  |
| Cost of services   | (9,086.5)   | (56.5)% | (8,778.9)   | (60.1)% | (9,013.1)   | (63.9)% |
| Gross profit   | 6,998.6   | 43.5%   | 5,829.3     | 39.9%   | 5,085.1     | 36.1%   |
| Selling expenses   | (693.5)   | (4.3)%  | (768.7)     | (5.3)%  | (730.0)     | (5.2)%  |
| Allowance for doubtful accounts (*)  | (166.7)   | (1.0)%  | (82.7)      | (0.6)%  | -           | -       |
| Administrative income (expenses)   | (996.9)   | (6.2)%  | (1,099.0)   | (7.5)%  | (934.9)     | (6.6)%  |
| Other operating income (expenses), net and equity results of investments in affiliates         | 35.1  | 0.2%    | 0.1         | 0.0%    | 9.5         | 0.1%    |
| Profit from operations before finance income (expenses) and income tax and social contribution | 5,176.6   | 32.2%   | 3,961.7     | 27.1%   | 3,429.7     | 24.3%   |
| Financial income (expenses), net   | (1,264.3)   | (7.9)%  | (458.1)     | (3.1)%  | 699.4       | 5.0%    |
| Profit before income tax and social contribution   | 3,912.3   | 24.3%   | 3,503.6     | 24.0%   | 4,129.1     | 29.3%   |
| Income tax and social contribution   | (1,077.2)   | (6.7)%  | (984.3)     | (6.7)%  | (1,182.0)   | (8.4)%  |
| Profit for the year  | 2,835.1   | 17.6%   | 2,519.3     | 17.2%   | 2,947.1     | 20.9%   |

(\*) Starting January 1, 2018, we adopted IFRS 9. As a result, in 2018 and 2017 we recorded our allowance for doubtful accounts in the income statements as a separate item. In 2016, the amount of allowance for doubtful accounts

in the income statements was R\$90.5 million and was presented as part of our selling expenses.

*Year Ended December 31, 2018 Compared to Year Ended December 31, 2017*

*Net operating revenue*

Net operating revenue increased by R\$1,476.9 million, or 10.1%, to R\$16,085.1 million in 2018 from R\$14,608.2 million in 2017. These main factors that led to the increase were:

- tariff repositioning index of 7.9% since November 2017;
- tariff repositioning index of 3.5% since June 2018;
- increase of 1.5% in our total billed volume (1.5% in water and 1.5% in sewage); and
- formalization of the agreement with the municipality of Guarulhos in 2018, in the amount of R\$928.0 million, representing an increase of R\$800.0 million in operating revenue.

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Construction revenue decreased by R\$348.2 million, or 11.1%, to R\$2,802.7 million in 2018 from R\$3,150.9 million in 2017. This variation was mainly due to the increase in asset investments carried out in 2017 in the municipalities served by the Company, particularly in the São Lourenço Production System (*Sistema Produtor São Lourenço*). See Note 3.3(b) to our financial statements included in this annual report for a description of the accounting policies applicable to our construction services business.

### ***Cost of services***

Our cost of services increased by R\$307.6 million, or 3.5%, to R\$9,086.5 million in 2018 from R\$8,778.9 million in 2017. As a percentage of net operating revenue, cost of services decreased to 56.5% in 2018 from 60.1% in 2017.

The increase in cost of services was principally due to the following factors:

- an increase of R\$162.5 million in the cost of electricity, mainly due to: (i) an average increase of 7.3% in free market tariffs, with a 3.6% increase in consumption; (ii) an average increase of 4.9% in the Tariff for the Use of Distribution System (TUSD), with a 13.5% increase in consumption; and (iii) an average increase of 10.4% in regulated market tariffs, without any relevant consumption variations;
- an increase of R\$139.4 million in the cost of services, due to several factors, mainly: (i) an increase of R\$34.9 million in maintenance of water and sewage systems costs; and (ii) a higher cost associated with the hiring of technical services, in the amount of R\$25.3 million;
- an increase of R\$94.7 million in salaries and payroll charges and Pension plan obligations mainly due to: (i) an increase of R\$156.2 million due to the provision for those who joined the Knowledge Retention Program (*Programa de Retenção do Conhecimento – PRC*), launched in 2018, aiming to mitigate the impact of the exit of employees who possess strategic knowledge acquired throughout their career; and (ii) an increase of R\$71.9 million in expenses related to health insurance. These increases were partially offset by the reversal of R\$136.5 million in the Provision for the Consent Decree (*Termo de Ajustamento de Conduta – TAC*), related to the employees who joined the PRC;
- an increase of R\$102.7 million in depreciation and amortization, arising from the conclusion of construction of concession intangible assets; and
- an increase of R\$97.3 million in general expenses, mainly due to the following factors: (i) higher provision for the Municipal Fund for Environmental Sanitation and Infrastructure, in the amount of R\$53.0 million, as a result of the increase in revenues generated from the municipality of São Paulo; and (ii) higher charges for the use of water, in the amount of R\$39.0 million, related to complementary payments made between 2014 and 2016, due to the signing of an agreement between us and the Alto Tietê Hydrographic Basin Agency Foundation (*Fundação Agência Bacia Hidrográfica Alto Tietê – FABHAT*) in 2018.

The increase was partially offset by the decrease of R\$340.9 million in construction costs, due to higher construction costs in 2017, mainly with regards to the São Lourenço Production System.

### ***Gross Profit***

As a result of the factors discussed above, gross profit for the year ended December 31, 2018 increased by R\$1,169.3 million, or 20.1 %, to R\$6,998.6 million in 2018 from R\$5,829.3 million in 2017. As a percentage of net operating revenue, our gross profit margin increased to 43.5% in 2018 from 39.9% in 2017.

***Selling Expenses***

Selling expenses increased by R\$7.5 million, or 1.1%, to R\$693.5 million in 2018 from R\$686.0 million in 2017. As a percentage of net operating revenue, selling expenses decreased to 4.3% in 2018 from 4.7% in 2017. The increase in selling expenses was primarily due to:

- an increase of R\$15.2 million in expenses with services, mainly due to an increase in expenses related to the hiring of credit recovery services and technical services, in the amounts of R\$6.5 million and R\$5.8 million, respectively;
- an increase of R\$8.1 million in general expenses, due to the increase in the collection of bills from certain banks; and
- an increase of R\$1.9 million in material expenses, mainly due to the consumption of fuels and lubricants.

The increase in selling expenses was partially offset by the decrease of R\$19.8 million in salaries and expenses, mainly due to the migration of employees whose termination amounts were provisioned in the Provision for Consent Decree (*Termo de Ajustamento de Conduta - TAC*), who joined the Knowledge Retention Program - PRC, generating a reduction of R\$17.0 million in total expenses with these provisions.



### ***Allowance for Doubtful Accounts***

Our allowance for doubtful accounts increased by R\$84.0 million, or 101.6%, to R\$166.7 million from R\$82.7 million, mainly due to the higher recovery of amounts in 2017, in the amount of R\$77.8 million.

### ***Administrative Income (Expenses)***

Administrative expenses decreased by R\$102.1 million, to R\$996.9 million in 2018 from R\$1,099.0 million in 2017, mainly due to the EMAE agreement occurred in 2017 .

### ***Other Operating Income (Expenses), Net and Equity in Results of Investments in Affiliates***

Other operating income, net was R\$35.1 million in 2018 compared with R\$0.1 million operating income, net in 2017.

Other operating income, net consists of gains and losses from sales of property, plant and equipment, sale of contracts awarded in public bids, right to sell electricity, indemnities and reimbursement of expenses, fines and collaterals, property leases, reuse of water, PURA projects and services.

Other operating expenses consist mainly of write-offs of concessions assets due to obsolescence, discontinued construction works, unproductive wells, projects considered economically unfeasible, losses on property, plant and equipment and exceeding cost of electricity sold.

Other operating income (expenses) increased by R\$35.0 million, mainly influenced by the provision of obsolete goods in 2017, in the amount of R\$15.1 million, and an increase in amounts received from the Hydrographic Basin Depollution Program, in the amount of R\$11.2 million, due to the accomplishment of the goals of the program.

### ***Financial Income (Expenses), Net***

Financial income (expenses), net consists primarily of interest on our indebtedness and foreign exchange losses (or gains) in respect to our indebtedness, offset partially by interest income on cash and cash equivalents and inflation based indexation accruals, mainly relating to agreements entered into with some customers to settle overdue accounts receivable.

Financial income (expenses), net increased by R\$806.2 million to a financial expense, net of R\$1,264.3 million in 2018 from a financial expense, net of R\$458.1 million in 2017. As a percentage of net operating revenues, financial expense amounted to 7.9% in 2018 compared with a financial expense of 3.1% in 2017. The variation was due to an increase of R\$819.5 million in exchange rate variation on loans and financing, due to the appreciation of the U.S. dollar and the Japanese Yen against the *Real* in 2018 (17.1% and 20.0%, respectively), compared to a more moderate appreciation in 2017 (1.5% and 5.3%, respectively).

### ***Profit before income tax and social contribution***

As a result of the factors discussed above, profit before income tax and social contribution increased by R\$408.7 million, to R\$3,912.3 million in 2018 from R\$3,503.6 million in 2017. As a percentage of net operating revenue, our profit before income tax and social contribution increased to 24.3% in 2018 compared to 24.0% in 2017.

### ***Income Tax and Social Contribution***

Income tax and social contribution expense increased by R\$92.9 million to R\$1,077.2 million in 2018 from R\$984.3 million in 2017. This increase was mainly due to the increase in operating revenues, mitigated by the higher electricity and services costs, as well as the increase in exchange rate variation expenses, due to the higher appreciation of the U.S. dollar and the Japanese Yen against the *Real* in 2018.

***Profit for the year***

As a result of the factors discussed above, our profit for the year increased to R\$2,835.1 million in 2018 from R\$2,519.3 million in 2017. As a percentage of net operating revenue, our profit for the year increased to 17.6% in 2018 from 17.2% in 2017.

***Year Ended December 31, 2017 Compared to Year Ended December 31, 2016***

***Net operating revenue***

Net operating revenue increased by R\$510.0 million, or 3.6%, to R\$14,608.2 million in 2017 from R\$14,098.2 million in 2016.

Net operating revenue, disregarding the effect of construction revenue, as of December 31, 2017, increased R\$1,092.0 million, or 10.5%, from R\$10,365.3 million in 2016 to R\$11,457.3 million in 2017. In 2017, the construction revenue was R\$3,150.9 million compared to R\$3,732.9 million in 2016. The variations in net operating revenue were principally due to:

- an increase of 8.4% in tariffs since May 2016 (ordinary tariff adjustment);
- an increase of 7.9% in tariffs since November 2017 (extraordinary tariff revision);
- an increase of 4.3% in our total billed volume (4.3% in water and 4.2% in sewage);
- the cancelation of the Water Consumption Reduction Incentive Program, concluded in April 2016, resulting in no bonus granted in 2017, compared to a bonus granted in the amount of R\$187.4 million in 2016 which resulted in a decrease in revenue in 2016; and
- a lower estimated loss of wholesale revenue in 2017, in the amount of R\$125.1 million, due to the payment received in the period, mainly from the municipality of Guarulhos.

These increases were partially offset by the suspension of the Contingency Tariff in April 2016, in the amount of R\$224.7 million in 2016.

#### *Cost of services*

Our cost of services decreased by R\$234.2 million, or 2.6%, to R\$8,778.9 million in 2017 from R\$9,013.1 million in 2016.

The decrease in cost of services was principally due to the following factors:

- a decrease of R\$570.9 million in construction costs due to lower investments in the municipalities we serve; and
- a decrease of R\$138.1 million in the cost of electricity, mainly due to an average decrease of 12.7% in free market tariffs, with a 16.9% increase in consumption; an average decrease of 27.5% in the Tariff for the Use of Distribution System (TUSD), with a 19.6% decrease in consumption; and an average decrease of 5.3% in regulated market tariffs, with a 5.7% decrease in consumption.

The decrease in cost of services was partially offset by:

- an increase of R\$303.2 million in salaries and payroll charges and pension plan obligations due to the reduction in non-recurring expenses in 2016 in connection with the migration of participants from the Defined Benefit Plan (G1) to the Defined Contribution Plan (Sabesprev Mais), which generated an early reduction of R\$223.5 million in the actuarial deficit. The increase in salaries and payroll charges is also due to an increase of R\$72.5 million, principally driven by the 1% increase related to the Career and Salary Plan since December 2016 and the 3.71% pay rise in May 2017;
- an increase of R\$100.8 million in depreciation and amortization, mainly due to the increase in operating intangible assets in 2017, principally due to new assets entering into operation; and

- an increase of R\$34.5 million in the provision for the Municipal Fund for Environmental Sanitation and Infrastructure, as a result of the increase in revenues generated from the municipality of São Paulo.

***Gross Profit***

As a result of the factors discussed above, gross profit for the year ended December 31, 2017 increased by R\$744.2 million, or 14.6 %, to R\$5,829.3 million in 2017 from R\$5,085.1 million in 2016.

***Selling Expenses***

Selling expenses increased by R\$38.7 million, or 5.3%, to R\$768.7 in 2017 from R\$730.0 million in 2016. The increase in selling expenses was primarily due to:

- an increase of R\$59.0 million in salaries and payroll charges and pension plan obligations due to the reduction in non-recurring expenses in 2016 in connection with to the migration of participants from the Defined Benefit Plan (G1) to the Defined Contribution Plan (Sabesprev Mais), which generated an early reduction of R\$30.4 million in the actuarial deficit in 2016. The increase in salaries and payroll charges is also due to an increase of R\$13.2 million, principally driven by the 1% increase related to the Career and Salary Plan since December 2016 and the 3.71% pay rise in May 2017;

The increase in selling expenses was partially offset by the decrease of R\$20.3 million related to outsourced services.

### ***Administrative Income (Expenses)***

Administrative expenses increased by R\$164.1 million, or 17.6%, to an expense of R\$1,099.0 million in 2017 from income of R\$934.9 million in 2016.

The increase in administrative expenses was principally due to:

- an increase of R\$70.9 million in salaries and payroll charges and pension plan obligations resulting from the reduction in non-recurring expenses in 2016 in connection with the migration of participants from the Defined Benefit Plan (G1) to the Defined Contribution Plan (Sabesprev Mais), which generated an early reduction of R\$80.3 million in the actuarial deficit in 2016. The increase in salaries and payroll charges is also driven by the 1% increase related to the Career and Salary Plan since December 2016 and the 3.71% pay rise in May 2017;
- an increase of R\$48.5 million in depreciation and amortization, mainly due to the implementation of the Integrated Business Management System (Enterprise Resource Planning – SAP ERP) in 2017; and
- an increase of R\$28.8 million related to outsourced services.

### ***Other Operating Income (Expenses), Net and Equity in Results of Investments in Affiliates***

Other operating income, net was R\$0.1 million in 2017 compared with R\$9.5 million operating income, net in 2016.

Other operating income, net consists of gains and losses from sales of property, plant and equipment, sale of contracts awarded in public bids, right to sell electricity, indemnities and reimbursement of expenses, fines and collaterals, property leases, reuse of water, PURA projects and services.

Other operating income decreased by R\$9.4 million, mainly due to the estimate for losses in 2017 on discontinued concessions, in the amount of R\$24.1 million, partially offset by higher revenues from the sale of surplus energy, in the amount of R\$8.5 million.

Our other operating expenses consist mainly of write-offs of concessions assets due to obsolescence, discontinued construction works, unproductive wells, projects considered economically unfeasible, losses on property, plant and equipment and exceeding cost of electricity sold.

### ***Financial Income (Expenses), Net***

Financial income (expenses), net consists primarily of interest on our indebtedness and foreign exchange losses (or gains) in respect to our indebtedness, offset partially by interest income on cash and cash equivalents and inflation based indexation accruals, mainly relating to agreements entered into with some customers to settle overdue accounts receivable.

Financial income (expenses), net increased by R\$1,157.5 million to financial expense, net of R\$458.1 million in 2017 from financial income, net of R\$699.4 million in 2016.

The variation was due to a positive variation of R\$1,186.6 million in the cost of currency variations on borrowings and financing, due to the strengthening of the *real* against the U.S. dollar and the Japanese Yen in 2017 (1.5% and 5.3%, respectively), compared to a devaluation of the *real* in 2016 (16.5% and 13.9%, respectively).

***Profit before income tax and social contribution***

As a result of the factors discussed above, profit before income tax and social contribution decreased by R\$625.5 million, to R\$3,503.6 million in 2017 from R\$4,129.1 million in 2016. As a percentage of net operating revenue, our profit before income tax and social contribution increased to 24.0% in 2017 compared to 29.3% in 2016.

***Income Tax and Social Contribution***

Income tax and social contribution expense decreased by R\$197.7 million, or 16.7%, to R\$984.3 million in 2017 from R\$1,182.0 million in 2016. This decrease was mainly due to our lower taxable result in 2017, which was impacted by the exchange rate variation.

***Profit for the year***

As a result of the factors discussed above, our profit for the year decreased to R\$2,519.3 million in 2017 from R\$2,947.1 million in 2016. As a percentage of net operating revenue, our profit for the year decreased to 17.2% in 2017 from 20.9% in 2016.

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## **B. Liquidity and Capital Resources**

### **Capital Sources**

In order to satisfy our liquidity and capital requirements, we have primarily relied on cash provided by operating activities, long-term borrowings from Brazilian federal governmental financial institutions, and long-term financing from multilateral organizations and from domestic and international development banks, and also from capital markets. As of December 31, 2018, we had R\$3,029.2 million in cash and cash equivalents. The outstanding current portion of our long-term indebtedness was R\$2,103.6 million as of December 31, 2018, of which R\$738.5 million was denominated in foreign currency. Long term indebtedness was R\$11,049.2 million as of December 31, 2018, of which R\$5,930.9 million consisted of foreign currency-denominated obligations.

Our management expects that the cash and cash equivalents available on December 31, 2018, the operating cash generation estimated for 2019 and the lines of credit available for investments are sufficient to meet our short-term liabilities, in light of our current financial position and our expected cash generated by operating activities. In our opinion, the working capital is sufficient for the company's present requirements.

### **Cash Flows**

#### ***Net Cash Generated from Operating Activities***

Cash generated from operating activities is the single largest source of our liquidity and capital resources, and we expect that it will continue to be so in the future. Our net cash generated from operating activities was R\$3,842.9 million, R\$3,301.9 million and R\$3,003.6 million in 2018, 2017 and 2016, respectively. The main driver of our cash flow from operating activities relates to our cash collections from customers, which is due to the nature of our business and to the fact that we are expanding our infrastructure. The increase in net cash generated in 2018 is principally due to the increase of 1.5% in our total billed volume (1.5% in water and 1.5% in sewage). This increase was partially offset by the income tax and social contribution paid in 2018.

#### ***Net Cash Used in Investing Activities***

Net cash used in investing activities was R\$ 2,189.3 million, R\$1,971.4 million and R\$2,130.7 million in 2018, 2017 and 2016, respectively. The main driver of our net cash outflow for investing activities relates to purchases of intangible assets, as required under our concession and program contracts, which is due to the fact that we are expanding our infrastructure and service coverage. Although we invested approximately R\$389.7 million (including capitalized interest) in the São Lourenço PPP, a construction project planned and initiated before the water crisis, and the amount of R\$928.0 million related to agreement with the municipality of Guarulhos, that did not impact our cash flow in 2018.

#### ***Net Cash Used in Financing Activities***

Our net cash used in financing activities was R\$907.5 million, R\$933.6 million and R\$625.9 million in 2018, 2017 and 2016, respectively. The main driver of our cash flows from financing activities relates to the proceeds and repayments of loans used to finance purchases of intangible assets related to our concession and program contracts, in order to support the expansion of our services and our payment of interest on shareholders' equity.

## Indebtedness Financing

Our total financial indebtedness increased by 8.7%, from R\$12,101.0 million as of December 31, 2017 to R\$13,152.8 million as of December 31, 2018. In addition, during the same period, our total indebtedness denominated in foreign currency increased by 17.6%, from R\$5,672.8 million as of December 31, 2017 to R\$6,669.4 million as of December 31, 2018.

As of December 31, 2018, we had R\$11,049.2 million in long-term indebtedness outstanding (excluding the current portion of long-term indebtedness), of which R\$5,930.9 million consisted of foreign currency-denominated long-term debt. We had an outstanding current portion of long-term indebtedness of R\$2,103.6 million as of December 31, 2018. As of December 31, 2018, R\$738.5 million of this current portion of long-term indebtedness was denominated in foreign currency. As of December 31, 2018, our S&P domestic rating was brAAA and our S&P global rating was BB. Our Moody's national rating was Aa2.br and our Moody's global rating was Ba2 as of December 31, 2018, while our Fitch national rating was AA(bra) and our Fitch global rating was BB, as of the same date.

Various contractual agreements we have entered into, including certain financing agreements with *Caixa Econômica Federal* and BNDES, provide for liens over a portion of our cash flows from the payment of water and sewage provision tariffs. In addition, we provide as guarantees a portion of our cash flow generation to transactions related to PPPs.

Pursuant to these agreements, cash received from operations is required to pass through designated accounts. In the event of a default under the relevant agreement, such cash and future cash flows that are required to be deposited in such accounts become restricted and are subject to security interests in favor of the relevant creditor. As of December 31, 2018, a substantial portion of our monthly cash flows from operations was subject to these liens. As of that date, the total amount of our secured debt, including indebtedness benefiting from these liens, was R\$4,792.5 million (R\$4,749.5 million of principal and R\$43.0 million related to interest and charges). See “—Indebtedness Financing—Financial Covenants—Local currency denominated indebtedness” and Note 17 to our financial statements included in this annual report. The following table sets forth information on our indebtedness outstanding as of December 31, 2018:



|  | December 31, 2018 |            |           | Final<br>Maturity | Interest Rates*  |
|--|-------------------|------------|-----------|-------------------|--|
|  | Current           | Noncurrent | Total     |                   |  |
| <b>Denominated in local<br/>currency:</b>                                      |                   |            |           |                   |  |
| 10 <sup>th</sup> issue of debentures   | 42,493            | 40,194     | 82,687    | 2020              | TJLP + 1.92% (1 <sup>st</sup> &<br>3 <sup>rd</sup> series) & IPCA +<br>9.53% (2 <sup>nd</sup> series)                        |
| 12 <sup>th</sup> issue of debentures   | 45,450            | 249,249    | 294,699   | 2025              | TR + 9.5%  |
| 14 <sup>th</sup> issue of debentures   | 41,270            | 103,005    | 144,275   | 2022              | TJLP + 1.92% (1 <sup>st</sup> &<br>3 <sup>rd</sup> series) & IPCA +<br>9.19% (2 <sup>nd</sup> series)                        |
| 15 <sup>th</sup> issue of debentures   | 359,394           | -          | 359,394   | 2019              | CDI + 0.99% (1 <sup>st</sup><br>series) & IPCA + 6.2%<br>(2 <sup>nd</sup> series)  |
| 17 <sup>th</sup> issue of debentures   | 279,100           | 532,691    | 811,791   | 2023              | CDI + 0.75% (1 <sup>st</sup><br>series) & IPCA + 4.5%<br>(2 <sup>nd</sup> series) & IPCA +<br>4.75% (3 <sup>rd</sup> series) |
| 18 <sup>th</sup> issue of debentures   | 33,469            | 165,267    | 198,736   | 2024              | TJLP + 1.92% (1 <sup>st</sup> and<br>3 <sup>rd</sup> series) & IPCA +<br>8.25% (2 <sup>nd</sup> series)                      |
| 20 <sup>th</sup> issue of debentures   | 248,334           | -          | 248,334   | 2019              | CDI + 3.80%  |
| 21 <sup>st</sup> issue of debentures   | -                 | 499,604    | 499,604   | 2022              | CDI + 0.60% & CDI +<br>0.90%   |
| 22 <sup>nd</sup> issue of debentures   | -                 | 756,040    | 756,040   | 2025              | CDI + 0.58% (1 <sup>st</sup><br>series) & CDI + 0.90%<br>(2 <sup>nd</sup> series) & IPCA +<br>6.00% (3 <sup>rd</sup> series) |
| <i>Caixa Econômica Federal</i>   | 75,223            | 1,266,592  | 1,341,815 | 2019/2039         | TR + 5% to 9.5%  |
| National Bank for Economic<br>and Social Development<br>(BNDES) Coastal region | 16,899            | -          | 16,899    | 2019              | 2.5% + TJLP  |
| National Bank for Economic<br>and Social Development<br>(BNDES) PAC            | 11,227            | 39,169     | 50,396    | 2023              | 2.15% + TJLP   |
| National Bank for Economic<br>and Social Development<br>(BNDES) PAC II 9751    | 4,364             | 18,811     | 23,175    | 2027              | 1.72% + TJLP   |
| National Bank for Economic<br>and Social Development<br>(BNDES) PAC II 9752    | 3,186             | 23,100     | 26,286    | 2027              | 1.72% + TJLP   |
| National Bank for Economic<br>and Social Development<br>(BNDES) Onda Limpa     | 23,632            | 123,875    | 147,507   | 2025              | 1.92% + TJLP   |
| National Bank for Economic<br>and Social Development<br>(BNDES) Tietê III      | 30,589            | 252,197    | 282,786   | 2028              | 1.66% + TJLP   |
|  | 31,615            | 490,729    | 522,344   | 2035              | 2.5% + TJLP  |

National Bank for Economic  
and Social Development  
(BNDES) 2015

|                             |        |         |             |   |
|-----------------------------|--------|---------|-------------|---|
| Financial leasing           | 19,077 | 549,589 | 568,6662035 | 7.73% to 10.12% + IPC<br>TJLP + 1.5% (FINEP)<br>& TR + 12.00% |
| Other                       | 1,380  | 8,163   | 9,5432025   | (Presidente Prudente)   |
| Interest and others charges | 98,410 | -       | 98,410      |   |

**Total denominated in local  
currency**

|                  |                  |                  |  |
|------------------|------------------|------------------|--|
| <b>1,365,112</b> | <b>5,118,275</b> | <b>6,483,387</b> |  |
|------------------|------------------|------------------|--|

**Denominated in foreign  
currency:**Inter-American Development  
Bank (IADB)

|   |         |           |                       |                |
|---|---------|-----------|-----------------------|----------------|
| US\$616,404,000<br>(2017 - US\$527,096,000) | 163,924 | 2,208,519 | 2,372,4432025 to 2035 | 3.31% to 3.42% |
|---|---------|-----------|-----------------------|----------------|

International Bank for  
Reconstruction and  
Development (IBRD)

|   |        |         |             |       |
|---|--------|---------|-------------|-------|
| US\$91,286,000 (2017 -<br>US\$79,946,000) | 11,779 | 341,646 | 353,4252034 | 2.85% |
|---|--------|---------|-------------|-------|

## Deutsche Bank -

|  |         |   |             |               |
|--|---------|---|-------------|---------------|
| US\$75,000,000 (2017 -<br>US\$150,000,000) | 288,479 | - | 288,4792019 | LIBOR + 4.50% |
|--|---------|---|-------------|---------------|

Eurobonds - US\$350,000,000  
(2017 - US\$ 350,000,000)

|   |           |               |       |
|---|-----------|---------------|-------|
| - | 1,354,532 | 1,354,5322020 | 6.25% |
|---|-----------|---------------|-------|

JICA 15 - ¥ 12,676,730,000  
(2017 - ¥ 13,829,160,000)

|        |         |             |             |
|--------|---------|-------------|-------------|
| 40,646 | 406,462 | 447,1082029 | 1.8% & 2.5% |
|--------|---------|-------------|-------------|

JICA 18 - ¥ 11,397,760,000  
(2017 - ¥ 12,433,920,000)

|        |         |             |             |
|--------|---------|-------------|-------------|
| 36,545 | 365,230 | 401,7752029 | 1.8% & 2.5% |
|--------|---------|-------------|-------------|

JICA 17 - ¥ 1,826,957,000  
(2017 - ¥ 1,534,959,000)

|        |        |            |              |
|--------|--------|------------|--------------|
| 11,835 | 51,786 | 63,6212035 | 1.2% & 0.01% |
|--------|--------|------------|--------------|

JICA 19 - ¥ 31,561,726,000  
(2017 - ¥ 29,777,232,000)

|        |           |               |              |
|--------|-----------|---------------|--------------|
| 64,028 | 1,047,081 | 1,111,1092037 | 1.7% & 0.01% |
|--------|-----------|---------------|--------------|

IADB 1983AB - US\$  
58,462,000 (2017 - US\$  
82,404,000)

|        |         |             |                           |
|--------|---------|-------------|---------------------------|
| 68,554 | 155,653 | 224,2072023 | LIBOR + 2.08% to<br>2.38% |
|--------|---------|-------------|---------------------------|

## Interest and others charges

|        |   |        |  |
|--------|---|--------|--|
| 52,710 | - | 52,710 |  |
|--------|---|--------|--|

**Total denominated in  
foreign currency**

|                |                  |                  |  |
|----------------|------------------|------------------|--|
| <b>738,500</b> | <b>5,930,909</b> | <b>6,669,409</b> |  |
|----------------|------------------|------------------|--|

**Total loans and financing**

|                  |                   |                   |  |
|------------------|-------------------|-------------------|--|
| <b>2,103,612</b> | <b>11,049,184</b> | <b>13,152,796</b> |  |
|------------------|-------------------|-------------------|--|

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\*

TR was 0.00% per month as of December 31, 2018; CDI stands for Interbank Deposit Rate (*Certificado de Depósitos Interbancários*), which was 6.40% per annum as of December 31, 2018; IGP M was 7.54% per annum as of December 31, 2018; TJLP stands for Long term Interest Rate (*Taxa de Juros a Longo Prazo*), published quarterly by the Central Bank, which was 6.98% per annum as of December 31, 2018; and USD LIBOR was 1.69 as of December 31, 2018.

The following table shows the maturity profile of our debt, as of December 31, 2018, for the period indicated:

|                     | 2019                          | 2020    | 2021    | 2022    | 2023  | After 2024 | Total    |
|---------------------|-------------------------------|---------|---------|---------|-------|------------|----------|
|                     | <i>(in millions of reais)</i> |         |         |         |       |            |          |
| Loans and financing | 2,103.6                       | 2,559.0 | 1,062.8 | 1,148.3 | 939.6 | 5,339.5    | 13,152.8 |

Referring to all of our foreign currency-denominated indebtedness, the amount of R\$4,593.1 million, net of transaction costs, as of December 31, 2018 was denominated in U.S. dollars and R\$2,023.6 million was denominated in Japanese Yen. This indebtedness consisted principally of:

- R\$2,372.5 million (US\$616.4 million) in U.S. dollar denominated loans contracted with the Inter-American Development Bank, or the IADB, composed of the following:
  - (i) two loans to finance the first phase of the Tietê Project in 1992, one of which was terminated in December 2016 and the other terminated in December 2017;
  - (ii) one loan to finance the second phase of the Tietê Project in 2000, under which payments of principal are made in semiannual installments with final maturity in July 2025. The principal amount accrues interest at USD LIBOR plus a variable spread paid semiannually; and
  - (iii) one loan to finance the third phase of the Tietê Project in 2010, under which payments of principal are made in semiannual installments with final maturity in September 2035. The principal amount accrues interest at USD LIBOR plus a variable spread paid semiannually;
- R\$353.4 million (US\$91.3 million) in U.S. dollar denominated loans contracted with the IBRD which was entered into on October 28, 2009, amounting to US\$100.0 million, for the financing of the Water Source Program (*Programa Mananciais*), a program ended in 2017, which consisted of various projects that focused on the preservation and improvement of water sources in the metropolitan region of São Paulo. The loan matures in March 2034. Repayments of principal will be made in semiannual installments starting in September 2019 after a grace period of ten years. The principal amount accrues interest at USD LIBOR plus a variable spread, paid semiannually;
- R\$224.2 million (US\$58.5 million) in U.S. dollar denominated loans from the AB Loan financing contracted with the IADB in May 2008. Under this loan, payments of principal are made in annual installments with final maturity in May 2023. The principal amount accrues interest at USD LIBOR plus a rate varying from 2.08% to 2.38%, paid semiannually. The proceeds were used to repay an outstanding series of debt securities in connection with the implementation of our investment plan;
- R\$1,354.5 million (US\$350.0 million) in U.S. dollar denominated Eurobonds issued in December 2010 with an interest rate of 6.25%. The bonds pay interest semi annually and mature in 2020. The proceeds from the offering were used to repay financial commitments throughout 2007 and 2011;
-

R\$2,023.5 million (¥57,463.2 million) in Japanese yen denominated loans contracted with the JICA, composed of the following: (i) ¥21,320.0 million denominated loans contracted in August 2004 for the financing of the environmental recovery program for the Baixada Santista metropolitan region, called the Clean Wave Program (*Programa Onda Limpa*). Under these loans, the payments of principal are made in semi annual installments with final maturity in August 2029. The principal amount accrues interest at a rate that varies from 1.8% to 2.5% per year, paid semiannually; (ii) ¥6,208 million in denominated loans contracted in October 2010 for the financing of the environmental improvement program in the basin of the Billings dam. The loan matures in October 2035, with repayments of principal made in semiannual installments. The principal amount accrues interest at a rate that varies from 0.01% to 1.2% per year, paid semiannually; (iii) ¥19,169 million denominated loans contracted in February 2011 to complement the financing for the first stage of the Clean Wave Program (*Programa Onda Limpa*), with commercial conditions similar to the loan entered into in August 2004. These funds were used for the provision of works and services in the Baixada Santista metropolitan region. The credit agreement expires in 18 years with final maturity in August 2029. The principal amount accrues interest at a rate that varies from 1.8% to 2.5% per year, paid semiannually; and (iv) ¥33,584 million denominated loan in February 2012 for the financing of the Corporate Program for Water Loss Reduction (*Programa Corporativo para Redução de Perdas*). The loan matures in February 2037. Repayments of principal will be made in semiannual installments starting in February 2019 after a grace period of seven years. The principal amount accrues interest at a rate that varies from 0.01% to 1.7% per year, paid semiannually; and

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- R\$288.5 (US\$75.0 million), in U.S. dollar denominated loan contracted in October 2016, with Deutsche Bank AG, London Branch and Banco Bradesco S.A., New York Branch, with an interest rate of 3-month LIBOR plus 4.50% interest per year and with final maturity in October 2019. Interest under this loan is paid quarterly and the principal amount is amortized in semiannual installments after an 18-month grace period. The proceeds from the loan were used to repay the US\$140.0 million Eurobond issued in November 2006, which matured in November 2016, and other financial commitments throughout 2016. The loan agreement includes financial covenants requiring our debt service coverage ratio to be higher than 2.35:1.00; and our ratio of total adjusted debt to EBITDA, determined on a consolidated basis, to be lower or equal than 3.65:1.00.

Our borrowings from multilateral institutions and with Government Agency, such as the IADB, IBRD and JICA are guaranteed by the federal government, and have a counter-guarantee from the state of São Paulo. For further information on the terms of these loan agreements, see “Item 7.B. Related Party Transactions—Government Guarantees of Financing”.

Our outstanding domestic debt was R\$6,483.4 million as of December 31, 2018 and consisted primarily of *real* denominated loans from federal and state owned banks, in particular, *Caixa Econômica Federal* and BNDES, as well as debentures issued in November 2009, June 2010, February 2011, February 2012, November 2012, January 2013, October 2013, June 2014, December 2015, June 2017 and February 2018 and financial leasing.

The following summarizes our principal borrowings from federal and State owned banks:

- from 2003 to 2018, we entered into several financing agreements with *Caixa Econômica Federal*, pursuant to which repayments of principal are paid in up to in 60, 180 or 240 months in monthly installments commencing 30 days following the applicable grace period, which varies from 10 to 48 months from the date of signature of the line of credit agreement. The final maturity is 2042. The principal amount accrues interest from 5.0% to 8.0%. The financing agreements are collateralized (i) by the pledge of collections of monthly billings of water supply and sewage services up to three monthly installments until reaching the total amount of the debt, or (ii) by a monthly plan of billings corresponding to the minimum of three times the monthly charge, depending on the terms of the relevant financing agreement. As of December 31, 2018, the outstanding debt was R\$1,341.8 million;
- in November 2007, we entered into a R\$129.9 million financing agreement with BNDES. Repayments of the principal amount are being made in 96 successive monthly installments, with final maturity in 2019. The principal amount accrues interest at the TJLP, but limited to 6.0% per year, plus 2.50% per year. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The financing agreement is collateralized by part of the billings from the provision of water and sewage services. As of December 31, 2018, the outstanding debt was R\$16.9 million;
- in May 2008, we entered into a R\$174.0 million financing agreement with BNDES. Repayments of the principal amount are being made in 150 successive monthly installments, with final maturity in 2023. The principal amount accrues interest at the TJLP, but limited to 6.0% per year, plus 2.15% per year. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The financing agreement is collateralized by part of the billings from the provision of water and sewage services. As of December 31, 2018, the outstanding debt was R\$50.4 million;
- in March 2010, we entered into a R\$294.3 million financing agreement with BNDES. Repayments of the principal amount are being made in 156 successive monthly installments, with final maturity in 2025. The principal amount accrues interest at the TJLP, but limited to 6.0% per year, plus 1.92% per year. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The financing agreement is collateralized by part of the

billings from the provision of water and sewage services. As of December 31, 2018, the outstanding debt was R\$147.5 million;

- in 2011, we entered into financial leases in the total amount of R\$49.6 million with certain contractors for the construction of infrastructure on land we own. During the construction phase, we recognized a contract asset (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, are classified as Contract Assets during the construction period and are transferred to Intangible Assets only after completion of the works. For more information of this adoption, see Note 4.1 to our 2018 financial statements included in this annual report) and the related liability of the lease at fair value. Upon the conclusion of the construction, we began paying the rental of the infrastructure (in 240 installments) and the lease was updated accordingly to the contract. On August 31, 2013, SES Campo Limpo Paulista and Várzea Paulista started operations, and the corresponding amount as of December 31, 2014 was of R\$138,602 million. As of December 31, 2018, the outstanding debt was R\$568.7 million;

- in March 2012, we entered into a R\$180.8 million financing agreement with BNDES. Amortization of the principal amount is being made in up to 156 successive monthly installments, with the final maturity in 2027. The principal amount accrues interest at the TJLP but it is limited to 6.0% per year plus a yearly 1.72%. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services. As of December 31, 2018, the outstanding debt was R\$49.5 million;

- in February 2013, we entered into a R\$1.3 billion financing agreement with BNDES. Amortization of the principal amount is being made in up to 144 successive monthly installments with the final maturity in 2028. The principal amount accrues interest at the TJLP but is limited to 6.0% per year plus a yearly 1.66%. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services. As of December 31, 2018, the outstanding debt was R\$282.8 million;
- in June 2014, we entered into a R\$61.1 million financing agreement with BNDES. Amortization of the principal amount is being made in up to 108 successive monthly installments after the grace period of 36 months, with the final maturity in 2026. The principal amount accrues interest at the TJLP but is limited to 6.0% per year plus a yearly 1.76%. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services;
- in June 2015, we entered into a R\$747.4 million financing agreement with BNDES. Amortization of the principal amount is being made in up to 204 successive monthly installments after the grace period of 36 months, with the final maturity in 2035. The principal amount accrues interest at the TJLP but is limited to 6.0% per year plus a yearly 2.18%. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services. As of December 31, 2018, the outstanding debt was R\$522.3 million; and
- in October 2015, we entered into a R\$48.3 million financing agreement with Funding Authority for Studies and Projects (*Financiadora de Estudos e Projetos*, or FINEP). Repayments of the principal amount shall be paid in up in 91 successive monthly installments after the grace period of 30 months, with the final maturity in 2025. The principal amount accrues interest at the TJLP, but it limited to 6.0% per year plus a yearly 1.5%. If TJLP exceeds 6% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services. As of December 31, 2018, the outstanding debt was R\$9.6 million.

Under the BNDES program, we issued three tranches of debentures in the aggregate amount of R\$826.1 million. In November 2009, we issued our tenth tranche of debentures in the aggregate principal amount of R\$275.4 million. The debentures are divided in three series: the first and third series will mature in November 2020 and the second in December 2020. The debentures of the first and third series, in the aggregate principal amount of R\$77.1 million and R\$115.7 million, respectively, bear interest at 1.92% per year, plus the TJLP. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The debentures of the second series, in the aggregate principal amount of R\$82.6 million, bear interest at the rate of the IPCA index plus 9.53% per year. This issuance was entirely subscribed by BNDES. As of December 31, 2018, the outstanding debt of the tenth issuance of debentures is R\$82.7 million. In February 2011, we issued our fourteenth tranche of debentures, the second tranche out of those three, also subscribed exclusively by BNDES. These debentures are divided in three series: the first and third series will mature in February 2022 and the second, in March 2022. The debentures of the first and third series, in the aggregate principal amount of R\$77.1 million and R\$115.7 million, respectively, bear interest at 1.92% per year, plus the TJLP. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The debentures of the second series, in the aggregate principal amount of R\$82.6 million, bear interest at the rate of the IPCA index plus 9.20% per year. As of December 31, 2018, the outstanding debt of the fourteenth issuance of debentures is R\$144.3 million. In October 2013, we concluded our eighteenth issuance of debentures, the third tranche out of those three also subscribed exclusively by BNDES. These debentures are divided in three series: the first and third series will mature in October 2024 and the second, in November 2024. The debentures of the first and third series, in the aggregate principal amount of R\$77.1 million and R\$115.7 million, respectively, bear interest at 1.92% per year, plus the TJLP. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The debentures of the second

series, in the aggregate principal amount of R\$82.6 million, bear interest at the rate of the IPCA index plus 8.26% per year. In December 2013, BNDES subscribed to the debentures of the first and second series. In December 2014 and July 2015, BNDES subscribed in part to the debentures of the third series and will subscribe to the other debentures of the third series in 2018. We have used the funds raised from the three issuances for investments primarily in the Corporate Program for Water Loss Reduction and on improvements and reforms of the Rio Grande's water treatment plant, including other projects for water supply and sewage collection systems in the São Paulo Northern Coast, Paraíba Valley and Mantiqueira Regions. As of December 31, 2018, the outstanding debt of the eighteenth issuance of debentures is R\$198.8 million.

In June 2010, we carried out our twelfth issuance of debentures, totaling R\$500 million, to the FGTS, based on the FGTS's program to finance companies in the sanitation, transport and real estate businesses. The debentures will mature in June 2025 and bear monthly interest based on the TR plus 9.5% per year. The proceeds of this issuance were used to fund a portion of our capital expenditure program in the water supply and sewage system. As of December 31, 2018, the outstanding debt of the twelfth issuance of debentures is R\$294.7 million.

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In February 2012, we issued our fifteenth issuance of debentures in two series in the aggregate principal amount of R\$771.0 million. The first and second series will mature in February 2017 and 2019, respectively. The debentures of the first series (in the aggregate principal amount of R\$287.3 million) bear interest at a rate of CDI plus 0.99% per year. The second series (in the aggregate principal amount R\$483.7 million) bears interest at a rate of IPCA plus 6.2% per year. The net proceeds were used to repay financial commitments throughout 2012, including the early redemption of our thirteenth debentures issuance. As of December 31, 2018, the outstanding debt of the fifteenth issuance of debentures is R\$359.4 million.

In January 2013, we carried out our seventeenth issuance of debentures of R\$1.0 billion in three series, the first for R\$424.7 million with maturity date of January 2018 and with an interest rate of 0.75% per year plus the CDI rate, the second for R\$395.2 million with a maturity of January 2020 and with the interest rate of 4.50% per year plus IPCA variation and the third for R\$180.1 million with a maturity date of January 2023 and with an interest rate of 4.75% per year plus IPCA variation. The proceeds of this issuance were used to pay our financial commitments for 2013. As of December 31, 2018, the outstanding debt of the seventeenth issuance of debentures is R\$811.8 million.

In December 2015, we carried out our twentieth issuance of debentures of R\$500 million, with a maturity date of December 2019 and bearing interest, each semester with an interest rate of 3.80% per year plus the CDI rate. The proceeds of this issuance were used to strengthen our cash position and refinance financial commitments which were set to mature in the first trimester of 2016. As of December 31, 2018, the outstanding debt of twentieth issuance of debentures is R\$248.3 million.

In June 2017, we carried out our twenty-first issuance of debentures in two series in the aggregate principal amount of R\$500 million. The first and second series will mature in June 2020 and 2022, respectively. The debentures of the first series (in the aggregate principal amount of R\$150 million) bear interest at a rate of CDI plus 0.60% per year. The debentures of the second series (in the aggregate principal amount of R\$350 million) bear interest at a rate of CDI plus 0.90% per year. The proceeds of this issuance shall be used to strengthen our cash position and refinance financial commitments which mature in 2017. As of December 31, 2018, the outstanding debt of the twenty-first issuance of debentures is R\$499.6 million.

In February 2018, we carried our twenty-second issuance of debentures in three series in the aggregate principal amount of R\$750 million. The first, second and third series will mature in February 2021, 2023 and 2025 respectively. The debentures of the first series (in the aggregate principal amount of R\$100 million) bear interest at a rate of CDI plus 0.58% per year, with semi-annual interest payments. The second series (in the aggregate principal amount R\$400 million) bears interest at a rate of CDI plus 0.90% per year, with semi-annual interest payments. The third series (in the aggregate principal amount R\$250 million) bears interest at a rate of IPCA plus 6.00% per year, with annual interest payments. The proceeds from this funding are intended to strengthen our cash position and refinance outstanding financial commitments in 2018. As of December 31, 2018, the outstanding debt of the twenty-second issuance of debentures is R\$756.0 million.

Part of our *real* denominated indebtedness is indexed to take into account the effects of inflation. This debt provides for inflation based increases to the principal amount, determined by reference to the IPCA.

#### *Financial Covenants*

We are subject to financial covenants under the agreements evidencing or governing our outstanding indebtedness.

#### Foreign currency denominated indebtedness

With respect to our indebtedness denominated in U.S. dollars, including our borrowings from the IADB, we are subject to financial covenants, including limitations on our ability to incur debt. For example:

The financial covenants in our Loan No. 1212 from the IADB require as follows:

- our tariff revenues must be sufficient to cover the operational expenses of our system, including administrative, operating and maintenance expenses, and depreciation;
- our tariff revenues must provide a return on the balance sheet value of our property, plant, and equipment of not less than 7%; and
- during project execution, the balance of our short-term borrowings must not exceed 8.5% of our total equity.

This contract contains an early maturity clause in the event of non-compliance on our part, of any obligation stipulated therein or in other contracts with the bank relating to the financing of the above-mentioned projects.

The financial covenants in our AB Loan Agreements with the IADB (No. 1983AB) require as follows:

- our debt service coverage ratio must be greater than or equal to 2.35:1.00; and
- our ratio of Net Debt (defined as all borrowed money, including debentures and Eurobonds, less interest and financial charges that have been provisioned for the current period) to Adjusted EBITDA (defined as our net income before net financial expenses, income tax and social contribution tax, depreciation and amortization, non-operating income or expenses, and extraordinary items net of income tax and social contribution, as set forth in our consolidated financial statements), each determined on a consolidated basis, must be less than 3.65:1.00.

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This contract contains an early maturity clause. In the event of non-compliance with the terms of the contract, the BID can request the anticipated payment of part or all of the loan. The contract also contains cross-default provisions whereby an event of non-compliance on our part relating to any other of our debts with BID or third-parties (in this case, if over US\$25 million) allows BID to request the early payment of the loan.

The indenture relating to our US\$350.0 million 6.25% notes due 2020 prohibit, subject to some exceptions, the incurrence of additional debt in the event that: (i) the ratio of Adjusted Total Debt to adjusted EBITDA (as defined in the related indentures) is greater than 3.65:1.00; or (ii) the Debt Service Coverage Ratio (as defined in the related indentures) is less than 2.35:1.00. This agreement has a cross-default clause, i.e. the early maturity of any debt in connection with our loans or the loans of any of our subsidiaries in a total principal amount of US\$25.0 million or more (or the corresponding amount in other currencies) shall imply this agreement's early maturity. See Note 17 to our financial statements included in this annual report.

Any significant devaluation of the *real* will affect the total portion of our debt denominated in foreign currencies when measured in *reais*. As a result, the Adjusted Total or Net Debt in *reais* will be affected, with consequent impact on the ratio between Adjusted Total or Net Debt to adjusted EBITDA.

As of December 31, 2018 and 2017, we had met all the requirements of these loans and financing agreements.

#### Local currency denominated indebtedness

With respect to our outstanding indebtedness denominated in *reais*, we are subject to financial covenants.

The covenant clauses apply to all of our indebtedness with BNDES, including the 10th, 14th, and 18th issuances of debentures held by BNDES, which totaled R\$1,444.8 million as of December 31, 2018. The only financing agreement which is exempt from the renegotiated financing is contract No. 08.2.0169.1. See Note 17 (a) (ii) to our financial statements included in this annual report.

In summary, the BNDES financings specify two bands for the ratios of Adjusted Net Debt / Adjusted EBITDA, Adjusted EBITDA / Adjusted Financial Expenses, and Other Onerous Debt / Adjusted EBITDA. The financings also specify a collateral mechanism by which we assign a portion of our tariff payment receivables to BNDES in order to provide a partial guarantee of the amounts due under the financings. Under this mechanism, each month we must ensure that a portion of the tariff payments which we receive are deposited on a daily basis into a blocked collateral account, before being released to a regular movements account later in the day provided that BNDES has not notified the bank that we are in default. If the ratio of Adjusted EBITDA / Adjusted Financial Expenses is equal to or higher than 3.50, the ratio of Adjusted Net Debt / Adjusted EBITDA equal to or lower than 3.00, and the Other Onerous Debt / Adjusted EBITDA equal to or lower than 1.00, the amount that must pass through this blocked collateral account is R\$225.9 million per month. If one of the three ratios mentioned above are not met in any two or more quarters, consecutive or not, within a twelve-month period, yet remain within the following band of ratios: Adjusted EBITDA / Adjusted Financial Expenses lower than 3.50 but equal to or higher than 2.80, Adjusted Net Debt / Adjusted EBITDA equal to or lower than 3.80 but higher than 3.00, and Other Onerous Debt / Adjusted EBITDA equal to or lower than 1.30 but higher than 1.00, the amount that must pass through the blocked collateral account is automatically increased by 20%.

The current covenant clauses are:

A. Maintenance of the following ratios, calculated quarterly and relative to amounts accumulated over the last 12 months at the time of disclosure of reviewed quarterly financial statements or audited annual financial statements:

- Adjusted EBITDA / Adjusted Financial Expenses equal to or higher than 3.50;
- Adjusted Net Debt / Adjusted EBITDA equal to or lower than 3.00; and
- Other Onerous Debt / Adjusted EBITDA equal to or lower than 1.00 (where “Other Onerous Debt” is equal to the sum of (i) social security liabilities and health care plans, (ii) installment payments of tax debt and (iii) installment payments of debt with electricity providers).

B. If any one of the ratios specified in A. above are not met in any two or more quarters, consecutive or not, within a twelve-month period, we shall be deemed to be in non-compliance with the first band ratios and must, as a result, automatically increase the amount passing through the blocked collateral account by 20%, provided that the following second band ratios are met:

- Adjusted EBITDA / Adjusted Financial Expenses lower than 3.50 but equal to or higher than 2.80;

- Adjusted Net Debt / Adjusted EBITDA equal to or lower than 3.80 but higher than 3.00; and
- Other Onerous Debt / Adjusted EBITDA equal to or lower than 1.30 but higher than 1.00.

C. If any one of the second band ratios specified in B. above are not met for any one quarter, or if we are required to but fails to ensure that the increased monthly amount specified in B. above passes through the blocked collateral account, then we shall be deemed to be in non-compliance with its ratio covenants, in which case BNDES may at its discretion:

- require us to provide additional financial guarantees within a deadline specified by BNDES, which may not be less than 30 days;
- suspend the release of funds; and/or
- declare the financings to be immediately due and payable.]

As of December 31, 2018, the amount that must pass through the blocked collateral account is R\$242.9 million per month, not including the financial guarantees for financing contract No. 08.2.0169.1.

The financial covenants applicable to financing contract No. 08.2.0169.1 are the following:

- Adjusted EBITDA / Adjusted Net Operational Revenue equal to or higher than 38%;
- Adjusted EBITDA / Adjusted Financial Expenses equal to or higher than 2.35; and
- Adjusted Net Debt / Adjusted EBITDA equal to or lower than 3.20.

BNDES will annually verify the maintenance of the ratios mentioned above for contract 08.2.0169.1 by reviewing our audited annual financial statements, which must be presented to BNDES or published by April 30 of the following year to which the financial statements refer. If we maintain all of the financial covenants for contract 08.2.0169.1, BNDES will reduce the interest charged on this loan from 2.15% to 1.82% per annum. If the financial covenants are maintained, the interest rate is reduced as of June 16 of the same year in which the financial covenants were verified until June 15 of the subsequent year.

The financing agreement established with BNDES in March 2010 is subject to a cross-default clause. For example, the early maturity of any of our debts, the financial contracts and/or amounts of which may compromise the obligations stipulated in the indenture shall cause the early maturity of such agreement.

Additionally, since 2018, we are subject to financial covenants under the new financing agreements executed with *Caixa Econômica Federal*. These financial covenants require us to maintain the following financial indexes, calculated for the past twelve months on a quarterly basis:

- Adjusted EBITDA / Adjusted Financial Expenses, equal to or greater than 2.80;
- Adjusted Net Debt / Adjusted EBITDA, equal to or lower than 3.80;
- Other Onerous Debt / Adjusted EBITDA equal to or lower than 1.30.

These agreements provide that disbursements may be suspended if any of these covenants are not being complied with. In the event of non-compliance with the terms of these agreements, Caixa Econômica Federal may request the anticipated payment of the entire loan.

The agreements with *Caixa Econômica Federal* also contain a cross-default clause and an early maturity clause, in the event of non-compliance with the terms of the contract, the *Caixa Econômica Federal* can request the anticipated payment of part or all of the loan. See Note 17 to our financial statements included in this annual report.

With respect to our outstanding debentures, the twelfth issuance requires us to maintain an Adjusted Current Ratio (current assets divided by current liabilities, excluding from current liabilities the current portion of noncurrent debts incurred by us that is recorded in current liabilities) higher than 1.0:1.0 and an EBITDA/Financial Expenses Ratio equal to or higher than 1.5:1.0. The twelfth debenture issuance has an early maturity clause, which is triggered if our credit ratings are downgraded two levels below the “brAA-” Brazil National Scale rating assigned to our debentures by the credit rating agency S&P at the time of their issuance. On July 11, 2018, our credit rating and the one assigned to the twelfth debenture issuance by S&P were both “brAAA”. This issuance has a cross-default clause. See Note 17 to our financial statements included in this annual report.

The tenth, fourteenth and eighteenth issuances follow the covenants included in the BNDES loans, as described above, and contain a cross-default clauses. See Note 17 to our financial statements included in this annual report.

The fifteenth, seventeenth, nineteenth and twentieth issuances require us to maintain an EBITDA/paid financial expenses ratio equal to or higher than 1.5:1.0 and an adjusted total debt/EBITDA ratio equal to or lower than 3.65:1.0. These issuances have a cross-default clause. See Note 17 to our financial statements.

The table below shows the more restrictive covenants ratios and our financial covenants ratios as of December 31, 2018.

The twenty-first and twenty-second issuances require us to maintain an EBITDA/paid financial expenses ratio equal to or higher than 1.5:1.0 and an adjusted net debt/EBITDA ratio equal to or lower than 3.50:1.0. These issuances have a cross-default clause. See Note 17 to our financial statements.

|  | <b>Restrictive Ratios</b>         | <b>Ratio as of December 31, 2018</b> |
|--|-----------------------------------|--------------------------------------|
| Adjusted EBITDA / Adjusted financial expenses      | Equal to or higher than 2.80:1.00 | 8.05                                 |
| Adjusted net debt / Adjusted EBITDA                | Equal to or lower than 3.80:1.00  | 1.56                                 |
| Adjusted total debt / Adjusted EBITDA              | Lower than 3.65:1.00              | 1.99                                 |
| Other onerous debt <sup>1/</sup> / Adjusted EBITDA | Equal to or lower than 1.30:1.00  | 0.46                                 |
| Adjusted current ratio                             | Higher than 1.0                   | 1.63                                 |
| EBITDA/Paid financial expenses                     | Equal to or higher than 2.35:1.00 | 8.93                                 |
| Net debt/Adjusted EBITDA                           | Equal to or lower than 3.50:1.0   | 1.52                                 |

(1) “Other Onerous Debts” correspond to the sum of social security liabilities, health care plan, installment payment of tax debts and installment payment of debts with the electricity supplier.

As of December 31, 2018 and 2017, we complied with all the covenants of our loans and financing agreements.

### **Capital Requirements**

We have, and expect to continue having, substantial liquidity and capital resource requirements. These requirements include debt service obligations, capital expenditures to maintain, improve and expand our water and sewage systems, and dividend payments and other distributions to our shareholders, including the State.

### **Capital Expenditures**

Historically, we have funded and plan to continue funding our capital expenditures with funds generated by operations and with long-term financing from international and national multilateral agencies and development banks. We generally include in our capital expenditure program for the following year the amount of investment that was not realized in the previous year. In 2018, we recorded R\$4.2 billion to improve and expand our water and sewage system and to protect our water sources in order to meet the growing demand for water and sewage services in the state of São Paulo. We have budgeted investments in the amount of approximately R\$18.7 billion from 2019 through 2023. See “Item 4.A. History and Development of the Company—Capital Expenditure Program”.

### **Dividend Distributions**

We are required by our bylaws to make dividend distributions, which can be made as payments of interest on shareholders' equity to our shareholders in an amount equal to or higher than 25% of the amounts available for distribution. In addition, our dividend policy, which was approved at the annual shareholders' meeting held on April 27, 2018, establishes that this percentage shall be maintained until the universalization of basic sanitation services in the areas where we operate. We declared dividends of R\$792.2 million, R\$703.9 million and R\$823.5 million in 2018, 2017 and 2016 and, respectively. See "Item 7.B. Related Party Transactions—Dividends".

**C. Research and Development, Patents and Licenses, Etc.**

***Research and innovation***

Our strategic innovation process goes beyond the development of new technologies, products and services. It involves the creation of new business models, new ways of meeting the needs of consumers, new organizational processes, new ways of competing and cooperating in the business environment and improvements to service delivery, while at the same time promoting protection of the environment and public health.

In 2018, we allocated R\$10.6 million to Research, Development and Innovation, or RD&I, projects. These resources are a differential in our results and indicate our capacity for innovation and pioneering, which can bring fiscal, tariff and financial advantages. We also set up a Corporate "Research, Technological Development and Innovation" Program, which allows us to differentiate the financial resources spent specifically for this purpose within our budget structure.



In line with business planning, the structuring of RD&I actions is based on the concept of a circular economy, that is, based on the intelligence of nature, the circular process opposes the traditional linear production process. As part of this concept, residues are inputs for the production of new products and new cycles. We have highlighted below certain RD&I projects that use the concept of a circular economy as part of the processes for the treatment of sewage.

The technical cooperation agreement with the German Fraunhofer Institute resulted in the inauguration of the Biogas Benefit System for Vehicular Use at the sewage treatment plant in Franca in April 2018. This project is the only one in Latin America that produces biomethane from sewage treatment. The plant treats an average of 500 liters per second of sewage and produces around 2,500 m<sup>3</sup> of biogas per day, enough to replace 1,500 liters of common gas daily. It currently supplies part of the unit's fleet of vehicles. Biomethane was also tested in passenger buses at the "Sweden-Brazil Innovation Week" promoted by the Swedish Embassy and Business Sweden, as well as the promotion of autonomy and performance evaluation in a luxury vehicle, originally manufactured to use natural gas and gasoline.

At the same plant, we developed and are operating a sludge dryer based on solar radiation, financed by the Funding Authority for Studies and Projects (*Financiadora de Estudos e Projetos*, or FINEP).

At the Barueri sewage treatment plant, we implemented a plasma gasification system for the processing of sludge generated. It is current in the adjustment phase to ensure it fully operates in a continuous and safe way. At the end of the process, the system generates inert residue with drastic reduction in its volume. The project was funded by FINEP.

To improve the quality of the water produced for industrial reuse, we installed an innovative ultraviolet disinfection system at the Jesus Netto wastewater reuse station, in the city of São Paulo.

Shortage of water is an increasingly imminent problem in large urban centers. Accordingly, an increasingly conscious use of water and the search for alternative ways of reusing water are essential. With regard to projects that use the concept of the circular economy in the processes of water treatment, we have undertaken tests under a technical cooperation agreement with Magni, the representative of the Danish company Liqtech, for the use of ceramic membranes for the ultrafiltration of silicon carbide for the recovery of waste water from water treatment plants.

In partnership with the São Paulo State University Júlio de Mesquita Filho - UNESP, we are evaluating the technical and environmental feasibility of the use of sludge from water treatment plants as raw material for the base and sub-base of pavements, adding value to a by-product.

The investment in optimization solutions and the implementation of innovative processes in water treatment and distribution and sewage collection and treatment seek to stimulate the development of fast and efficient solutions, consolidating competitive advantages in the market and improving its economic-financial sustainability.

We also developed biofiltration units for odor control to be installed in the sewage and pumping stations in Pinheiros and Pomar, in the city of São Paulo. This is an example of a project fostered by studies developed internally by us. This project is also funded by FINEP.

We are also developing an engineering project for a vacuum collection and evacuation system for the depletion of a small area located in the municipality of Itanhaém. With the future implementation of this pilot system, it is expected that we will obtain parameters for the design, operation and maintenance of this type of technology and that it will be a technical alternative for exhaustion in areas lacking the necessary infrastructure.

From our partnership with the São Paulo Research Foundation (*Fundação de Amparo à Pesquisa do Estado de São Paulo* –FAPESP) financial resources are invested equally to subsidize and support the development of basic and

applied research projects under the Program for Support of Research in Partnership for Technological Innovation for research projects in academic or research institutions, whose themes originated from the demands pointed out by the operational areas. As an example, we highlight: the use of autonomous microlaboratories for real-time phosphorus monitoring, development of an expert system for detection and diagnosis of leaks in urban water distribution networks, the development of an electronic tongue for taste and odor of water, alternatives for application of water treatment plant sludge in soils and landfills, granular aerobic sludge, among others. These projects are in progress, with preliminary results published.

In partnership with FINEP, the “Technological Innovations Plan of Sabesp for Sanitation” was financed under the FINEP Inova Brasil program. The plan consists of four projects, totaling approximately R\$60 million. These projects include: a system for the production of reuse water for urban and industrial uses; biofiltration units for odor control to be installed in sewage elevated stations; sludge dryer based on solar radiation for the Franca sewage treatment plant; and a plasma gasification system to process the sludge generated at the Barueri sewage treatment system.

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### ***Open Innovation***

We are investing in the development and implementation of actions as part of Open Innovation, integrating ideas, thoughts, processes and research from players from various internal and external segments of our company, aiming to improve its processes, products and services. This project includes: Pitch Sabesp; partnerships among sanitation companies, participation in collaborative networks, design of the Innovation Lab and Coworking, among others.

Pitch Sabesp was a public competition in which 27 challenges were proposed in five different areas. The process was open to the participation of individuals and companies, including startups resident in Brazil and abroad. The selected projects will soon be in the testing phase for technical, economic-financial and business evaluation.

Collaborative Networks for Innovation, in which we participate, provide integration with the different spheres of government, startups, companies, universities, development institutions, etc. All players seek to add knowledge and experience, to build joint solutions for the challenge of implementing open innovation in the public sector. The participation of the Urban Living Labs working group (urban sustainability laboratory - ULL) associated with an international consortium, the Belmont Forum, supported by the nexus among water use, food and power generation, or FEW, and the partnership with Ino3W Ltd. (Ino3W community water system) with the purpose of sharing the information on innovative technologies among large sanitation companies around the world.

In 2018, we entered into the second agreement with the São Paulo Research Foundation (*Fundação de Amparo à Pesquisa do Estado de São Paulo – FAPESP*) to focus on supporting the execution of scientific and/or technological research in micro, small and medium enterprises in the State of São Paulo.

We publish the DAE Magazine, a quarterly engineering journal that in 2018 totaled more than 200 issues since its first edition. This journal includes a specialized team of opinion makers and is currently classified in the Qualis/CAPES system under the category “B2”. Through the publication of technical and scientific articles on basic and environmental sanitation, we aim to encourage and disseminate improvements in processes, innovations and technological advances.

### **D. Trend Information**

Several factors may affect our future results of operations, liquidity and capital resources, including:

- the interests of our controlling shareholder;
- our potential corporate reorganization, as approved by State Law No. 16,525 on September 15, 2017 or any other type of reorganization that might be approved by the government that may include change in control;
- regulations issued by ARSESP regarding several aspects of our business, with respect to our ability to adjust our tariffs and the competency of state and municipalities to manage their sanitation affairs;
- Brazilian economic conditions;
- the effects of extreme weather events;
- the effects of any continuous international financial turmoil that may affect liquidity in the Brazilian capital and lending markets;
-

the effects that further changes in the Basic Sanitation Law and its interpretation may have on the basic sanitation industry in Brazil and on us;

- the effects of inflation in our results of operations;
- the effects of fluctuations in the value of the Brazilian *real* and in interest rates on our net interest income;
- the renewal of our concession agreements;
- the impact on our business of lower water consumption practices adopted by our customers during the water crisis, which we do not know if they will return to their prior standards despite the discontinuation of the measure we adopted to serve the São Paulo metropolitan region during the water crisis;
- investments made, by some sectors, during the water crisis in search of alternative sources of supply, such as the drilling of artesian wells, the reuse of water and the use of rainwater;
- the May 2017 renewal of the concession that regulates the volume of water that may be extracted from the Cantareira System, the main water system we use to serve the São Paulo metropolitan region, based on the volume of water available in the reservoirs divided into five tranches: (i) if the volume of water available is higher than 60% of the reservoirs' capacity, we can 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;

- any measures that we may be required to take to ensure the provision of water to our customers;
- our ability to access financing with favorable terms in the future;
- the potential impacts of the Provisional Measure No. 868/2018 on our business if it is converted into law;
- the outcome of any pending or future legal proceedings; and
- the formalization of agreements with certain of the municipalities we serve.

Some of these factors are described in more detail under “5.A. Operating and Financial Review and Prospects”.

In addition, you should read “3.D. Risk Factors” for a discussion of the risks we face in our business operations, which could affect our business, results of operations or financial condition.

#### **E. Off Balance Sheet Arrangements**

We had no off balance sheet arrangements as of December 31, 2018.

#### **F. Tabular Disclosure of Contractual Obligations**

Our debt obligations and other contractual obligations as of December 31, 2018 were as follows:

|   | <b>Less than<br/>1 year</b>    | <b>1 3 years</b> | <b>3 5 years</b> | <b>More than<br/>5 years</b> | <b>Total</b>    |
|---|--------------------------------|------------------|------------------|------------------------------|-----------------|
|   | (in millions of <i>reais</i> ) |                  |                  |                              |                 |
| Loans and financing                                 | 2,103.6                        | 3,621.8          | 2,088.0          | 5,339.4                      | 13,152.8        |
| Estimated interest payments <sup>(1)</sup>          | 477.7                          | 878.8            | 570.2            | 1,024.8                      | 2,951.5         |
| Accounts payable to suppliers<br>and<br>contractors | 466.0                          | -                | -                | -                            | 466.0           |
| Services payable                                    | 454.0                          | -                | -                | -                            | 454.0           |
| Program contract commitments                        | 244.5                          | 91.3             | 62.0             | 14.4                         | 412.2           |
| Purchase obligations <sup>(2)</sup>                 | 4,197.3                        | 3,014.8          | 1,291.3          | 6,844.6                      | 15,348.0        |
| <b>Total</b>  | <b>7,943.1</b>                 | <b>7,606.7</b>   | <b>4,011.5</b>   | <b>13,223.2</b>              | <b>32,784.5</b> |

(1) Estimated interest payments on loans and financing were determined considering the interest rates as of December 31, 2018. However, our loans and financing are subject to variable interest indexation and foreign exchange fluctuations, and these estimated interest payments may differ significantly from payments actually made. The debt agreements have cross-default clauses.

(2) The purchase obligations are the contractual obligations of investments and expenses.

We believe that we can meet the maturity schedule through a combination of funds generated by operations, the net proceeds of new issuances of debt securities in the Brazilian and international capital markets and additional borrowings from domestic and foreign lenders. Our borrowings are not affected by seasonality. For information

concerning the interest rates on our indebtedness outstanding as of December 31, 2018, see Note 17 to our financial statements as of December 31, 2018 and 2017 and for the years ended December 31, 2018, 2017 and 2016, included elsewhere in this annual report.

## **ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES**

### **A. Directors and Senior Management**

Under our bylaws and Brazilian Corporate Law, we are managed by our board of directors (*Conselho de Administração*), which currently consists of nine directors, and a board of executive officers (*Diretoria*), which currently consists of six executive officers.

As our controlling shareholder, the State has the ability to elect the majority of our board of directors and, therefore, our direction and future operations. Upon the election of a new State governor and any resulting change in the administration of the State, all or some of the members of our board of directors, including our chairman, have historically been replaced by designees of the new administration. Our board of directors may in turn replace some or all of the executive officers. See “Item 3.D. Risk Factors—Risks Relating to Our Control by the State of São Paulo—We are controlled by the State of São Paulo, whose interests may differ from the interests of non-controlling shareholders, including holders of ADSs”.

### ***Board of Directors***

Our bylaws provide for a minimum of seven and a maximum of eleven directors. The members of our board of directors are elected at a general shareholders' meeting to serve a two-year term. Such terms may be renewed three consecutive times. Pursuant to our bylaws, our employees have the option to elect one member of our board of directors. Currently, our employees have not elected a director. In addition, pursuant to Law No. 6,404/1976 of December 15, 1976, as amended, or the "Brazilian Corporate Law", at least one member of the board of directors of mixed capital companies, such as us, must be appointed by the minority shareholders. Finally, according to the Novo Mercado rules and Federal Law No. 13,303/16, at least two, or 25.0% (whichever is greater), of the board of directors must be comprised of independent members.

All the current members of our board of directors were elected at the annual shareholders' meeting held on April 27, 2018, except for Benedito Pinto Ferreira Braga Junior who joined our board of directors on January 10, 2019 when he was appointed our Chief Executive Officer, and Monica Ferreira do Amaral Porto who joined our board of directors on March 12, 2019. The tenure of all the directors will end upon the election of members for the new term at the annual shareholders' meeting in 2020. Currently, we have six members considered independent under the Novo Mercado rules and Federal Law No. 13,303/16.

Our board of directors ordinarily meets once a month or, when necessary for the interests of our company, when called by a majority of the directors or the chairman. Its responsibilities include the establishment of policy and general orientation of our business, and the appointment and supervision of our executive officers.

The following are the names, ages, positions, dates of election and brief biographical descriptions of the current members of our board of directors:

| <b>Director</b>                            | <b>Age</b> | <b>Position</b>                   | <b>Date Elected</b> |
|--|------------|-----------------------------------|---------------------|
| Mario Engler Pinto Junior                  | 62         | Chairman                          | April 27, 2018      |
| Benedito Pinto Ferreira Braga Junior       | 71         | Member                            | January 10, 2019    |
| Monica Ferreira do Amaral Porto            | 62         | Member                            | March 12, 2019      |
| Reinaldo Guerreiro                         | 66         | Independent Member <sup>(1)</sup> | April 27, 2018      |
| Francisco Vidal Luna                       | 72         | Independent Member <sup>(1)</sup> | April 27, 2018      |
| Luís Eduardo Alves de Assis <sup>(2)</sup> | 62         | Independent Member <sup>(1)</sup> | April 27, 2018      |
| Francisco Luiz Sibut Gomide                | 73         | Independent Member <sup>(1)</sup> | April 27, 2018      |
| Lucas Navarro Prado                        | 38         | Independent Member <sup>(1)</sup> | April 27, 2018      |
| Ernesto Rubens Gelbeke                     | 75         | Independent Member <sup>(1)</sup> | April 27, 2018      |

(1) These members comply with the independence requirements established by Federal Law No. 13,303/16 and the *Novo Mercado* rules.

(2) Member indicated by the minority shareholders.

*Mario Engler Pinto Junior.* Mr. Pinto has been the Chairman of our board of directors since April 2018. Mr. Pinto holds a law degree and PhD in Commercial Law from the University of São Paulo (*Universidade de São Paulo – USP*). He is the CEO and a member of the board of directors of the São Paulo Partnership Company (*Companhia Paulista de Parcerias - CPP*), a member of the State Capital Protection Board (*Conselho de Defesa dos Capitais do Estado - CODEC*), chief advisor on public and corporate finance to the Treasury Department, an arbitrator for the B3 Arbitration Chamber, a member of the Advisory Chamber for the Governance Market for State-Owned Companies (*Mercado de Governança de Estatais*) and a member of the Fiscal Council for the Luso-Brazilian Bank (*Banco*

*Luso-Brasileiro*). He is also a professor at the bachelor's and master's levels and for a specialization course at the Getúlio Vargas Foundation (*Fundação Getúlio Vargas – FGV*), where he also conducts legal research regarding contractual and corporate arrangements in the public and private sector and serves as coordinator of the professional master's degree program. He has been an active lawyer since 1979 and served as a São Paulo State Attorney from 1984 to 2014. He was also a member of the Energy Council for the Regulatory Agency of Sanitation and Energy for the State of São Paulo (*Conselho de Orientação de Energia da Agência Reguladora de Saneamento e Energia do Estado de São Paulo*) from 2008 to 2010, a member of our board of directors from 2006 to 2011, a member of our audit committee from 2006 to 2009, a member of the board of directors for the Brazilian Institute of Corporate Governance (*Instituto Brasileiro de Governança Corporativa – IBGC*) from 2004 to 2006, Deputy Attorney General for the State of São Paulo from 2000 to 2003 and a member of the board of directors for the airline Viação Aérea São Paulo from 2000 to 2001.

*Benedito Pinto Ferreira Braga Junior*. Mr. Braga has been our Chief Executive Officer and a member of our board of directors since May 2018. He has a degree in civil engineering from the School of Engineering of São Carlos University of São Paulo (*Escola de Engenharia de São Carlos da Universidade de São Paulo – USP*), a master's degree in Hydrology from Stanford University and a master's degree in Hydraulics from USP, and a PhD in Water Resources from Stanford University. He was Secretary of Sanitation and Water Resources of the State of São Paulo (*Secretário de Saneamento e Recursos Hídricos do Estado de São Paulo*) from January 2015 to May 2018 and was the Chairman of Sabesp's Board of Directors from January 2015 to April 2018. He was a professor at the Polytechnic School of USP (*Escola Politécnica da USP*), from 1980 until December 2018, and has been in a position of Sitting Professor since 1998. He was Co-Chairman of the International Organizing Committee of the World Water Forum in Brasilia (2018), in Korea (2015) and Chairman of the Committee in France (2012). He is an Honorary Chairman of the World Water Council – WWC, of which he was the Chairman from 2012 to 2018. Mr. Braga was also the Chairman of the Intergovernmental Council of UNESCO's International Hydrological Program from 2008 to 2009, Chairman of the International Water Resources Association – IWRA, from 1998 to 2000, as well as, Executive Officer of National Water Agency (*Agência Nacional de Águas, or ANA*) from 2001 to 2009.



*Monica Ferreira do Amaral Porto.* Mrs. Porto has been a member of our board of directors since March 2019. She has a degree in Civil Engineering from the Polytechnic School of the University of São Paulo (Escola Politécnica da Universidade de São Paulo – USP) and master’s and PhD degrees in Hydraulic Engineering from the same institution. She has had a faculty position at the Department of Environmental and Hydraulic Engineering of the Polytechnic School of USP (*Departamento de Engenharia Hidráulica e Ambiental*) since 1984 and has been a Full Professor since 2005. She has also been a Head of Department at this institution since June 2018. She was Deputy Secretary of the Department of Sanitation and Water Resources of the State of São Paulo (*Secretaria de Saneamento e Recursos Hídricos do Estado de São Paulo – SSRH*) between January 2015 and May 2018. She is the Chairperson of the Committee for the Integration of the Paraíba do Sul River Basin (*Comitê de Integração da Bacia do Rio Paraíba do Sul*), representing the SSRH. She was the Chief Executive Officer of the Hydraulic Technology Center Foundation (*Fundação Centro Tecnológico da Hidráulica*) between 2008 and 2014. She has been a member of the Management Board of the Department of Infrastructure and Construction Works of the São Paulo Municipal Government (*Conselho de Gestão da Secretaria de Infraestrutura e Obras da Prefeitura de Municipal de São Paulo*) since January 2017. She was an alternate member of the Board of Governors of the World Water Council, representing USP. From 1998 to 2012, she participated in several international water resource entities: she is a member of the Advisory Committee for the World Water Quality Assessment, the United Nations Environment Program and the Stockholm Water Prize Committee, among others. She was the Chairperson of the Brazilian Association of Water Resources (*Associação Brasileira de Recursos Hídricos*) from 1996 to 1997.

*Reinaldo Guerreiro.* Mr. Guerreiro has been an independent member of our board of directors since January 2007 and a member of our Audit Committee from January 2007 to May 2017. He holds a doctorate in Accounting and Controllershship, a Master’s degree in Accounting and Controllershship and a Bachelor’s degree in Accounting Sciences, all of them from the Business, Economics and Accounting School at the University of São Paulo (*Universidade de São Paulo - USP*). Currently, he is a professor and Deputy Head of the Accounting Department at the Business, Economics and Accounting School at USP. He has authored books in management accounting and has published various scientific articles in domestic and international magazines. He is a specialized consultant in financial management. Mr. Guerreiro has worked on various projects in the areas of financial management, costs, budget and IT in a variety of companies, such as Banco do Brasil, *Caixa Econômica Federal*, Previ and for the São Paulo Government - GESp.

*Francisco Vidal Luna.* Mr. Luna has been an independent member of our board of directors since April 2013 and a member of our Audit Committee from April 2013 to September 2016. He has a doctorate in Economics from the Business, Economics and Accounting School at the University of São Paulo (*Universidade de São Paulo - USP*) and is a retired professor of the same university. In the public sector, he has served as the Secretary of Planning for the state and city of São Paulo. He has also worked at the Treasury Department for the State of São Paulo and the Federal Planning Bureau, among other roles. In the private sector, he was the Executive Chairman of Banco Inter American Express S.A. He is currently a member of the Board of Directors and Chairman of the Audit Committee of Desenvolve SP, member of the Board of Directors and Audit Committee of Gafisa S.A and member of the Board of Curators of FIPE – Fundação Instituto de Pesquisas Econômicas, a member of the Board of Trustees of the *Fundação Faculdade de Medicina - FFM* and a member of the Board of Trustees of *FIPE - Fundação Instituto de Pesquisas Econômicas*.

*Luís Eduardo Alves de Assis.* Mr. Assis has been an independent member of our Board of Directors since April 2014 and a member of our Audit Committee since September 30, 2016. He holds a degree in Economics from the University of São Paulo (*Universidade de São Paulo - USP*), a Master’s degree from the State University of Campinas (*Universidade Estadual de Campinas – UNICAMP*) and an MBA from *Scuola Superiore Enrico Mattei* in Milan, Italy. He was director of Monetary Policy of the Central Bank of Brazil and a professor in the Department of Economics at the Pontifical University of São Paulo (*Pontifícia Universidade Católica de São Paulo - PUC-SP*) and

at the Getulio Vargas Foundation (*Fundação Getulio Vargas - FGV-SP*). He has developed his long career in the financial market, having held the positions of Chief Economist and Investment Director at Citibank, Chief Executive Officer at HSBC Investment Bank Brasil, Chief Executive Officer at HSBC Asset Management, Chief Operating Officer at HSBC Bank Brasil, Senior Strategic Planning Executive at the HSBC Group in London and Local Director for Latin America at HSBC. Currently, he serves as the President of Fator Seguradora and as vice-president of the Fernand Braudel Institute of World Economics council. He also writes an opinion column for the newspaper *O Estado de São Paulo*.

*Francisco Luiz Sibut Gomide* Mr. Gomide has been an independent member of our board of directors since April 2017. He was a member of our Audit Committee from May 2017 to August 2017. He holds Bachelor's degrees in Civil Engineering and in Economic Sciences from the Federal University of Paraná (*Universidade Federal do Paraná*) and a PhD in Hydrology and Water Resources from the Colorado State University. He was the Minister of Mines and Energy in 2002, CEO of ESCELSA – Espírito Santo Centrais Elétricas S.A. between 1995 and 2001, the CEO of the Energy Company of Mato Grosso do Sul between 1997 and 2001, the General Brazilian Director of Itaipu Binacional between 1993 and 1995, the CEO of the Energy Company of Paraná (*Companhia Paranaense de Energia – Copel*) between 1986 and 1993 and the Chief Financial Officer of the same company from 1983 to 1985. Mr. Gomide was also a professor at the Federal University of Paraná (*Universidade Federal do Paraná*) from 1970 to 1995. Between 1969 and 1982, he was a hydraulic engineer and hydrologist at the Energy Company of Paraná.

*Lucas Navarro Prado.* Mr. Prado has been an independent member of our board of directors and a member of our Audit Committee since August 2017. He holds a law degree from the University of São Paulo (*Universidade de São Paulo - USP*) and a master's degree in Corporate Finance and Investment Banking from the University of São Paulo's Business Institute Foundation (FIA-USP). From 2005 to 2007, he served as the advisor to the public-private partnership division of the Planning, Budget and Management Ministry of Brazil. Mr. Prado served as an advisor to SABESP's CEO between 2007 and 2009 and as the head of SABESP's legal department between 2009 and 2011.

*Ernesto Rubens Gelbcke.* Mr. Gelbcke has been an independent member of our board of directors since April 2018. Mr. Gelbcke has a Bachelor's degree and a Master's degree in accounting sciences, both from the School of Economics, Administration and Accounting of the University of São Paulo (Faculdade de Economia, Administração e Contabilidade da Universidade de São Paulo – FEA USP). He worked at Arthur Andersen (various positions, including São Paulo audit coordinator and member of the Brazil technical policies committee) from 1965 to 1976, Directa Auditores (founder and CEO) from 1977 to 2014, Grant Thornton Brasil (chairman of the board of directors) from 2014 to 2015, Gelbcke Consultores (founder and consultant) since 2001, and GHG Contadores (founder) since 2017. He was one of the twelve elected members of the Accounting Pronouncements Committee, representing the Foundation Institute of Accounting, Actuary and Financial Research (*Fundação Instituto de Pesquisas Contábeis, Atuariais e Financeiras – FIPECAFI*) from its creation in 2006 until 2016. He was also a professor at FEA USP from 1971 to 2003, professor and coordinator of the audit specialization course at the Central Bank with the Foundation Institute for Accounting, Actuarial and Financial Research (Fundação Instituto de Pesquisas Contábeis, Atuariais e Financeiras – FIPECAFI) from 1978 to 1980, among others. He has authored and co-authored various articles, technical opinions and books, such as “Accounting Manual for Stock Companies” (Manual de Contabilidade das Sociedades por Ações), “Manual for Corporate Accounting” (Manual de Contabilidade Societária), and “Intermediate Accounting” (*Contabilidade Intermediária*). He was a member of the fiscal committee and of the audit committee of AMBEV S.A. from 2007 to 2009, a member of the Board of Directors of the Brazilian Institute of Independent Accountants (*Instituto dos Auditores Independentes do Brasil – IBRACON*) from 2015 to 2017, and a member of the audit committee of AES Eletropaulo in 2017, among others. Since 2017, he has been a member of the fiscal council of FIPECAFI. This term expires in 2019.

### ***Board of Executive Officers***

Our board of executive officers is composed of six executive officers appointed by our board of directors for a two-year term. Such terms may be renewed three consecutive times. Our executive officers are responsible for all matters concerning our day to day management and operations. Members of our board of executive officers have individual responsibilities established by our board of directors and our bylaws.

The following are the names, ages, positions, dates of election and brief biographical descriptions of our board of executive officers:

| <b>Executive Officer</b>             | <b>Age</b> | <b>Position</b>  | <b>Date Elected</b> |
|--------------------------------------|------------|--|---------------------|
| Benedito Pinto Ferreira Braga Junior | 71         | Chief Executive Officer                                | January 10, 2019    |
| Adriano Candido Stringhini           | 43         | Corporate Management Officer                           | January 10, 2019    |
| Rui de Britto Álvares Affonso        | 61         | Chief Financial Officer and Investor Relations Officer | June 22, 2017       |
| Paulo Massato Yoshimoto              | 66         | Metropolitan Region Officer                            | June 22, 2017       |
| Ricardo Daruiz Borsari               | 63         | Regional Systems Officer                               | January 10, 2019    |
| Edison Airoldi                       | 62         | Technology, Enterprises and Environment Officer        | June 22, 2017       |

*Benedito Pinto Ferreira Braga Junior.* See above, “—Board of Directors”.

*Adriano Candido Stringhin.* Mr. Stringhini was Sabesp's Head of Communication from April 2009 to January 2019 and Head of Legal Affairs from 2007 to 2009. He has a master's degree in Law from the Law School of University of São Paulo (*Faculdade de Direito da Universidade de São Paulo – USP*). He has a degree in Law from USP and he is specialist in Organizational Strategic Communication and Public Relations from School of Communications and Arts of USP (*Escola de Comunicações e Artes – ECA/USP*). He was the Head Lawyer of Funding Authority for Studies and Projects (*Financiadora de Estudos e Projetos -FINEP-SP*) of the Ministry of Science and Technology (*Ministério da Ciência e Tecnologia*) from 2002 to 2007. He was advisor of the Chief Executive Officer of the Administrative Council for Economic Defense (*Conselho Administrativo de Defesa Econômica – CADE*), between 1999 and 2001. He was a professor in undergraduate and graduate courses of several institutions, among them: Fundação Getúlio Vargas - FGV, Mackenzie University and School of Law of the Lawyers of São Paulo Institute (*Escola Paulista de Advocacia do Instituto dos Advogados de São Paulo – IASP*).

*Rui de Britto Álvares Affonso.* Mr. Affonso has been our Chief Financial Officer and Investor Relations Officer since July 2003. Mr. Affonso holds a PhD and a Master's degree in Economics from the State University of Campinas (*Universidade Estadual de Campinas – UNICAMP*), and a degree in Economics from the University of São Paulo (*Universidade de São Paulo - USP*). He has been a professor at UNICAMP since 1986, a professor at the Business, Economics and Accounting School of USP from 1983 to 1989, and a Director of Public Economy at the Foundation of Administrative Development (*Fundação do Desenvolvimento Administrativo*) from 1994 to 2003. He also represented Brazil on the board of directors of the Forum of Federations, a non governmental entity located in Canada, from 2000 to 2006. Mr. Affonso has also held several positions in state government. In 2017 Mr. Affonso won the Professional Award of the Year of 2016 in Finance by ANEFAC/SERASA EXPERIAN

- National Association of Executives of Finance, Administration and Accounting.

*Paulo Massato Yoshimoto.* Mr. Yoshimoto has been our Metropolitan Region Officer since February 2004. He holds a degree in Civil Engineering from the Lins School of Engineering (*Escola de Engenharia de Lins*). Mr. Yoshimoto joined us in 1983, and has held the positions of executive assistant to the operations office and head of the water production and maintenance and metropolitan planning departments. Mr. Yoshimoto has also held the position of senior planning professional at *Empresa Metropolitana de Planejamento* from 1975 to 1983.

*Ricardo Daruiz Borsari.* Mr. Borsari has a degree in Civil Engineering and a master's degree in Civil Engineering from the Polytechnic School of University of São Paulo (*Escola Politécnica da Universidade de São Paulo – USP*). He was Secretary of Sanitation and Water Resources of the State of São Paulo from May to December 2018. He worked in several positions at the Department of Water and Electric Energy (*Departamento de Águas e Energia Elétrica – DAEE*), among them: Engineer since 1978, Executive Officer from January 2015 to May 2018 and from June 2001 to February 2007, Executive Officer of Engineering and Construction Works from August 2010 to October 2011, Executive Officer of the Technology Center of Hydraulic and Water Resources from July 2008 to October 2011. He was Executive Secretary of the Alto Tietê River Basin Committee from 2001 to 2005 and from 2017 to 2018 and Chief Executive Officer and member of the Board of Directors of Metropolitan Water and Energy Company (*Empresa Metropolitana de Águas e Energia – EMAE*), from 2011 to 2015. He was a member of the Board of Directors of Companhia Energética de São Paulo - CESP between April 2015 and May 2018. Mr. Borsari was a professor at several institutions, including: School of Engineering of Mackenzie University from 1979 to 1980, School of Engineering of Fundação Armando Álvares Penteado – FAAP, from 1982 to 1986, Polytechnic School of USP, from 1989 to 2004, and Pontifical University Catholic of São Paulo – PUCSP, from 1997 to 2001.

*Edison Airoidi.* Mr. Airoidi has been our Technology, Enterprises and Environment Officer since June 2015. He holds a degree in Mechanical Engineering from the Polytechnic School at the University of São Paulo (*Universidade de São Paulo - USP*) and a Master's degree in Business Administration from the Foundation Institute of Administration (*Fundação Instituto de Administração - FIA*). Mr. Airoidi joined us in 1981 and has worked with us as the Head of the Northern Region business unit, the Water Production business unit and the Technical and Integrated Planning Unit.

## **B. Compensation**

Pursuant to Brazilian Corporate Law, our shareholders are responsible for establishing the aggregate amount of compensation we pay to the members of our board of directors, members of our fiscal committee and our executive officers. According to Instruction No. 480 issued by CVM, we have to periodically disclose certain information on the aggregate compensation such as averages and fringe benefits.

In 2018, 2017 and 2016, the aggregate compensation, including benefits in kind granted that we paid to members of our board of directors, board of executive officers and fiscal committee for services in all capacities was R\$4.6 million, R\$4.4 million and R\$4.4 million, respectively. At our annual shareholders' meeting held on April 27, 2018, our shareholders approved R\$4.7 million in aggregate compensation payable to members of our board of directors, members of our fiscal committee and our executive officers in 2018.

The table below sets forth the breakdown of the total compensation received by our directors and members of our board of executive officers and fiscal committee and other data related to their compensation for the periods indicated:

|   | <b>Year ended December 31,</b>                                 |              |              |
|---|--|--------------|--------------|
|   | <b>2018</b>  | <b>2017</b>  | <b>2016</b>  |
|   | <i>(in thousands of R\$, except where indicated otherwise)</i> |              |              |
| <b>Total compensation per administrative body</b> |  |              |              |
| Board of directors                                | 1,106  | 848          | 923          |
| Board of executive officers                       | 3,228  | 3,208        | 3,184        |
| Fiscal committee                                  | 280  | 313          | 299          |
| <b>Total amount of compensation</b>               | <b>4,614</b>   | <b>4,369</b> | <b>4,406</b> |
| <b>Number of members (in individuals)</b>         |  |              |              |
| Board of directors                                | 10   | 7            | 8            |
| Board of executive officers                       | 6  | 6            | 6            |
| Fiscal committee                                  | 5  | 5            | 5            |
| <b>Fixed annual compensation</b>                  |  |              |              |
| Salary  |  |              |              |
| Board of directors                                | 851  | 659          | 710          |
| Board of executive officers                       | 1,849  | 1,856        | 1,877        |
| Fiscal committee                                  | 215  | 247          | 243          |
| Direct and indirect benefits                      |  |              |              |
| Board of directors                                | 255  | 189          | 213          |
| Board of executive officers                       | 841  | 796          | 812          |
| Fiscal committee                                  | 65   | 66           | 56           |
| <b>Variable compensation</b>                      |  |              |              |
| Bonus   |  |              |              |
| Board of directors                                | -  | -            | -            |
| Board of executive officers                       | 538  | 556          | 494          |
| Fiscal committee                                  | -  | -            | -            |
| <b>Maximum amount of compensation</b>             |  |              |              |
| Board of directors                                | 162  | 156          | 157          |
| Board of executive officers                       | 677  | 691          | 618          |
| Fiscal committee                                  | 66   | 62           | 61           |
| <b>Minimum amount of compensation</b>             |  |              |              |
| Board of directors                                | 99   | 96           | 96           |
| Board of executive officers                       | 498  | 439          | 420          |
| Fiscal committee                                  | 60   | 62           | 51           |
| <b>Average amount of compensation</b>             |  |              |              |
| Board of directors                                | 115  | 121          | 114          |
| Board of executive officers                       | 516  | 535          | 531          |
| Fiscal committee                                  | 61   | 62           | 61           |

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### ***Profit Sharing and Pension Plans***

We have established a pension and benefit fund (*Fundação SABESP de Seguridade Social*), or SABESPREV, to provide our employees with retirement and pension benefits. This pension plan provides benefit payments to former employees and their families. Both we and our employees make contributions to the pension plan under SABESPREV, which we called as plan G1. Our total contributions to the pension plan totaled R\$36.2 million, R\$48.7 million and R\$24.3 million in 2018, 2017 and 2016, respectively. In addition to the pension plan under SABESPREV, we are also required to pay supplemental pension payments relating to the employment contract of certain employees prior to the creation of SABESPREV, which we called as plan G0. Based on independent actuarial reports, as of December 31, 2018, our obligation under these both plans (G0 and G1) totaled R\$2,970.0 million. For further information on our pension plans see Note 21 to our financial statements included in this annual report.

Beginning in 2008, payments under the profit sharing plan were based both on general goals that evaluate us as a whole and on other goals that evaluate the performance of our different business units. Payments are proportionally reduced annually if the goals are not completely achieved.

We recorded profit sharing expenses of R\$110.5 million, R\$94.4 million and R\$83.7 million in 2018, 2017 and 2016, respectively. We do not have a stock option plan for our employees.

### **C. Board Practices**

The members of our board of directors are elected at an annual shareholders' meeting to serve a two year term. Such term may be renewed three consecutive times. Our next annual shareholders' meeting will be held on April 29, 2019. Our board of directors ordinarily meets once a month or when called by a majority of the directors or the chairman. See "Item 6.A. Directors and Senior Management—Board of Directors".

Our board of executive officers is composed of six executive officers appointed by our board of directors for a two year term. Such term may be renewed three consecutive times. Although our bylaws provide that the meetings of our board of executive officers shall be held at least twice a month, meetings are held on a weekly basis. See "Item 6.A. Directors and Senior Management—Board of Executive Officers".

None of our directors and/or executive officers is a party to an employment contract providing for benefits upon termination of employment. Those directors and officers who are also our employees will remain as our employees after their tenure as directors and/or officers, in this case, maintaining all benefits granted to our employees.

### ***Fiscal Committee (Conselho Fiscal)***

Our fiscal committee, which is established on a permanent basis, consists of a minimum of three and a maximum of five members and generally meets once a month. Our fiscal committee currently consists of four members and four alternates. All of the current members of our fiscal committee were elected in the shareholders' meeting held on April 27, 2018, except Marcio Cury Abumussi, who joined our fiscal committee on October 30, 2018. Their tenure will end on April 29, 2019. The primary responsibility of the fiscal committee, which is independent from management and from the external auditors appointed by our board of directors, is to review our financial statements and report on them to our shareholders.

The following are the names, ages, position, date of election and brief biographical descriptions of the current and alternate members of our fiscal committee:

| <b>Fiscal Committee Members</b>            | <b>Age</b> | <b>Position</b> | <b>Date Elected</b> |
|--|------------|-----------------|---------------------|
| Humberto Macedo Puccinelli                 | 61         | Member          | April 27, 2018      |
| Pablo Andres Fernandez Uhart               | 45         | Member          | April 27, 2018      |
| Rui Brasil Assis                           | 65         | Member          | April 27, 2018      |
| Alexandre Pedercini Issa <sup>(1)</sup>    | 37         | Member          | April 27, 2018      |
| Marcio Cury Abumussi                       | 50         | Alternate       | October 30, 2018    |
| Gustavo Carvalho Tapia Lira                | 40         | Alternate       | April 27, 2018      |
| César Aparecido Martins Louvison           | 58         | Alternate       | April 27, 2018      |
| Leticia Pedercini Issa Maia <sup>(1)</sup> | 38         | Alternate       | April 27, 2018      |

<sup>(1)</sup> Members indicated by the minority shareholders



*Humberto Macedo Puccinelli.* Mr. Puccinelli has been a member of our fiscal committee since April 2011. Mr. Puccinelli holds a degree in Economics from the Pontifical University of São Paulo (*Pontifícia Universidade Católica de São Paulo - PUC-SP*). He worked at the Economy and Planning Secretariat State of São Paulo (*Secretaria de Planejamento e Gestão do Estado de São Paulo*) from 1985 to 1995, at the Health State Department as Assistant Secretary from 1995 to 1996, at the State Treasury from 1996 to 2002, and at the Economy and Planning Secretariat State of São Paulo as Assistant Secretary in 2003. He has been the Technical Assistant of the State Treasury since January 2004.

*Pablo Andres Fernandez Uhart.* Mr. Uhart has been a member of our fiscal committee since April 2017. He holds a Bachelor's degree in Public Administration from the Getulio Vargas Foundation (*Fundação Getúlio Vargas – FGV - SP*) and an MBA from the Pontifical Catholic University of Rio de Janeiro (*Pontifícia Universidade Católica do Rio de Janeiro – PUC - RJ*). He also was an advisor to the São Paulo State Secretary (*Secretaria da Fazenda do Estado de São Paulo – FESP*) and has more than twenty years of experience in finance, having held the positions of Corporate Controller, Regional Head (Latin America) of Treasury Center and Corporate Finance, and Advisor & Risk Manager at Nestlé from 1995 to 2013.

*Rui Brasil Assis.* Mr. Assis has been a member of our fiscal committee since April 2014. He holds a degree in Civil Engineering from Escola de Engenharia de Lins. In the public sector, he worked for Lins City Hall from 1980 to 1983, the Water and Electricity Department from 1983 to 1999, the Water Resources, Sanitation and Construction Secretariat from 1999 to 2003, the Energy, Water Resources and Sanitation Secretariat from 2003 to 2007, the Energy and Sanitation Secretariat from 2007 to 2010 and the Secretariat for Infrastructure and Environment since 2011 (former Secretariat for Sanitation and Water Resources). Mr. Assis has been a member of the fiscal committee of the Foundation Hydraulic Technology Center (*Fundação Centro Tecnológico de Hidráulica*) since 2014. He has also served as a member of the deliberative council of the Foundation Agency of Alto Tietê Water Basin (*Fundação Agência de Bacia Hidrográfica do Alto Tietê*) from 2006 to 2014 and since 2017. Mr. Assis was a member of the fiscal committee of EMAE from 2007 to 2011, the board of directors of the Association for Water Management of the Paraíba do Sul River Basin (*AGEVAP*) from 2003 to 2006 and the board of directors of the Environmental Company of São Paulo State (*Companhia Ambiental do Estado de São Paulo - CETESB*) from 1999 to 2007.

*Alexandre Pedercini Issa.* Mr. Pedercini has been a member of our fiscal committee since April 2017. He holds a Bachelor's degree in Administration from Milton Campos College (*Faculdade Milton Campos*) and an MBA in Strategic Business Management from the Foundation for Education and Culture of Minas Gerais (*Fundação Mineira de Educação e Cultura – FUMEC*). He was a member of the Board of Directors of the Sanitation Company of Minas Gerais State (*Companhia de Saneamento de Minas Gerais – COPASA*) from 2011 to 2016, a member of the fiscal committee of the Telecommunications provider that is part of the Minas Gerais Energy Company Group (*Companhia Energética de Minas Gerais – CEMIG*) between 2013 and 2015. Additionally, he is also the founder and administrator of the investment club Letalex.

*Marcio Cury Abumussi.* Mr. Abumussi holds a degree in Mechanical Engineering from Universidade Paulista and a post-graduate degree in Public Management – Management, Accounting and Finance from Fundação Instituto de Pesquisas Contábeis Atuariais – FIEPECAFI. Since 2017, Mr. Abumussi is the Head of the Technical Department of the Secretariat of Finance of the State of São Paulo, in which he has held several roles, among which: technical assistant from 1997 to 2001, Head of the technical division from 2001 to 2008, Head of the technical department from 2009 to 2016 and general administrative coordinator in 2017. He was a sitting member of the Fiscal Council of Companhia Paulista de Securitização – CPSEC from 2010 to 2017 and alternate member of the Fiscal Council of Empresa Paulista de Planejamento Metropolitano S/A – Emplasa from 2010 to 2011.

*Gustavo Carvalho Tapia Lira.* Mr. Tapia has been a member of our fiscal committee since April 2018. He holds a Bachelor's degree in Administration and a Master's degree in Political Economics, both from the Pontifical University of São Paulo (*Pontifícia Universidade Católica de São Paulo – PUC-SP*). Since 2013, he has been the expert advisor of the Management and Planning Secretariat's Office (*Gabinete da Secretaria de Planejamento e Gestão*), where he also served as an economic advisor public executive from 2009 to 2013. He also worked as an examiner for the Fundação Procon-SP, from 2005 to 2008. He was a member of the fiscal committee of the Paulista Company of Events and Tourism (*Companhia Paulista de Eventos e Turismo – CPETUR*) and is currently a member of the fiscal committee of the São Paulo Retirement Plan (*São Paulo Previdência – SPPREV*).

*César Aparecido Martins Louvison.* Mr. Louvison has been a member of our fiscal committee since April 2017. He holds a Bachelor's degree in Law from the University of Marília (*Universidade de Marília*) and was a professor in several universities and secondary schools (1981-2006). He is currently the Technical Director III of Hydrological Resources Department and was previously a Public Executive at the Secretariat for Sanitation and Water Resources (*Secretaria de Saneamento e Recursos Hídricos do Estado de São Paulo*) between 2013 and 2017. He has also been an administrative director of the Barueri Campus of the Pontifical Catholic University of São Paulo (*Pontifícia Universidade Católica de São Paulo – PUC - SP*) between 2010 and 2011, an Administrative Officer of the Office for the Development of Sanitary Education and Mass Immunization (*Fomento de Educação Sanitária e Imunização em Massa – FESIMA*) between 2000 and 2007, Planning and Control Technical Assistant II of the Justice and Citizenship Defense Secretariat's Office of the State of São Paulo (*Secretaria de Estado da Justiça e Defesa da Cidadania de São Paulo*) between 1998 and 1999, and director of the Brazilian detention center for the youth (*Fundação do Bem-Estar do Menor – FEBEM-SP*) from 1996 to 1998.

*Leticia Pedercini Issa Maia.* Mrs. Pedercini has been a member of our fiscal committee since April 2017. She holds a Bachelor's degree in Administration from the Administrative School of Minas Gerais (*FEAD Minas - Centro de Gestão Empreendedora*). She is the founder and manager of Hydrocenter Válvulas Tubos e Conexões Ltda since 2004 and the Chief Financial Officer of GPI Distribuidora since 2012. She has also been the Vice-President of the Fiscal Council of the Sanitation Company of Minas Gerais State (*Companhia de Saneamento de Minas Gerais – COPASA*) from 2015 to 2016, the President of the Fiscal Council of the Sanitation Company of Minas Gerais State (*Companhia de Saneamento de Minas Gerais – COPASA*) from 2014 to 2015 and a member of the Fiscal Committee of the Sanitation Company of Minas Gerais State (*Companhia de Saneamento de Minas Gerais – COPASA*) from 2011 to 2014. Prior to that, she was a portfolio manager at Clube de Investimentos Letalex from 2007 to 2008 and the CFO of Grupo Dismetel from 1999 to 2004.

### ***Audit Committee***

Our bylaws provide for an audit committee to be comprised of three board members, who will cumulatively comply with the requirements of (i) independence, (ii) technical expertise, and (iii) identifying and complying with applicable exemptions in accordance with the United States Securities and Exchange Commission, or the SEC, and New York Stock Exchange, or NYSE, rules. Our Board of Directors determined that Ernesto Rubens Gelbcke qualifies as a financial expert under the SEC rules. The members are appointed by the board of directors and pursuant to our bylaws, the members of our audit committee may be appointed simultaneously to their election to the board of directors or by a subsequent resolution.

The audit committee is mainly responsible for assisting and advising the board of directors in its responsibilities to ensure the quality, transparency and integrity of our published financial information and financial statements. The audit committee is also responsible for supervising all matters relating to the Code of Conduct and Integrity, accounting, internal controls, the internal and independent audit functions, compliance, risk management and internal policies, such as the related parties transaction policy. The audit committee and its members have no decision-making powers or executive functions.

The minimum availability required from each member of the audit committee is thirty hours per month. Under our bylaws, the members shall exercise their roles for the same period as their corresponding term of office, or until otherwise resolved by the general shareholders' meeting or by resolution of the board of directors. In the event that an audit committee member resigns or is removed from office after exercising any portion of his or her term, such member may only rejoin the audit committee at least three years from the end of such member's term. All of our audit committee members are independent.

The following are the names, positions and dates of election of the members of our audit committee:

| <b>Director</b>             | <b>Position</b>                  | <b>Date Elected</b> |
|-----------------------------|----------------------------------|---------------------|
| Ernesto Rubens Gelbcke      | Coordinator and Financial Expert | June 21, 2018       |
| Lucas Navarro Prado         | Member                           | August 24, 2017     |
| Luís Eduardo Alves de Assis | Member                           | September 30, 2016  |

### ***Eligibility and Advisory Committee***

In accordance with Federal Law No. 13,303/16, and pursuant to our bylaws, as approved at the extraordinary shareholders' meeting held on April 27, 2018, we created an Eligibility and Advisory Committee, responsible for supervising the process for the appointment and evaluation of members of our board of directors, executive board and fiscal council.

This committee is composed of up to three members, elected by a general shareholders' meeting, without a fixed term of office. Members must have at least three years' professional experience in public administration, or three years' experience in the private sector in an area in which, or related to which, we operate. Currently, our Eligibility and Advisory Committee is composed of three members, which is representatives from our legal, human resources and compliance departments.

Members of the Eligibility and Advisory Committee may attend board of directors' meetings where matters related to this committee are discussed and have the right to speak, but not to vote, in accordance with our bylaws.

This committee is also responsible for providing methodological and procedural support to the board of directors to evaluate the performance of officers and other members of statutory committees.

We expect that a written charter addressing the committee's purpose and detailing its required responsibilities will be approved by the board of directors.

**D. Employees**

As of December 31, 2018, we had 14,449 full time employees. On December 31, 2017, we had 956 interns and 485 apprentices (*aprendizes*), as defined by Federal Law No. 10,097/2000, dated December 19, 2000, as amended.

The following table sets forth the number of our full time employees by main category of activity and geographic location as of the dates indicated:

|   | <b>As of December 31,</b> |               |               |
|---|---------------------------|---------------|---------------|
|   | <b>2018</b>               | <b>2017</b>   | <b>2016</b>   |
| <b>Number of employees by category of activity:</b> |                           |               |               |
| Projects and operations                             | 10,683                    | 9,176         | 9,456         |
| Administration                                      | 2,074                     | 2,147         | 2,220         |
| Finance   | 433                       | 387           | 424           |
| Marketing   | 1,259                     | 1,962         | 2,037         |
| <b>Number of employees by corporate division:</b>   |                           |               |               |
| Head office   | 1,485                     | 1,342         | 1,389         |
| São Paulo metropolitan region                       | 6,661                     | 6,353         | 6,634         |
| Regional Systems                                    | 6,303                     | 5,977         | 6,114         |
| <b>Total number of employees</b>                    | <b>14,449</b>             | <b>13,672</b> | <b>14,137</b> |

The average tenure of our employees is approximately 19.2 years. We also outsource certain services such as maintenance, delivery of water and sewage bills, meter reading, catering and security. We believe that our relations with our employees are generally satisfactory.

Approximately 70% of all our employees are members of unions. The five main unions that represent our employees are (i) the Union of Workers in Water, Sewage and Environment of the State of São Paulo – SINTAEMA; (ii) workers union of Santos Urban Industries, Baixada Santista region, South Coast and Vale Ribeira – SINTIUS; (iii) the Union of Engineers of the State of São Paulo – SEESP; (iv) the Union of Attorneys of the State of São Paulo – SASP; and (v) the Union of Industrial Technicians of the State of São Paulo – SINTEC.

The collective bargaining agreement signed in 2016 resulted in: (i) a salary increase of 10.03% (which corresponds to the inflation adjustment for the period); (ii) a 10.03% increase in meal vouchers, food stipends and nursery stipends; (iii) maintenance of the clause from the 2014/2015 collective bargaining agreement which guarantees the employment of 98% of our employees; (iv) and maintenance of the Christmas food stipend.

The collective bargaining agreement signed in 2017 resulted in: (i) a salary increase of 3.7% (which corresponds to the inflation adjustment for the period); (ii) a 7.1% increase in meal vouchers; (iii) a 36.1% increase in food assistance; (iv) a 8.39% increase in nursery stipends; (v) maintenance of the clause from the 2016/2017 collective bargaining agreement which guarantees the employment of 98% of our employees; and (vi) maintenance of the Christmas food stipend on an exceptional basis.

The collective bargaining agreement signed in 2018 resulted in: (i) a salary increase of 1.29% (which corresponds to the inflation adjustment for the period); (ii) a 2% increase in meal vouchers; (iii) a 2% increase in food assistance; (iv) a 2% increase in nursery stipends; (v) maintenance of the clause from the 2017/2018 collective bargaining agreement which guarantees the employment of 98% of our employees; and (vi) maintenance of the Christmas food stipend on an exceptional basis.

We experienced a two-day strike in 2013, which did not interrupt the essential services that we provide. In 2018, 2017, 2016, 2015 and 2014 there were no strikes. Under Brazilian law, our non-administrative employees are considered “essential employees” and, therefore, are limited in their right to strike.

**E. Share Ownership**

As of December 31, 2018, less than 1% of our common shares were owned by our directors and executive officers. See “Item 7.A. Major Shareholder” for more information.

**ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**

**A. Major Shareholder**

On April 22, 2013 our shareholders approved a stock split, following which each common share represented three new common shares. Since then, our outstanding capital stock consists of 683,509,869 common shares, without par value. Under state laws, the State is required to own at least one-half plus one of our outstanding common shares. All of our shareholders, including the State, have the same voting rights.

The following table sets forth ownership information for each of our shareholders that beneficially owned 5.0% or more of our common shares and for our officers and directors, individually and as a group, as of April 17, 2019:

|  | <b>Common shares</b> |               |
|--|----------------------|---------------|
|  | <b>Shares</b>        | <b>%</b>      |
| State of São Paulo <sup>(1)</sup>          | 343,524,291          | 50.3%         |
| Directors and executive officers of Sabesp | 3,000                | 0.0%          |
| Others                                     | 339,982,578          | 49.7%         |
| <b>Total<sup>(2)</sup></b>                 | <b>683,509,869</b>   | <b>100.0%</b> |

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- (1) It includes shares held by the Secretariat of Finance and Planning of the State of São Paulo (Secretaria da Fazenda e Planejamento do Estado de São Paulo) and other companies controlled by the Government of the State of São Paulo.
- (2) As of April 17, 2019, 83% of our outstanding common shares were held by 9,410 registered shareholders in Brazil.

As of April 17, 2019, 17% of our outstanding common shares were held in the United States, in the form of ADSs. According to the ADS depository's records, which contain information regarding the ownership of our ADSs, there were, as of March 31, 2019, 30 record holders of ADSs in the United States.

On May 12, 2017, we announced that the State of São Paulo's Privatization Program Board, established by State Law No. 9,361/1996, dated as of July 5, 1996, resolved to take the following measures:

- (i). to proceed with studies aiming to provide alternatives to our current capitalization model;
- (ii). the hiring of the International Finance Corporation, a member institution of the World Bank Group; and
- (iii). the conclusion of an agreement between us and the São Paulo State Government, through the Secretariat of Sanitation and Water Resources (currently Secretariat of Infrastructure and Environment) and the Secretariat of Finance (currently Secretariat of Finance and Planning), to delineate the scope of the International Finance Corporation's hiring and to govern the relationship between the contracting parties, including the proportional reimbursement of expenses.

The proposed capitalization plan provides for the creation of a new parent company to which the State of São Paulo would transfer all of its ownership interest in us, thus maintaining direct control over our operations through this new parent company. In the process, institutional investors may be invited to participate in the new company's capital, but the State of São Paulo will in any case retain sufficient shareholding interest to exercise corporate control, as required by law.

In September 2017, the State of São Paulo obtained approval for State Law No. 16,525/2017, which authorizes the State of São Paulo to set up a controlling company to hold all of the shares that the State of São Paulo holds in our company. Once formed, this controlling company will control our company, pursuant to the provisions of Art. 116 of 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.

## **B. Related Party Transactions**

***Transactions with the State of São Paulo***

We have entered into extensive transactions with the State, which is our controlling shareholder, and we expect to continue to do so. The State is our largest customer. It owns some of the facilities that we use in our business, it is one of the governmental entities that regulate our business, and it has assisted us in obtaining financing on favorable terms.

Many of our transactions with the State reflect policies of the State that depend on decisions of elected officials or public servants, and are accordingly subject to change. Among the practices that could change are those described below concerning the provision of State guarantees, and the terms on which we use State owned reservoirs.

***Rendering Services***

We provide water and sewage services to the federal government, state and municipal governments and government entities in the ordinary course of our business. Gross revenue from sales to the State, including State entities, totaled R\$501.1 million in 2018, R\$463.0 million in 2017 and R\$445.7 million in 2016. Our accounts receivable from the State for sanitation services totaled R\$105.7 million, R\$106.0 million and R\$77.4 million, as of December 31, 2018, 2017 and 2016, respectively. In addition, as required by law, we invest our cash and cash equivalents with government financial institutions.

***Payment of Pensions***

Pursuant to a law enacted by the State, certain former employees of some State-owned companies that provided services to us in the past and later merged to form our company acquired a legal right to receive supplemental pension benefit payments. These rights are referred to as “Plan G0”. These amounts are paid by us, on behalf of the State, and are claimed by us as reimbursements from the State, as primary obligor. In 2018, 2017 and 2016, we made payments to former employees of R\$180.8 million, R\$179.5 million and R\$178.7 million, respectively in respect of Plan G0. The State made reimbursements in 2018, 2017 and 2016 in the amounts of R\$173.5 million, R\$192.9 million and R\$139.5 million, respectively.



### *Agreements with the State*

In September 1997, we and the State entered into a memorandum of understanding providing that we would, in effect, apply dividends we declared that were otherwise payable to the State to offset accounts receivable in connection with the provision of water and sewage services to the State and its controlled entities.

On December 11, 2001, we entered into an agreement with the State and the DAEE. Pursuant to this agreement, the State acknowledged and agreed, subject to an audit by a State appointed auditor, to pay us amounts it owed to us in respect of:

- water and sewage services we provided to governmental agencies, State owned autonomous entities and foundations through December 1, 2001, and that was not offset in accordance with the September 1997 memorandum of understanding, in the total amount of R\$358.2 million. This amount was renegotiated and included in the second amendment to this agreement discussed below; and
- supplemental retirement and pension benefits we paid from March 1986 to November 2001 on behalf of the State to former employees of the State owned companies which merged to form our company; as we did not reach an agreement regarding these amounts, a joint inquiry has commenced in order to ensure agreement between us and the State, in the total amount of R\$320.6 million. This amount was renegotiated and included in the third amendment to this agreement discussed below.

The agreement provided that the DAEE would transfer to us ownership of the Taiacupeba, Jundiaí, Biritiba, Paraitinga and Ponte Nova reservoirs (herein after referred to as “the reservoirs”), which form the Alto Tietê system, and that the fair value of these assets would reduce the amounts owed to us by the State.

Under the December 2001 agreement, in 2002, a State owned construction company (*Companhia Paulista de Obras e Serviços*), or the CPOS, on behalf of the State, and an independent appraisal firm (*Engenharia de Avaliações*), or the ENGEVAL, on our behalf, presented their valuation reports relating to the reservoirs. Under the agreement, the arithmetic average of these appraisals is deemed the fair value of the reservoirs. The appraisals contained in these reports were in the amounts of R\$335.8 million and R\$341.2 million, respectively. Because we had already made investments in these reservoirs by then, the arithmetic average of the appraisals submitted to our board of directors by August 2002, R\$300.9 million, was net of a percentage corresponding to these investments. Our board of directors approved the valuation reports. This amount was updated until September 2008 according to IPCA index and amounted to R\$696.3 million.

Under the December 2001 agreement, for amounts due in excess of the fair value of the reservoirs, the State is to make payments in 114 consecutive monthly installments. The nominal amount owed by the State would not be indexed to inflation or earn interest if there was a delay in concluding the appraisal of fair value. The installments will be indexed on a monthly basis by the IGP M index, plus 6.0% per year, starting on the date the first installment becomes due.

On October 29, 2003, the Public Prosecution Office of the State of São Paulo (*Ministério Público do Estado de São Paulo*), on behalf of the people of the State, brought a civil public action in a Trial Court of the State of São Paulo (*12 Vara da Fazenda Pública do Estado de São Paulo*) alleging that a transfer to us of ownership of the Alto Tietê system reservoirs from the DAEE would be illegal. An injunction against the transfer of ownership of such reservoirs was granted but was later reversed. However, in October 2004, the court of first instance handed down its judgment on the civil public action and declared the agreement between us, DAEE and State of São Paulo null and void. This decision was suspended by us, and the State treasury and DAEE appealed the decision. On August 23, 2010, the appeal was denied. We have petitioned for clarification of the appeal court’s decision and will seek to take the case to the Supreme Court. The effects of the appeal court’s decision will be suspended until the end of the legal process. We

have assessed that it is not probable that we will ultimately prevail in our appeal, which would prohibit the transfer of the reservoirs in payment of the accounts receivable due from the State.

The December 2001 agreement also provided that the legal advisors of the State would carry out specific analyses, which have commenced, to ensure agreement among the parties as to the methodology employed in determining the amount of reimbursement for pension benefits owed to us by the State. The commencement of payments with respect to pension amounts owed to us by the State has been postponed until these analyses are completed, the appraisal report is approved and the credit assignments relating to the transfer of the reservoirs are formalized. As discussed above, the transfer of these reservoirs is currently being disputed and we are not certain whether the transfer will be legally permitted. Under the December 2001 agreement, the first payment was to be made in July 2002.

On March 22, 2004, we and the State entered into a first amendment to the December 2001 agreement. Under this amendment, the State acknowledged that it owed R\$581.8 million to us relating to unpaid accounts receivable from the State until February 29, 2004, and we acknowledged that we owed an aggregate amount of R\$518.7 million to the State as dividends, in the form of interest on shareholders' equity. Accordingly, we and the State agreed to offset each other's credit up to the limit of R\$404.9 million, which was an amount adjusted up to February 2004. The outstanding balance of R\$176.9 million (as of February 29, 2004) of the State's consolidated debt would be paid in consecutive monthly installments from May 2005 until April 2009. These installments would be indexed according to the IPCA index, plus an interest rate of 0.5% per month. Upon the execution of the first amendment, part of the debt that the State owed to us for the use of water and sewage services through February 2004 was offset by the debt that we owed to the State as dividends, in the form of interest on shareholders' equity. The outstanding balance of R\$113.8 million as dividends in the form of interest on shareholders' equity that we owed to the State was netted against accounts overdue after February 2004. The first amendment did not amend the provisions of the December 2001 agreement regarding the supplemental retirement and pension benefits we paid from March 1986 to November 2001 on behalf of the State to former employees of the State owned companies.

On December 28, 2007, we and the State entered into a second amendment to the December 2001 agreement, pursuant to which the State agreed to pay (i) the outstanding balance under the first amendment, in the amount of R\$133.7 million (as of November 30, 2007), in 60 consecutive monthly installments, beginning on January 2, 2008, and (ii) the amount of R\$236.1 million relating to part of the accounts overdue and unpaid from March 2004 through October 2007 regarding the provision of water supply and sewage collection services. As part of this amendment, we agreed to pay during the period from January through March 2008 the outstanding balance of dividends in the amount of R\$400.8 million, in the form of interest on shareholders' equity, due from March 2004 through December 2006. We paid these amounts as agreed. Under the second amendment, dividends payable by us are no longer required to be applied to offset accounts receivable from the State, and as a result, we are currently unable to determine the amount, if any, of the declared dividends that the State will apply to current and future accounts receivable owed to us by the State or its entities. In addition, pursuant to the second amendment, we and the State agreed on complying with certain mutual obligations relating (i) to the improvement of payment processes and budget management procedures; (ii) the rationalization of the use of water and the volume of water and sewage bills under the responsibility of the State; (iii) the recording of government entities with accounts overdue in a delinquency system or reference file; and (iv) the possibility of interrupting water supply to these entities in case of non payment of water and sewage bills. Finally, this second amendment did not amend the provisions of the December 2001 agreement regarding the supplemental retirement and pension benefits we paid from March 1986 through November 2001 on behalf of the State to former employees of the State owned companies that merged to form our Company.

In 2007, we received payment installments from the State in the amount of R\$326.0 million. As of December 31, 2007, our dividends payable to the State, due from 2004 through 2007, were in the amount of R\$552.0 million. We are currently unable to determine the amount, if any, of the declared dividends that the State will apply to current and future accounts receivable owed to us by the State or its entities. The second amendment no longer requires that dividends be applied to offset accounts receivable from the State.

On March 26, 2008, we entered into a commitment agreement (*termo de compromisso*) with the State with the purpose of finding an alternate solution to the deadlock related to the amount owed by the State to us in connection with the supplemental retirement and pension benefits we paid from March 1986 to November 2001 on behalf of the State to former employees of the State owned companies which merged to form our Company. In this agreement, we and State committed to hiring specialized companies to carry out new valuations of the amounts owed to us by the State and of the reservoirs. An independent consulting firm, FIPECAFI, has been retained to resolve the disagreement and validate the amount we paid from March 1986 through November 2001 on behalf of the State to former employees of the State owned companies that merged to form our Company, which the State has not yet agreed to reimburse us hereinafter referred to as the "Disputed Reimbursement Amount". In addition, FIPECAFI performed, together with another independent consulting firm, a new evaluation of the reservoirs that might be transferred to us as amortization of the reimbursement payable by the State to us.

On November 17, 2008, we, the State and DAEE entered into a third amendment to the December 2001 agreement, pursuant to which the State recognized a debt balance payable to us totaling R\$915.3 million, hereinafter referred to as the "Undisputed Reimbursement Amount", as adjusted based on the IPCA. We accepted on a provisional basis the reservoirs as part of the payment of the Undisputed Reimbursement Amount and offered to the State a provisional settlement, recognizing a credit totaling R\$696.3 million, corresponding to the value of the reservoirs located in the Alto Tietê region. We and the State have agreed that the final offset will only be recorded when the effective transfer of the reservoirs is recorded at the Real Estate Registry. The outstanding balance of Undisputed Reimbursement Amount, amounting to R\$219.0 million, was being paid by the State in 114 consecutive monthly installments and was totally paid in 2018.

On March 18, 2015, we, the State and DAEE, with the intervention of the Department of Sanitation and Water Resources, executed a term of agreement, in the amount of R\$1,012.3 million, of which R\$696.3 million refers to the principal amount and R\$316.0 million refers to the monetary adjustment of the principal through February 2015.

The principal amount is payable in 180 installments, as follows:

- The first 24 installments were settled by an immediate transfer of 2,221,000 preferred shares issued by the São Paulo Company of Electric Power Transmission (Companhia de Transmissão de Energia Elétrica Paulista - CTEEP), totaling R\$87.2 million, based on the share closing price as of March 17, 2015. As of April 20, 2016, the Company sold these shares for R\$111.1 million; and

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- The amount of R\$609.1 million, payable in 156 monthly installments, was adjusted by IPCA until the initial payment date on April 5, 2017, after which installments are adjusted by IPCA plus simple interest of 0.5% per month.

Given that the lawsuit regarding the transfer of the reservoirs is pending final and unappealable court decision, the agreement also provides for the following:

- If transfer is possible and the reservoirs are effectively transferred to us and registered at the authority's office, we will reimburse to the State the amounts paid in replacement of the reservoirs (principal amount) in 60 monthly installments adjusted by IPCA until the payment date of each installment; and
- If the transfer of the reservoirs is not possible, the State will pay us, in addition to the principal amount, the inflation adjustment credit in the amount of R\$316.0 million in 60 installments, following payment of the principal amount. The amount will be adjusted based on IPCA at the start date of payments and, as of that date, IPCA will be incurred plus 0.5% simple interest rate/month over the amount of each installment.

In addition to the Undisputed Reimbursement Amount, there is an outstanding balance relating to the Disputed Reimbursement Amount. As of December 31, 2018, the Disputed Reimbursement Amount amounted to R\$1,107.1 million, but due to the uncertainty regarding the recovery of the amount our management decided not to recognize the reimbursements. See Note 10 to our financial statements included in this annual report regarding the Disputed Reimbursement Amount. We and the State have agreed that the dispute relating to the Disputed Reimbursement Amount will not prevent us from carrying out the commitments made in the December 2001 agreement.

In addition, the third amendment to the December 2001 agreement provides for the regularization of the monthly flow of benefits. While we are liable for the monthly flow of benefits to the former employees of the state owned companies that merged to form our Company, the State shall reimburse us based on criteria identical to those applied when determining the Undisputed Reimbursement Amount. Should there be no preventive court decision, the State will assume the flow of monthly payment of benefits portion deemed as undisputed.

Finally, the third amendment to the December 2001 agreement established that the Public Attorney's Office of the State of São Paulo, or the Public Attorney's Office, would issue a revised interpretation of the calculation and eligibility criteria applicable to the Disputed Reimbursement Amount. At that time, we believed that the Public Attorney's Office would issue a revised interpretation which would have helped us bring the negotiations with the State to a conclusion. However, contrary to our expectations, the Public Attorney's Office interpretation of the calculation and eligibility criteria applicable to the Disputed Reimbursement Amount refuted the reimbursement of the largest portion of this amount. As of December 31, 2018, we had made a provision of R\$2,606.1 million in our pension obligations accounts in respect of the pension benefit obligation of Plan G0.

Even though the negotiations with the State are still progressing, we cannot assure you that we will recover the receivables related to the Disputed Reimbursement Amount.

We will not waive the receivables from the State to which we consider ourselves to be legally entitled. Accordingly, we will take all possible actions to resolve the issue at all administrative and court levels. Should this conflict persist, we will take all the necessary actions to protect our interests. On March 24, 2010, we sent to the controlling shareholder the official letter approved by our executive committee, proposing that the matter be discussed at the B3 Arbitration Chamber. In June 2010, we sent a settlement proposal to the Secretary of Treasury, which was denied, and on November 9, 2010, we filed a civil lawsuit against the State of São Paulo seeking full reimbursement of the amounts paid as benefits granted by Law No. 4,819/1958. Regardless of the civil lawsuit, we will continue to actively seek a settlement with the State government.

*Agreement with the State and the city of São Paulo*

On June 23, 2010 the State and the city of São Paulo executed an agreement in the form of a *convênio*, to which we and ARSESP consented, under which they agreed to manage the planning and investment for the basic sanitation system of the city of São Paulo on a joint basis. The principal terms of this *convênio* were as follows:

- the State and the city of São Paulo would execute a separate agreement with us, granting us exclusive rights to provide water and sewage services in the city of São Paulo;
- ARSESP would regulate and oversee our activities regarding water and sewage services in the city of São Paulo, including tariffs;
- a management committee (*Comitê Gestor*), consisting of six members appointed for two-year terms, with the State and the city of São Paulo given the right to appoint three members each, would be responsible for planning water and sewage services for the city and for reviewing our investment plans; and

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- we may participate in management committee meetings but may not vote.

In application of the *convênio*, we executed a separate contract with the State and the city of São Paulo, also dated June 23, 2010, to regulate the provision of these services for the following 30 years. The principal terms of this contract are as follows:

- The total investment stated in the contract must be equal to 13% of gross revenues from the provision of services to the city of São Paulo, net of the taxes on revenues.
- We must transfer 7.5% of the gross revenues obtained from providing sanitation services in the municipality of São Paulo and subtract (i) COFINS and PASEP taxes, and (ii) unpaid bills of publicly owned properties in the city of São Paulo, to the Municipal Fund for Environmental Sanitation and Infrastructure (*Fundo Municipal de Saneamento Ambiental e Infraestrutura*), established by Municipal Law No. 14,934/2009. In April 2013, ARSESP postponed the application of such municipal charges based on a request from the São Paulo State Government to analyze, among other things, methods to reduce the impact on consumers. In May 2014 ARSESP maintained the suspension of Resolution 407/2013 until the results are obtained in the revision of the contract signed between us, the city and the State of São Paulo, thereby delaying the authorization to pass the charge through to consumers on the service bill.
- Our investment plan must be compatible with the sanitation plans of the State, the city of São Paulo and, if necessary, the Metropolitan region.
- ARSESP will ensure that the tariffs will adequately compensate us for the services we provide and that tariffs may be adjusted in order to restore the original balance between each party's obligations and economic gain (*equilíbrio econômico financeiro*).

We currently have an investment plan in place that reflects our obligations under the *convênio* and addresses their compatibility with the sanitation plans of the State, the city of São Paulo and, if necessary, the São Paulo metropolitan region. The investment plan is not irrevocable and is reviewed every four years by our management committee. We draft a detailed work plan every two years, particularly with respect to the investments to be executed in the subsequent period. In December 2016, we concluded the first four-year revision of our contract with the city of São Paulo, which altered our service quality, investment and investment tracking targets. However, the issue of the 7.5% charge was not discussed.

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. This administrative appeal was denied by ARSESP on February 28, 2019. For more information, see "Item 4.B. Business Overview—Tariffs—Second Ordinary Tariff Revision (2017-2020)".

### ***Dividends***

We regularly pay dividends to our shareholders, including the State of São Paulo. In the past, we have withheld part of the dividends to which the State was entitled in order to offset it against our pending receivables from the State as described above.

In accordance with our agreements with the State, we do not anticipate that we will withhold dividends to which the State was entitled in order to offset it against our pending receivables from the State in the near future.

### ***Government Guarantees of Financing***

In some situations, the federal government, the State or government agencies guarantee our performance under debt and project related agreements.

Furthermore, the federal government has guaranteed, and the State has provided a counter guarantee, in respect of the financial agreements we entered into with the IADB (i) in 1992 and 2000 for the total original aggregate amount of US\$600.0 million related to the financing of the first and second phases of the Tietê River recovery project to reduce pollution; and (ii) in 2010 for the aggregate amount of US\$600 million related to the financing of the third phase of the Tietê River project. The federal government has also guaranteed and the State of São Paulo has provided a counter guarantee, in respect of the financial agreement we entered with the IBRD in the amount of US\$100 million for the Water Source Program (*Programa Mananciais*).

We also entered into credit agreements with JICA, which were guaranteed by the federal government, with counter guarantee from the State of São Paulo, for the financing of (i) the Clean Wave Program for the Baixada Santista metropolitan region, on August 6, 2004, for an aggregate principal amount of ¥21,320 million; (ii) the second phase of the Clean Wave Program, in February 2011, for an aggregate principal amount of ¥19,169 million; (iii) the environmental improvement program in the basin of the Billings dam, in October 2010, for an aggregate principal amount of \$6,208 million; and (iv) the Corporate Program for Water Loss Reduction, in February 2012, for an aggregate principal amount of ¥33,584 million.



For more information on the aforementioned loans, see “Item 5.B. Liquidity and Capital Resources—Indebtedness Financing”.

### *Use of Reservoirs*

We withdraw water for use in the São Paulo metropolitan area from the Guarapiranga and Billings reservoirs. We do not pay any fees for the use of these reservoirs, although we are responsible for maintaining them and funding their operating costs. The State incurs no operating costs on our behalf.

EMAE, a company that is also controlled by the State of São Paulo, has a concession to produce hydroelectric energy using water from the same reservoirs. EMAE commenced various lawsuits against us in the past seeking compensation for the water we withdraw from these reservoirs. Those lawsuits have now been settled by way of an agreement between EMAE and us.

The settlement agreement settled the compensation arrangements between EMAE and our company. It requires us to pay the following amounts to EMAE:

- R\$46.3 million, plus inflation adjustments indexed to the IPCA index, payable in five annual installments from April 2017 through April 2022, plus
- R\$6.6 million, plus inflation adjustments indexed to the IPCA index, payable in 25 annual installments from October 2017 through October 2042.

If we fail to pay any installment to EMAE when due, all remaining amounts to be paid under the agreement will become immediately due and payable.

On April 11, 2016, we were also named in a separate lawsuit commenced by minority shareholders of EMAE against the State of São Paulo, as controlling shareholder of EMAE. The minority shareholders are seeking an order to require the State to stop us from 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 us. The lawsuit is in its initial phase. The settlement agreement between EMAE and us will not necessarily put an end to this separate lawsuit.

In addition, on August 7, 2017 we were named in a new lawsuit against us, EMAE and ANEEL, brought by Alvaro Luiz de Lima de Alvares Otero, another minority shareholder of EMAE, requesting the annulment of ANEEL’s order approving the settlement agreement mentioned above, as well as 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 will not necessarily put an end to this separate lawsuit.

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.

***Agreements with Lower Tariffs***

We have entered into agreements with public entities, including State entities and municipalities, which manage approximately 9,082 properties. Under these agreements, these public entities pay a different tariff which is approximately 25.0% lower than the tariff that applies for the public entities that have not entered into these agreements, provided such entities implement our Program for Rational Use of Water (*Programa de Uso Racional da Água – PURA*), which has a fixed target for reduction or maintenance of water consumption, according to technical evaluations carried out by us. These agreements are valid for a 12 month term with automatic renewal for equal periods. Pursuant to the terms of these agreements, if these entities fail to make any payment on a timely basis to us, we have the right to cancel the agreement, thereby revoking the 25.0% tariff reduction.

***Personnel Assignment Agreement among Entities Related to the State Government***

We have personnel assignment agreements with entities related to the State Government, under which the expenses are fully passed on and monetarily reimbursed. The expenses related to personnel assigned by us to other state government entities in 2018, 2017 and 2016 amounted to R\$8.9 million, R\$9.9 million and R\$10.4 million, respectively.

The expenses related to personnel assigned by other entities to us totaled R\$0.1 million in 2018. There were no expenses related to personnel assigned by other entities to us in 2017. The expenses related to personnel assigned by other entities to us totaled R\$0.01 million in 2016.

### ***Services Obtained from State Government Entities***

As of December 31, 2018 and 2017, we had an outstanding amount payable of R\$8.7 million and R\$1.4 million, respectively, for services rendered by São Paulo State government entities, including the supply of electric power by the Energy Company of São Paulo (*Companhia Energética de São Paulo –CESP*).

### ***Non operating Assets***

We lend land, free of charge, to DAEE. Such non operating assets totaled R\$1.0 million as of December 31, 2018 and 2017.

### ***Transactions with SABESPREV Pension Fund***

SABESPREV is a pension fund we established to provide our employees with retirement and pension benefits. The assets of SABESPREV are independently held, but we nominate 50.0% of SABESPREV's board of directors, including the chairman of the board, who has the deciding vote pursuant to the applicable legislation. Both we and our employees make contributions to SABESPREV pension plans. We contributed R\$20.8 million, R\$19.2 million and R\$10.8 million in 2018, 2017 and 2016, respectively. On May 29, 2001, a federal law was enacted which, among other provisions, limits the amount mixed capital companies, like us, may contribute to their pension plans. Specifically, the ordinary contributions made by us to our pension plans may not exceed the contributions made by the beneficiaries of these plans.

Our original pension plan (the Defined Benefit Plan) has an actuarial deficit. We have commenced studies to manage this deficit and have also created a new, Defined Contribution Plan (SABESPREV Mais). Our new plan was approved by Previc in June 2010, after which our old plan stopped accepting new members. Contributions to the new plan are also shared between plan members and Sabesp, and benefits are established based on the balance of the individual member's account when payment on his or her benefit begins. This balance consists of contributions and profitability obtained when applying resources. We intended to have members of the old plan migrate their reserves to the new plan. This migration was interrupted by a judicial order as a result of proceedings brought by representative entities for our employees and ex employees. In October 2010, the judge presiding over the case pronounced in an interim decision that people and reserves were not allowed to migrate between the plans until a further decision was made. This decision also prevents the plan from charging contributions to account for the deficit for those who remained covered by the original plan. In September 2012, the judge presiding over the case ordered a financial expert inspection and in early 2013 a financial expert was appointed to the case. The results of this inspection were unfavorable to the representative entities for our employees and ex employees and in 2016 the proceeding was dismissed, revoking the interim decision made in October 2010.

In 2016, participants were again offered the ability to migrate according to the rules established by the regulatory authority. The Retiree and Pensioner Association filed a judicial proceeding questioning the amounts that were transferred from the benefits plan to the individual accounts of the participants who migrated to the Defined Contribution Plan. On March 14, 2018, the judge presiding over the case held that the adjustment of the Defined Benefit Plan's actuarial deficit was permitted and terminated the lawsuit related to the migration process of members from the Defined Benefit Plan to the Defined Contribution Plan.

***Compensation of Management***

The compensation paid by us to the members of our board of directors, board of executive officers and fiscal committee amounted to R\$4.1 million, R\$3.8 million and R\$3.9 million in 2018, 2017 and 2016, respectively, and it refers to salaries and other short term benefits management. An additional R\$0.5 million, R\$0.6 million and R\$0.5 million related to the bonus program was accrued to executive officers in 2018, 2017 and 2016.

For further information on management compensation, see “Item 6.B. Directors and Senior Management—Compensation”.

***Loan agreement through credit facility***

We hold interests in some companies. Although we do not hold the majority of shares in any of the companies in which we hold interests, we are party to shareholders’ agreements which provide for the power of veto with regard to certain management proposals and decisions. Due to our significant influence on these companies by way of shareholders’ agreements, for accounting purposes, these companies are accounted for by applying the equity method of accounting.

We entered into loan agreements with the special purpose enterprises Aquapolo Ambiental S.A. on March 30, 2012 and Attend Ambiental S.A. on May 9, 2014 under which we made loans to finance their respective operations, until their loans due to banks are cleared.

The table below summarizes the terms of those agreements at December 31, 2018:

| Companies               | Principal<br>disbursed | Interest<br>balance | Total         | Interest<br>rate   | Maturity |
|-------------------------|------------------------|---------------------|---------------|--------------------|----------|
| Aquapolo Ambiental S.A. | 19,000                 | 13,857              | 32,857        | CDI + 1.2%<br>p.a. | (1)      |
| <b>Total</b>            | <b>19,000</b>          | <b>13,857</b>       | <b>32,857</b> | -                  | -        |

(1) The loan agreement originally expired on April 30, 2015, was extended to October 30, 2015 and on November 25, 2015 a new amendment changed the payment schedule for three annual installments, the first of which maturing on December 30, 2021 and the last on December 30, 2023.

As of December 31, 2018, the principal and interest balance of this agreement was R\$32.9 million, recorded as a non current assets under “Other Accounts Receivable”. In 2018, we recognized financial income of R\$2.8 million.

#### ***Pró-Conexão***

In 2012, the State of São Paulo approved a project to subsidize connections to the sewage system for low income families. Initially intended to last eight years, the project involves capital expenditures of up to R\$349.5 million of which 80% will be provided by the State government and 20% by us. In this period, we expect that this program will create 192,000 new sewage connections benefiting approximately 800,000 people.

As of December 2018, we had completed approximately 25.5 thousand sewage connections under the *Pró-Conexão* program.

#### **C. Interests of Experts and Counsel**

Not applicable.

### **ITEM 8. FINANCIAL INFORMATION**

#### **A. Financial Statements and Other Financial Information**

See “Item 18. Financial Statements”.

#### **Legal Proceedings**

We are currently subject to numerous legal proceedings relating to civil, tax, labor, corporate and environmental issues arising in the normal course of our business. Several individual disputes account for a significant part of the total amount of claims against us. Our material legal proceedings are described in Note 20 to our financial statements included in this annual report, and that description is incorporated by reference under this Item.

***Civil Public Actions Related to Environmental Matters***

We are subject to administrative and judicial proceedings, including proceedings initiated by the *Companhia Ambiental do Estado de Sao Paulo* (CETESB), the State of São Paulo Public Prosecutor Office and non governmental organizations. These proceedings result from alleged environmental damage and relief sought against us includes: (i) cessation of the release of raw sewage into certain local bodies of water; (ii) remedies, in some cases, for environmental damages that have not yet been specified and evaluated by the court's technical experts; (iii) requirements to install and operate sewage treatment facilities in locations referred to in the civil public actions; and (iv) imposition of a limit on water extracted from the water springs most affected by the water crisis. In certain cases, we are subject to daily fines for non compliance. In our response to these lawsuits, we note that the installation and operation of sewage treatment facilities in locations referred to in the civil public actions is included in our investment plan. There have already been unfavorable judicial decisions against us and their effects may include: (i) investment in works or services not considered by our long term investment plan; (ii) early execution of works or services that were considered for execution in future years in our long term investment plan; (iii) payments related to environmental indemnification; and (iv) a negative impact on our image in national and international markets and in public bodies.

Although we are not able to predict the final outcome of these lawsuits, we believe that the outcome, if unfavorable to us, may have a material adverse effect on us. We recognize provisions for classify certain of these proceedings as defined in Note 3.15 to our financial statements included in this annual report. As of December 31, 2018, we have provisions totaling R\$170.4 million for the matters stated in Note 20 to our financial statements included in this annual report.

**Other Legal Proceedings**

On December 30, 2003, the Civil Entity Coordination Committee of Piracicaba filed a civil class action against us, the National Water Agency and the State of São Paulo Treasury Department seeking, among other claims relief for: (i) the termination of use of 31 m<sup>3</sup>/s of water from one of the municipality's reservoirs; (ii) the creation of a schedule to regulate water use and withdrawal from the Piracicaba river basin by the Cantareira system to eliminate possible damage to populations downstream; and (iii) the development of an environmental impact study on the Cantareira system evaluating the impact of water use and withdrawal on the various basins that constitute the system. In August 2012, this civil public action was decided favorably for us in two lower courts, and the plaintiff's appeal to a higher court seeking special and extraordinary recourse was denied based on inadmissibility. We are currently awaiting a court decision on the action brought by the plaintiff against the decisions of inadmissibility cited. The amount involved in this proceeding as of December 31, 2018 is R\$25.8 billion. We have assessed that we do not have a current obligation as a result of a past event, and accordingly have not made any provisions.

On November 30, 2012, the Public Prosecutor's Office of the State of São Paulo on November 30, 2012 filed a civil class action against us seeking: (i) the nullification of the contract we entered into with the municipality of São Paulo on June 23, 2010 regarding the supply of water and sewage services; (ii) our exclusion from the B3's Corporate Sustainability Index; and (iii) sewage treatment coverage of the entire municipality of São Paulo by 2018. The plaintiff's request for an injunction was denied, and the courts maintained this decision after we presented our defense. On November 18, 2014, the case was dismissed in the first instance, and the plaintiff presented an appeal. This first decision was upheld by the Court of Justice and was finally settled. The amount involved in these proceedings is R\$16.5 billion as of December 31, 2018. We have assessed that we do not have a current obligation as a result of a past event, and accordingly have not made any provisions.

## **Dividends and Dividend Policy**

### ***Amounts Available for Distribution***

At each annual shareholders' meeting, the board of directors is required to recommend the allocation of net profits for the preceding fiscal year. For purposes of Brazilian Corporate Law, net profits are defined as net income after income tax and social contribution tax for such fiscal year, net of any accumulated losses from prior fiscal years and any amounts allocated to employees' and management's participation in our profits. In accordance with Brazilian Corporate Law, the amounts available for dividend distribution are the amounts equal to half of the net profit as increased or reduced by:

- the amount intended to form the legal reserve; and
- the amount intended to form the reserves for contingencies and any written-off amounts of the same reserves formed in previous fiscal years.

We are required to maintain a legal reserve, to which we must allocate 5.0% of net profits for each fiscal year until the amount for such reserve equals 20.0% of our paid in capital. However, we are not required to make any allocations to our legal reserve in respect of any fiscal year in which the aggregate amount of the legal reserve plus our other established capital reserves exceeds 30.0% of our capital. Net losses, if any, may be offset against the legal reserve. As of December 31, 2018, 2017 and 2016 the balance of our legal reserve was R\$1,200.0 million, R\$1,058.3 million and R\$923.3 million, respectively, which was equal to 8.0%, 10.6% and 9.3%, respectively, of our capital.

Brazilian Corporate Law also provides for two discretionary allocations of net profits that are subject to approval by the shareholders at each annual shareholders' meeting. First, a percentage of net profits may be allocated to a contingency reserve for anticipated losses that are deemed probable in future years. Any amount so allocated in a prior year must be either reversed in the fiscal year in which the loss was anticipated if such loss does not in fact occur, or written off in the event that the anticipated loss occurs. Second, if the mandatory distributable amount exceeds the sum of realized net profits in any given year, such excess may be allocated to an unrealized revenue reserve. Under Brazilian Corporate Law, realized net profits is defined as the amount of net profits that exceeds the net positive result of equity adjustments and profits or revenues from operations with financial results after the end of the next succeeding fiscal year.

Under Brazilian Corporate Law, any company may authorize the creation of a discretionary reserve in its bylaws. Bylaws which authorize the allocation of a percentage of a company's net income to the discretionary reserve must also indicate the purpose, criteria for allocation and maximum amount of the reserve. We may also allocate a portion of our net profits for discretionary allocations for plan expansion and other capital investment projects, the amount of which would be based on a capital budget previously presented by management and approved by our shareholders.

Under Law No. 10,303/2001 of October 31, 2001, as amended, capital budgets for more than one year must be revised at each annual shareholders' meeting. After completion of the relevant capital projects, we may retain the allocation until the shareholders vote to transfer all or a portion of the reserve to capital or retained earnings. As of December 31, 2018, 2017 and 2016 we had an investment reserve of R\$3,840.4 million, R\$6,939.3 million and R\$5,249.8 million, respectively.

The amounts available for distribution may be further increased by a reversion of the contingency reserve for anticipated losses constituted in prior years but not realized. The amounts available for distribution are determined on the basis of our financial statements prepared in accordance with Brazilian GAAP.

The legal reserve is subject to approval by the shareholder vote at our annual shareholders' meeting and may be transferred to capital but is not available for the payment of dividends in subsequent years.

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### ***Mandatory Distribution***

Brazilian Corporate Law generally requires that the bylaws of each Brazilian corporation specify a minimum percentage of the amounts available for distribution by such corporation for each fiscal year that must be distributed to shareholders as dividends, also known as the mandatory distributable amount. Under our bylaws, the mandatory distributable amount has been fixed at an amount equal to not less than 25.0% of the amounts available for distribution, to the extent amounts are available for distribution at the end of each given fiscal year.

The mandatory distribution is based on a percentage of adjusted net income, not lower than 25.0%, rather than a fixed monetary amount per share. Brazilian Corporate Law, however, permits a publicly held company, such as us, to suspend the mandatory distribution if the board of directors and the fiscal committee report to the shareholders' meeting that the distribution would be inadvisable in view of the company's financial condition. The suspension is subject to the approval of holders of common shares. In this case, the board of directors must file a justification for such suspension with the CVM. Profits not distributed by virtue of the suspension mentioned above shall be attributed to a special reserve and, if not absorbed by subsequent losses, must be paid as dividends as soon as the financial condition of such company permits such payments.

### ***Payment of Dividends***

We are required by Brazilian Corporate Law and by our bylaws to hold an annual shareholders' meeting by the fourth month after the end of each fiscal year at which, among other things, the shareholders have to decide on the payment of an annual dividend when profits were accrued. The decision to distribute annual dividends is based on the financial statements prepared for the relevant fiscal year. Under Brazilian Corporate Law, dividends generally are required to be paid within 60 days following the date the dividend was declared, unless a shareholders' resolution sets forth another date for payment, which, in either case, must occur prior to the end of the fiscal year in which the dividend was declared. A shareholder has a three year period from the dividend payment date to claim dividends (or interest payments on shareholders' equity as described under "—Record of Dividend Payments and Interest on Shareholders' Equity") distributed on his or her shares, after which the amount of the unclaimed dividends reverts to us. The depositary will set the currency exchange date to be used for payments to ADS holders as soon as practicable upon receipt of those payments from us.

Our bylaws allow us to pay interim dividends from preexisting and accumulated profits related to the current or preceding fiscal year.

In general, shareholders who are not residents of Brazil must register with the Central Bank to have dividends, sales proceeds or other amounts with respect to their shares eligible to be remitted outside of Brazil. The common shares underlying our ADSs are held in Brazil by Banco Bradesco S.A., as the custodian and agent for the depositary, which is the registered owner of the common shares underlying the ADSs. Our current registrar is Banco Bradesco S.A. The depositary electronically registers the common shares underlying the ADSs with the Central Bank and, therefore, is able to have dividends, sales proceeds or other amounts with respect to these shares eligible to be remitted outside Brazil. See "Item 10.D. Exchange Controls".

Payments of cash dividends and distributions, if any, will be made in Brazilian *reais* to the custodian on behalf of the depositary, which will then convert such proceeds into U.S. dollars and will cause such U.S. dollars to be delivered to the depositary for distribution to holders of ADSs. See "Item 10.D. Exchange Controls". Under current Brazilian law, dividends generally paid to shareholders who are not Brazilian residents, including holders of ADSs, will not be subject to Brazilian withholding income tax, except for dividends declared based on profits generated prior to December 31, 1995. See "Item 10.E. Taxation".

***Record of Dividend Payments and Interest on Shareholders' Equity***

Brazilian corporations are permitted to distribute dividends in the form of a tax deductible notional interest expense on shareholders' equity in accordance with Law No. 9,249/1995 of December 26, 1995, as amended. The amount of tax deductible interest that may be paid is calculated by applying the daily *pro rata* variation of the government's long-term interest rate (TJLP) on the shareholders' equity during the relevant period and cannot exceed the greater of:

- 50.0% of net income (before taking into account such distribution and any deductions for income taxes and after taking into account any deductions for social contributions on net profits) for the period in respect of which the payment is made; or
- 50.0% of earnings reserves and retained earnings.

Any payment of interest on shareholders' equity to holders of ADSs or common shares, whether or not they are Brazilian residents, is subject to Brazilian withholding income tax at the rate of 15.0% or 25.0% if the beneficiary is resident in a low tax jurisdiction (tax haven). See "Item 10.E. Taxation". The amount paid to shareholders as interest on shareholders' equity, net of any withholding tax, may be included as part of the mandatory dividends distributable amount as prescribed in Brazilian Corporate Law.

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Dividends and interest on shareholders' equity over the minimum established in a company's bylaws are recognized when approved by the shareholders in the general meeting. Consequently, the amounts recognized as of December 31, 2018 correspond to the minimum established by law of 25.0% of the net income and the difference of R\$792.2 million will be recorded in 2019 after the annual shareholders' meeting.

### *Distributions of dividends*

The following table sets forth the distributions of dividends that we made to our shareholders in respect of our 2018, 2017 and 2016 earnings. All these amounts distributed or to be distributed were or will be in the form of interest on shareholders' equity.

| <b>Year ended December 31,</b> | <b>Aggregate<br/>amount proposed</b> | <b>Payment Dates</b> | <b>Payment per<br/>share</b> | <b>Payment per<br/>ADS</b> |
|--------------------------------|--------------------------------------|----------------------|------------------------------|----------------------------|
|                                | (in millions of<br><i>reais</i> )    |                      |                              | (in <i>reais</i> )         |
| 2018                           | 792.2                                | June 28, 2019        | 1.16                         | 1.16                       |
| 2017                           | 703.9                                | June 26, 2018        | 1.03                         | 1.03                       |
| 2016                           | 823.5                                | June 27, 2017        | 1.20                         | 1.20                       |

\* We recorded dividends in the amount of R\$673.3 million, which pursuant to our bylaws is our minimum dividend amount. We expect to pay the dividends on June 28, 2019.

### *Dividend Policy*

We intend to declare and pay dividends and/or interest on shareholders' equity, as required by Brazilian Corporate Law, our bylaws and our dividend policy. Our board of directors may propose the distribution of interest on shareholders' equity, calculated based on our semiannual or quarterly financial statements. The declaration of dividends is annual, including dividends in excess of the mandatory distribution, and requires approval by the vote of the majority of the holders of our common shares. The proposed distribution of dividends should consider (i) the need for investments to universalize basic sanitation services; (ii) the achievement of our corporate purpose, as set forth in our bylaws; (iii) the cash generation and cash requirements; and (iv) our economic and financial sustainability. The amount of any distributions will depend on many factors, such as our results of operations, financial condition, cash requirements, prospects and other factors deemed relevant by our board of directors and shareholders. Within the context of our tax planning, we may in the future continue to determine that it is in our best interest to distribute interest on shareholders' equity.

## **B. Significant Changes**

Other than as disclosed in this annual report, no significant change has occurred since the date of the audited financial statements included in this annual report.

## **ITEM 9. THE OFFER AND LISTING**

### **A. Offer and Listing Details**

*Market for our Common Shares*

Our common shares have been listed on the São Paulo Stock Exchange (B3) under the trading symbol “SBSP3” since June 4, 1997 and, starting on April 24, 2002, have been included in the *Novo Mercado* segment of that exchange.

*Market of our ADSs*

Our ADSs, each of which represents one of our common shares are listed on the NYSE under the trading symbol “SBS”.

**B. Plan of Distribution**

Not applicable.

**C. Markets**

**Trading on the Brazilian Stock Exchange**

Our common shares are traded on the B3, the only Brazilian stock exchange that trades shares. Trading on the B3 is limited to brokerage firms and a limited number of authorized entities. The CVM and the B3 have discretionary authority to suspend trading in shares of a particular issuer under certain circumstances.

Trading on the B3 is conducted between 10:00 a.m. and 4:55 p.m. or from 10:00 a.m. to 5:55 p.m. (during daylight savings time in Brazil). The B3 also permits trading from 5:30 p.m. to 6:00 p.m. during a different trading period called the “after market”. The after-market session is restricted to certain stocks that were traded in the portfolios IBOV and/or IBrX and that were traded on the same day during the regular negotiation. Trading during aftermarket is subject to regulatory limits on price volatility and on the volume of shares transacted through internet brokers.

In order to maintain better quality control over the fluctuation of its index, the B3 has adopted a “circuit breaker” system pursuant to which trading sessions are suspended (i) for a period of 30 minutes whenever the index of this stock exchange falls more than 10% from the index registered for the previous day; (ii) for one hour if the index of this stock exchange falls 15% or more from the index registered for the previous day, after the reopening of trading; and (iii) for a certain period of time to be defined by the B3, if the index of this stock exchange falls 20% or more from the index registered for the previous day, after the reopening of trading. The minimum and maximum price is based on a reference price for each asset, which will be the previous session’s closing quote, when considering the asset at the beginning of the day before the first trade, or the price of the day’s first trade. The asset’s reference price will be altered during the session if there is an auction sparked by the intraday limit being breached. In this case the reference price will become whatever results from the auction.

The B3 settles the sale of shares three business days after they have taken place, without monetary adjustment of the purchase price. The shares are paid for and delivered through a settlement agent affiliated with the B3. The B3 performs multilateral compensation for both the financial obligations and the delivery of shares. According to the B3’s regulations, financial settlement is carried out by the Central Bank’s reserve transfer system. The securities are transferred by the B3’s custody system. Both delivery and payment are final and irrevocable.

Trading on the B3 is significantly less liquid than trading on the NYSE or other major exchanges in the world. Although any of the outstanding shares of a listed company may trade on the B3, in most cases fewer than half of the listed shares are actually available for trading by the public, the remainder being held by a controlling group or by government entities.

Trading on the B3 by a holder not deemed to be domiciled in Brazil for Brazilian tax and regulatory purposes, or a “non Brazilian holder”, is subject to certain limitations under Brazilian foreign investment regulations. With limited exceptions, non Brazilian holders may trade on Brazilian stock exchanges in accordance with the requirements of CMN Resolution No. 4,373/2014, which requires that securities held by non Brazilian holders be maintained in the custody of financial institutions authorized by the Central Bank and by the CVM or in deposit accounts with financial institutions. In addition, Resolution No. 4,373/2014 requires non Brazilian holders to restrict their securities trading to transactions on the B3 or qualified over the counter markets. With limited exceptions, non Brazilian holders may not transfer the ownership of investments made under Resolution No. 4,373/2014 to other non Brazilian holders through a private transaction. See “Item 10.E. Taxation—Brazilian Tax Considerations—Taxation of Gains” for a description of certain tax benefits extended to non Brazilian holders who qualify under Resolution No. 4,373/2014.

### ***The Novo Mercado Segment***

Since April 24, 2002, our common shares have been listed on the Novo Mercado segment of the B3. The Novo Mercado is a listing segment designed for the trading of shares issued by companies that voluntarily undertake to abide by certain additional corporate governance practices and disclosure requirements in addition to those already required under Brazilian law. A company with shares listed on the Novo Mercado must follow good practices of corporate governance. These rules generally increase shareholders’ rights and enhance the quality of information provided to shareholders. On April 18, 2002, June 19, 2006, April 23, 2012 and April 27, 2018 our shareholders approved changes to our bylaws to comply with the Novo Mercado requirements.

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

- maintain only common shares;

- hold public offerings of shares in a manner favoring diversification of the company's shareholder base and broader access to retail investors;
- grant tag along rights for all shareholders in connection with a transfer of control of the company;
- limit the term of all members of the board of directors to two years;
- hold a tender offer by the company's controlling shareholder (the minimum price of the shares to be offered will be determined by an appraisal process) if it elects to delist from the Novo Mercado, unless a waiver is granted by the company's shareholders;
- maintain a related party transactions policy, including (i) the criteria to be followed in the performance and approval of related party transactions, (ii) the procedures for identifying conflicts of interest and establishing voting restrictions for conflicted shareholders, directors and executive officers, and (iii) the procedures for identifying related parties and related party transactions;
- the chairman of the board of directors is prohibited from simultaneously holding the position of chief executive officer;

- the board of directors must disclose its opinion on takeover proposals within 15 days from the presentation of the proposal;
- relevant facts, notices to market or to shareholders and press releases must be made in English simultaneously with the disclosure made in Portuguese;
- ensure that at least two or 20.0% (whichever is greater) of the members of the board of directors are independent, as defined under the *Novo Mercado* regulation;
- maintain a minimum free float of at least (i) 25.0% of the capital stock of the company, or (ii) 15.0% of the capital stock of the company, in the event that the average daily trading volume is equal to or greater than R\$25.0 million;
- the company must have an internal audit committee;
- disclose information on the share ownership of controlling shareholders and certain related parties on a monthly basis;
- resolve and require the shareholders, directors, and members of the fiscal committee of the company to resolve any and all disputes among them by arbitration before the Chamber of Market Arbitration (*Câmara de Arbitragem do Mercado*); and
- the company must adopt and publish a code of conduct approved by the board of directors, as well as, policies for (i) compensation; (ii) election of board and committee members; (iii) risk management; (iv) related party transactions; and (v) the purchasing and trading of securities.

Companies already listed in the Novo Mercado segment have until April 2021 to make the necessary changes in order to comply with these new rules. We are working to implement such changes and believe that such implementation will be completed by the April 2021 deadline.

#### *Regulation of Brazilian Securities Markets*

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

Under Brazilian Corporate Law, a company is either public (*companhia aberta*), such as we are, or closely held (*companhia fechada*). All public companies, including us, are registered with the CVM and are subject to reporting requirements. A company registered with the CVM may have its securities traded on the Brazilian stock exchanges or in the Brazilian over the counter market. Our common shares are listed and traded on the B3 and may be traded privately subject to certain limitations.

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

We have the option to ask that trading in our securities on the B3 be suspended in anticipation of a material announcement. Trading may also be suspended on the initiative of the B3 or the CVM, among other reasons, based

on or due to a belief that a company has provided inadequate information regarding a material event or has provided inadequate responses to the inquiries by the CVM or the São Paulo Stock Exchange.

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

Trading on the B3 by non residents of Brazil is subject to limitations under Brazilian foreign investment and tax legislation. The Brazilian custodian for our common shares underlying the ADSs must, on behalf of the depositary for our ADSs, obtain registration from the Central Bank to remit U.S. dollars abroad for payments of dividends, any other cash distributions, or upon the disposition of the shares and sales proceeds thereto. In the event that a holder of ADSs exchanges ADSs for common shares, the holder will be entitled to continue to rely on the custodian's registration for five business days after the exchange. Thereafter, the holder may not be able to obtain and remit U.S. dollars abroad upon the disposition of our common shares, or distributions relating to our common shares, unless the holder obtains a new registration. See "Item 10.D. Exchange Controls".

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**D. Selling Shareholders**

Not applicable.

**E. Dilution**

Not applicable.

**F. Expenses of the Issue**

Not applicable.

**ITEM 10. ADDITIONAL INFORMATION**

**A. Share Capital**

Not applicable.

**B. Memorandum and Articles of Association**

The following is a summary of the material terms of our common shares, including related provisions of our bylaws and Brazilian Corporate Law. This description is qualified by reference to our bylaws and to Brazilian law.

**Corporate Purposes**

We are a mixed capital company (*sociedade de economia mista*) of unlimited duration, incorporated on September 6, 1973, with limited liability, duly organized and operating under Brazilian Corporate Law. As set forth in Article 2 of our bylaws, our corporate purpose is to render basic sanitation services, aimed at the universalization of basic sanitation in the state of São Paulo 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.

**Directors' Powers**

In addition to the general provisions of Brazilian law, our Board of Director's Internal Charter contains the specific provisions set out below regarding a director's power to vote on a proposal, arrangement or contract in which that director has a material interest. Under Brazilian Corporate Law, a director or an executive officer is prohibited from voting in any meeting or with respect to any transaction in which that director or executive officer has a conflict of interest with the company and must disclose the nature and extent of the conflicting interest to be recorded in the minutes of the meeting. In any case, a director or an executive officer may not transact any business with the company, including any borrowing, except on reasonable or fair terms and conditions that are identical to the terms and conditions prevailing in the market or offered by third parties.

According to our Board of Director's Internal Charter, when a matter involves a conflict of interest with ours or a particular interest in the matter, each member of the Board of Directors shall (i) declare his impediment in a timely

manner, as soon as he becomes aware of the fact, (ii) refrain from intervening in the matter in discussion or deliberation, (iii) include the fact in the minutes of the meeting, and (iv) abstain from discussions and deliberations.

Under our bylaws, our shareholders are responsible for establishing the compensation we pay to the members of our board of directors, members of the fiscal committee and the executive officers.

Pursuant to Brazilian Corporate Law, each member of our board of executive officers must be a resident in Brazil. Our bylaws do not establish any mandatory retirement age limit.

See also “Item 6.A. Directors and Senior Management”.

## **Description of Common Shares**

### ***General***

Each common share entitles the holder thereof to one vote at our annual or special shareholders’ meetings. According to the Brazilian Corporate Law and CVM regulation, our shareholders’ meetings must be called by publication of a notice in the *Diário Oficial do Estado de São Paulo*, the official government publication of the State of São Paulo, and in a newspaper of general circulation in our principal place of business (in our case, the publication “*Valor Econômico*”), currently the city of São Paulo, at least fifteen days prior to the meeting. In addition, the CVM requires issuers of American Depositary Shares, like us, to issue the first call for a shareholders’ meeting up to 30 days before such shareholders’ meeting. The quorum to hold shareholders’ meetings on first call requires the attendance of shareholders, either in person or by proxy, representing at least 25.0% of the shares entitled to vote and, on second call, the meetings can be held with the attendance of shareholders, also either in person or by proxy, representing any number of shares entitled to vote.

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Under Brazilian Corporate Law, our common shares are entitled to dividends or other distributions made in respect of our common shares in proportion to their share of the amount available for the dividend or distribution. See “Item 8A. Financial Statements and Other Financial Information—Dividends and Dividend Policy” for a more complete description of payment of dividends and other distributions on our common shares. In addition, upon any liquidation of our Company, our common shares are entitled to our remaining capital after paying our creditors in proportion to their ownership interest in us.

In principle, a change in shareholder rights, such as the reduction of the compulsory minimum dividend, is subject to a favorable vote of the shareholders representing at least one half of our voting shares. Under some circumstances that may result in a change in the shareholder rights, such as the creation of preferred shares, Brazilian Corporate Law requires the approval of a majority of the shareholders who would be adversely affected by the change attending a special meeting called for such reason. It should be emphasized, however, that our bylaws expressly prevent us from issuing preferred shares. Brazilian Corporate Law specifies other circumstances where a dissenting shareholder may also have appraisal rights.

According to Brazilian Corporate Law, neither a company’s bylaws nor actions taken at a general meeting of shareholders may deprive a shareholder of certain rights, such as:

- the right to participate in the distribution of profits;
- the right to participate equally and ratably in any remaining residual assets in the event of liquidation of the company;
- the right to supervise the management of the corporate business as specified in Brazilian Corporate Law;
- the right to preemptive rights in the event of a subscription of shares, debentures convertible into shares or subscription bonuses (except in some specific circumstances under Brazilian law); and
- the right to withdraw from the company in the cases specified in Brazilian Corporate Law.

Pursuant to Brazilian Corporate Law and our bylaws, each of our common shares carries the right to one vote at our shareholders’ meetings. We may not restrain or deny that right without the consent of the holders of a majority of the shares affected.

Neither Brazilian Corporate Law nor our bylaws expressly address:

- staggered terms for directors;
- cumulative voting, except as described below; or
- measures that could prevent a takeover attempt.

However, under the laws of the State of São Paulo, the State is required to own at least a majority of our outstanding common shares.

According to Brazilian Corporate Law and its regulations, shareholders representing at least 10 percent of our capital, may request that a multiple voting procedure be adopted to entitle each share to as many votes as there are board members and to give each shareholder the right to vote cumulatively for only one candidate or to distribute their votes

among several candidates. Pursuant to Brazilian Corporate Law, shareholder action must be taken at a shareholders meeting, duly called for and not by written consent.

In addition, shareholders owning at least 15.0% of the capital may request the right to elect, separately a member of the Board of Directors.

***Preemptive Rights***

Each of our shareholders has a general preemptive right to subscribe for shares or securities convertible into shares in any capital increase, in proportion to his or her ownership interest in us, except in the event of the grant and exercise of any option to acquire shares of our capital stock. The preemptive rights are valid for a 30 day period from the publication of the announcement of the capital increase. Shareholders are also entitled to sell this preemptive right to third parties. Under Brazilian Corporate Law, we may amend our bylaws to eliminate preemptive rights or to reduce the exercise period in connection with a public offering of shares or an exchange offer made to acquire another company.

In the event of a capital increase by means of the issuance of new shares, holders of ADSs, or of common shares, would, except under circumstances described above, have preemptive rights to subscribe for any class of our newly issued shares. However, an ADS holder may not be able to exercise the preemptive rights relating to the common shares underlying his or her ADSs unless a registration statement under the Securities Act is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. See “Item 3.D. Risk Factors—Risks Relating to Our Common Shares and ADSs—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”.

### ***Redemption and Rights of Withdrawal***

Brazilian Corporate Law provides that, under limited circumstances, a shareholder has the right to withdraw his or her equity interest from the company and to receive payment for the portion of shareholder's equity attributable to his or her equity interest. This right of withdrawal may be exercised by dissenting our shareholders in the event that at least half of all voting shares outstanding authorize us:

- to reduce the mandatory distribution of dividends;
- to merge into another company or to consolidate with another company, subject to the conditions set forth in Brazilian Corporate Law;
- to participate in a centralized group of companies, as defined under Brazilian Corporate Law and subject to the conditions set forth therein;
- to change our corporate purpose;
- to split up, subject to the conditions set forth in Brazilian Corporate Law;
- creating preferred shares or increasing an existing class of preferred shares without maintaining the existing ratio with the remaining class of preferred shares, unless when already set forth in or authorized by the bylaws;
- to transform into another type of company;
- to transfer all of our shares to another company or to receive shares of another company in order to make the company whose shares are transferred a wholly owned subsidiary of such company, known as *incorporação de ações*; or
- to acquire control of another company at a price which exceeds the limits set forth in Brazilian Corporate Law.

The right of withdrawal lapses 30 days after publication of the minutes of the shareholders' meeting that approved a corporate action described above. We would be entitled to reconsider any action giving rise to withdrawal rights within 10 days following the expiration of such rights if the withdrawal of shares of dissenting shareholders would jeopardize our financial condition. Brazilian Corporate Law allows companies to redeem their shares at their economic value, subject to the provisions of their bylaws and certain other requirements. Our bylaws currently do not provide that our capital stock will be redeemable at its economic value and, consequently, any redemption pursuant to Brazilian Corporate Law would be made based on the book value per share, determined on the basis of the last balance sheet approved by the shareholders. However, if a shareholders' meeting giving rise to redemption rights occurred more than 60 days after the date of the last approved balance sheet, a shareholder would be entitled to demand that his or her shares be valued on the basis of a new balance sheet dated within 60 days of such shareholders' meeting.

In addition, the rights of withdrawal in the third, fourth and eighth bullet points above may not be exercised by holders of shares if such shares (i) are liquid, defined as being part of the Bovespa index (*Índice Bovespa*) or other stock exchange index (as defined by the CVM), and (ii) are widely held, such that the controlling shareholder or companies it controls have less than 50.0% of our shares. Our common shares are included on the Bovespa index.

This right of withdrawal may also be exercised in the event that the entity resulting from a stock merger as described above, consolidation or spin off of a listed company fails to become a listed company within 120 days of the shareholders' meeting at which such transaction was approved.

We may cancel the right of withdrawal if the payment amount has a material adverse effect on our finances.

### **Conversion Right**

Not applicable because our capital stock is only comprised of common shares.

### **Special and General Meetings**

Unlike the laws governing corporations incorporated under the laws of the United States' state of Delaware, the Brazilian corporate law does not allow shareholders to approve matters by written consent obtained as a response to a consent solicitation procedure. All matters subject to approval by the shareholders must be approved in a general meeting, duly convened pursuant to the provisions of Brazilian corporate law. Shareholders may be represented at a shareholders' meeting by attorneys in fact who are (i) shareholders of the corporation, (ii) a Brazilian attorney, (iii) a member of management or (iv) a financial institution.

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General shareholders' meetings shall be called, convened and deliberated under Brazilian Corporate Law to address all matters of interest to the company. General shareholders' meetings may be called by publication of a notice in the *Diário Oficial do Estado de São Paulo* and in a newspaper of general circulation in our principal place of business, and the first call should be made at least 15 days prior to the meeting. In our case, the first call is made 30 days in advance due the issuance of ADRs, as recommended by the CVM. The second call should be made at least 8 days in advance, if quorum is not reached, pursuant to the Brazilian Corporate Law.

At duly called and convened meetings, our shareholders are empowered to take any action regarding our business. Shareholders have the exclusive right, during our annual shareholders' meetings required to be held within 120 days of the end of our fiscal year, to approve our financial statements and to determine the allocation of our net income and the distribution of dividends related to the fiscal year immediately preceding the meeting. The members of our board of directors are generally elected at annual shareholders' meetings. However, according to Brazilian corporate law, they can also be elected at extraordinary shareholders' meetings. At the request of shareholders holding a sufficient number of shares, a fiscal committee can be established and its members elected at any shareholders' meeting.

A special shareholders' meeting may be held concurrently with the annual shareholders' meeting and at other times during the year. Our shareholders may take the following actions, among others, exclusively at shareholders' meetings:

- election and dismissal of the members of our board of directors and our fiscal committee, if the shareholders have requested the setup of the latter;
- approval of the aggregate compensation of the members of our board of directors and board of executive officers, as well as the compensation of the members of the fiscal committee;
- amendment of our bylaws;
- approval of our merger, consolidation or spin off;
- approval of our dissolution or liquidation, as well as the election and dismissal of liquidators and the approval of their accounts;
- granting stock awards and approval of stock splits or reverse stock splits;
- approval of stock option plans for our management and employees, as well as for the management and employees of other companies directly or indirectly controlled by us;
- approval, in accordance with the proposal submitted by our board of directors, of the distribution of our net income and payment of dividends;
- authorization to delist from the *Novo Mercado* and to become a private company, except if the cancellation is due to a breach of the *Novo Mercado* regulations by management, and to retain a specialized firm to prepare a valuation report with respect to the value of our shares, in any such events;
- approval of our management accounts and our financial statements;
- approval of any primary public offering of our shares or securities convertible into our shares; and

- deliberate upon any matter submitted by the board of directors.

### **Limitations on Rights to Own Securities**

There are no limitations under Brazilian law and our bylaws on the rights of non residents or foreign shareholders to own securities, including the rights of such non resident or foreign shareholders to hold or exercise voting rights.

### **Equal Treatment Provisions**

Pursuant to our bylaws and the *Novo Mercado* regulations, any party that acquires our control must extend a tender offer for the shares held by non controlling shareholders at the same conditions and purchase price paid to the controlling shareholder. In addition, State Law No. 119/1973, which created our Company, requires the State to hold the majority of our shares at all times.

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## Reserves

### *General*

The Brazilian Corporate Law provides that all discretionary allocations of “adjusted income” are subject to shareholder approval and may be added to capital or distributed as dividends in subsequent years. In the case of our capital reserve and the legal reserve, they are also subject to shareholder approval; however, the use of their respective balances is restricted to being added to capital or absorbed by losses. They cannot be used as a source for income distribution to shareholders.

### *Investment Reserve*

Our investment reserve is composed specifically of internal funds for expansion of water and sewage service systems. As of December 31, 2018, we had an investment reserve of R\$3,840.4 million.

### *Legal Reserve*

Under Brazilian Corporate Law, we are required to record a legal reserve to which we must allocate 5% of the adjusted net income each year until the amount of the reserve equals 20.0% of paid in capital. Any accumulated deficit may be charged against the legal reserve. As of December 31, 2018, the balance of our legal reserve was R\$1,200.0 million.

## Arbitration

In connection with our listing with the *Novo Mercado* segment of the B3, we, our shareholders, directors and officers have undertaken to refer to arbitration any and all disputes or controversies arising out of the *Novo Mercado* rules or any other corporate matters. See “Item 9.C. Markets”. Under our bylaws, any dispute among us, our shareholders and our management with respect to the application of *Novo Mercado* rules, the Brazilian Corporate Law, the application of the rules and regulations regarding Brazilian capital markets, will be resolved by arbitration conducted pursuant to the B3 Arbitration Rules in the Market Arbitration Chamber. Any dispute among shareholders, including holders of ADSs, and any dispute between us and shareholders, including holders of ADSs, will also be submitted to arbitration.

## Options

There are currently no outstanding options to purchase any of our common shares.

### **C. Material Contracts**

For a description of the material contracts entered into by the State and us, see “Item 7.B. Related Party Transactions—Transactions with the State of São Paulo” and “Item 7.B. Related Party Transactions—Agreements with the State”.

### **D. Exchange Controls**

The right to convert dividend or interest payments and proceeds from the sale of shares into foreign currency and to remit such amounts outside Brazil is subject to restrictions under foreign investment legislation which generally requires, among other things, that the relevant investments have been registered with the Central Bank and the CVM. Such restrictions on the remittance of foreign capital abroad may hinder or prevent the custodian for our common

shares represented by our ADSs or the holders of our common shares from converting dividends, distributions or the proceeds from any sale of these shares into U.S. dollars and remitting the U.S. dollars abroad. Holders of our ADSs could be adversely affected by delays in, or refusal to grant any, required government approval to convert Brazilian currency payments on the common shares underlying our ADS and to remit the proceeds abroad.

Accordingly, the proceeds from the sale of ADSs by ADR holders outside Brazil are not subject to Brazilian foreign investment controls, and holders of the ADSs are entitled to favorable tax treatment under certain circumstances. See “Item 3.D. Risk Factors—Risks Relating to Our Common Shares and ADSs—Investors who exchange ADSs for common shares may lose their ability to remit foreign currency abroad and to obtain Brazilian tax advantages” and “Item 10.E. Taxation—Brazilian Tax Considerations”.

Since March 30, 2015, CMN Resolution No. 4,373/2014, of September 29, 2014, has been in full effect, providing for the issuance of depositary receipts in foreign markets in respect to shares of Brazilian issuers. The CMN Resolution No. 4,373/2014, among other acts, revoked CMN Resolution No. 1,927/1992, of May 18, 1992, CMN Resolution No. 1,289/1987, of March 20, 1987, and CMN Resolution No. 2,689/2000, of January 26, 2000. Under Brazilian law relating to foreign investment in the Brazilian capital markets, foreign investors registered with the CVM and acting through authorized custodial accounts managed by local agents may buy and sell shares on Brazilian stock exchanges without obtaining separate certificates of registration for each transaction. Foreign investors may register their investment under Law No. 4,131/1962, of September 3, 1962, as amended, or under CMN Resolution No. 4,373, of September 20, 2014.

The Law No. 4,131/1962 is the main legislation concerning investment of direct foreign capital and foreign direct equity in companies based in Brazil. It is applicable to any amount of capital that enters Brazil in the form of foreign currency, goods or services. Foreign investment portfolios are regulated by CMN Resolution No. 4,373/2014, CVM Instruction No. 559/2015, of March 27, 2015, which regulates the approval of ADR programs by the CVM, and CVM Instruction No. 560/2015, of March 27, 2015, which regulates the filing of transactions and disclosure of information by foreign investors, all reflecting the provisions of CMN Resolution No. 4,373/2014.

As of January 1, 2016, foreign investors that intend to be registered with the CVM shall fulfill the requirements under CVM Instruction No. 560/2015. In accordance with CMN Resolution No. 4,373/2014 the definition of a foreign investor includes individuals, legal entities, mutual funds and other collective investment entities, domiciled or headquartered abroad. In order to become a 4,373 Holder, a foreign investor must:

- appoint at least one representative in Brazil, with powers to perform actions relating to its investment;
- appoint an authorized custodian in Brazil for its investments, which must be a financial institution or entity duly authorized by the Central Bank or CVM;
- appoint a tax representative in Brazil;
- through its representative in Brazil, register itself as a foreign investor with the CVM;
- through its representative in Brazil, register its foreign investment with the Central Bank; and
- be registered with the Federal Tax Authority (*Secretaria da Receita Federal*), or the “RFB”, pursuant to RFB Normative Instruction No. 1,548/2015, of February 13, 2015, and RFB Normative Instruction No. 1,863/2018, of December 27, 2018.

## **E. Taxation**

This summary contains a description of certain Brazilian and U.S. federal income tax consequences of the purchase, ownership and disposition of common shares or ADSs by a holder.

The summary is based upon the tax laws of Brazil and the federal income tax laws of the United States as in effect on the date of this annual report, which laws are subject to change, possibly with retroactive effect, regarding the U.S. federal income tax, and to differing interpretations. Holders of common shares or ADSs should consult their own tax advisors as to the Brazilian, U.S. or other tax consequences of the purchase, ownership and disposition of common shares or ADSs, including, in particular, the effect of any non-Brazilian, non-U.S., state or local tax laws.

Although there presently is no income tax treaty between Brazil and the United States, the tax authorities of the two countries have had discussions in the past regarding such a treaty. No assurance can be given, however, as to if or when a treaty will enter into force or how it will affect the U.S. holders of common shares or ADSs.

### **Brazilian Tax Considerations**

The following discussion summarizes the principal Brazilian tax consequences of the acquisition, ownership and disposition of common shares or ADSs by a holder that is not domiciled in Brazil for purposes of Brazilian taxation (a “non Brazilian holder”). It is based on Brazilian laws and regulations as currently in effect, and, therefore, any change in such law may change the consequences described below. Each non Brazilian holder should consult his or her own tax

adviser concerning the Brazilian tax consequences of an investment in common shares or ADSs.

A non Brazilian holder of ADSs may withdraw them in exchange for common shares in Brazil. Pursuant to Brazilian law, the non Brazilian holder may invest in the common shares under CMN Resolution 4,373/2014 or as a foreign direct investment under Law No. 4,131/1962.

### ***Taxation of Dividends***

As a result of the tax legislation adopted on December 26, 1995, dividends based on profits generated after January 1, 1996, including dividends paid in kind, payable by us in respect of common shares or ADSs, are exempt from withholding income tax. Dividends relating to profits generated prior to January 1, 1996 may be subject to Brazilian withholding income tax at varying rates, depending on the year the profits were generated.

Beginning in 2008, the Brazilian accounting rules were significantly modified in order to align them with IFRS. After the issuance of such new rules, a transitory tax regime (*regime tributário de transição*), or RTT, was created mainly to ensure neutrality of the new accounting rules in connection with the calculation and payment of corporate taxes on income. Thus, according to the RTT, Brazilian companies had, only for purposes of calculation of their taxable profit, to use the accounting rules and criteria that existed until December 2007.

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As a result of the application of the RTT, the accounting profit of a Brazilian company might be significantly higher (or lower) than its taxable profit. Although this specific matter has not been expressly regulated by law, the Brazilian tax authorities issued a normative instruction stating that the amount of dividends paid in excess of the profit of a company determined as per the accounting rules and criteria that existed until December 2007 should be subject to taxation.

On April 14, 2014, Law No. 12,973 was issued to, among other, terminate the Transitory Regime (RTT) and regulate how corporate taxable income should be assessed taking as a starting point the accounting profit calculated according to the new accounting rules introduced as from 2008. Such Law states that dividends related to all accounting profits generated between January 2008 and 31 December 2013 in excess of the established methods and criteria in force in December 31, 2007, are not subject to withholding tax, and does not integrate the calculation of income tax and social contribution. With reference to 2014, the law is not clear, but tax authorities state that dividends paid in excess of the profit of a company determined as per the accounting rules and criteria that existed until December 2007 should be subject to withholding income tax at the rate of 15%, or 25% if the non-Brazilian holder is domiciled in a country or location that does not impose income tax or where the maximum income tax rate is lower than 20% (“Nil or Low Taxation Jurisdiction”). As of 2015, in view of the termination of the RTT, there would be no differences between the accounting and the taxable profit, so that dividends generated since 2015 should be fully paid with no Brazilian withholding tax implications.

### ***Taxation of Gains***

Gains realized on disposition of common shares are subject to income tax in Brazil, regardless of whether the sale or the disposition is made by a non-Brazilian holder to a resident or person domiciled in Brazil. This is due to the fact that the common shares can be considered assets located in Brazil for purposes of Law No. 10,833/2003.

Thus, gains, for purposes of taxation of gains earned in a sale or disposition of common shares carried out on a Brazilian stock exchange (which includes transactions carried out on the organized over-the-counter market):

- are exempt from income tax when assessed on a non-Brazilian holder that (1) has registered its investment in Brazil with the Central Bank under the rules of CMN Resolution No. 4,373/2014, and (2) is not a resident of or domiciled in a Nil or Low Taxation Jurisdiction; or
- in all other cases, including gains realized by a non-Brazilian holder that is not a 4,373 holder and/or is a resident of or domiciled in a Nil or Low Taxation Jurisdiction, subject to income tax at a 15.0% rate. In these cases, a withholding income tax at a rate of 0.005% will be applied and can later be offset with the eventual income tax due on the capital gain.

Any other gains assessed on the disposition of the common shares that are not carried out on the Brazilian stock exchange are subject to income tax at (i) a flat rate of 15% for a 4,373/2014 holder that is not a resident of or domiciled in a Nil or Low Taxation Jurisdiction; (ii) a flat rate of 25.0% for a non-Brazilian holder that is a resident of or domiciled in a Nil or Low Taxation Jurisdiction; (iii) progressive rates that may vary from 15.0% to 22.5% (15.0% for the part of the gain that does not exceed R\$5.0 million, 17.5% for the part of the gain that exceeds R\$5.0 million but does not exceed R\$10.0 million, 20.0% for the part of the gain that exceeds R\$10.0 million but does not exceed R\$30.0 million and 22.5% for the part of the gain that exceeds R\$30.0 million), for all other non-Brazilian holders. If these gains are related to transactions conducted on the Brazilian non-organized-over-the-counter market with intermediation, withholding income tax of 0.005% shall also be applicable and can be offset with the eventual income tax due on the capital gain.

In the case of redemption of securities or capital reduction by a Brazilian corporation, such as ourselves, the positive difference between the amount effectively received by the non-Brazilian holder and the corresponding acquisition cost

is treated, for tax purposes, as capital gain derived from disposition of common shares not carried out on a Brazilian stock exchange.

Any exercise of preemptive rights relating to the common shares will not be subject to Brazilian income tax. Any gain on the sale or assignment of preemptive rights relating to the common shares by a non-Brazilian holder of common shares or ADSs will be subject to Brazilian taxation at the same rate applicable to the sale or disposition of common shares.

There is no assurance that the current preferential treatment for holders of ADSs and non-Brazilian holders of common shares under CMN Resolution No. 4,373/2014 will continue in the future or that it will not be changed in the future. Reductions in the rate of tax provided for by Brazil's tax treaties do not apply to the tax on gains realized on sales or exchange of common shares.

***Sale of ADSs by non-Brazilian holder to another non-Brazilian holder***

Gains realized outside Brazil by a non-Brazilian holder on the disposition of ADSs should not be subject to Brazilian tax. As mentioned above, according to Law No. 10,833/2003 of December 2003, or Law No. 10,833, the disposition of assets located in Brazil by a non-Brazilian holder, whether to other non-Brazilian holder or Brazilian holders, may become subject to taxation in Brazil. Although we believe that the ADSs do not fall within the definition of assets located in Brazil for the purposes of Law no. 10,833, considering the general and unclear scope of it and the lack of definitive judicial court ruling to act as the leading case in respect thereto, we are unable to predict whether such understanding will ultimately prevail in the courts of Brazil.

In case the ADSs are considered assets located in Brazil, gains on disposition of ADSs by a non-Brazilian holder to a resident in Brazil or even to a non-Brazilian resident may be subject to income tax in Brazil according to the rules described below for ADSs or the tax rules applicable to common shares, as applicable.

#### ***Exchange of ADSs for common shares***

Although there is no clear regulatory guidance, the withdrawal of ADSs in exchange for common shares is not subject to Brazilian income tax to the extent that, as described above, ADSs do not fall within the definition of assets located in Brazil for the purposes of Law No. 10,833/2003.

Upon receipt of the underlying common shares in exchange for ADSs, non-Brazilian holders may also elect to register with the Central Bank the U.S. dollar amount of such preferred shares or common shares as a foreign portfolio investment under Resolution No. 4,373/2014 or as a foreign direct investment under Law No. 4,131/1962.

#### ***Exchange of common shares for ADSs***

With reference to the deposit of common shares in exchange for ADSs, the difference between the acquisition cost of the common shares and the market price of the common shares may be subject to Brazilian income tax at progressive rates that may vary from 15.0% to 22.5% (15.0% for the part of the gain that does not exceed R\$5.0 million, 17.5% for the part of the gain that exceeds R\$5.0 million but does not exceed R\$10.0 million, 20.0% for the part of the gain that exceeds R\$10.0 million but does not exceed R\$30.0 million and 22.5% for the part of the gain that exceeds R\$30.0 million), except for non-Brazilian holders located in a Nil or Low Taxation Jurisdiction, which, in this case, would be subject to income tax at a flat rate of 25.0%. In some circumstances, there may be arguments to claim that this taxation is not applicable in the case of a non-Brazilian holder that is a 4,373 Holder and is not a resident of or domiciled in a Nil or Low Taxation Jurisdiction.

#### ***Discussion on Low or Nil Taxation Jurisdictions***

On June 24, 2008, Law No. 11,727/2008 was enacted defining the concept of a “privileged tax regime” in connection with transactions subject to transfer pricing and thin capitalization rules. In this conception, privileged tax regimes are more comprehensive than tax havens. A “privileged tax regime” is considered to be a jurisdiction which: (i) does not tax income or taxes income at a maximum rate lower than 20.0%; (ii) grants tax advantages to a non-resident entity or individual (a) without requiring substantial economic activity in the jurisdiction of such non-resident entity or individual or (b) to the extent such non-resident entity or individual does not conduct substantial economic activity in the jurisdiction of such non-resident entity or individual; (iii) does not tax income generated abroad, or imposes tax on income generated abroad at a maximum rate lower than 20.0%; or (iv) restricts the ownership disclosure of assets and ownership rights or restricts disclosure about economic transactions. On 2014 the Brazilian Revenue Service Ordinance 488 was published, reducing from 20% to 17% the minimum threshold for certain specific cases. The reduced 17% threshold applies only to countries and regimes aligned with international standards of fiscal transparency in accordance with rules to be established by the Brazilian tax authorities.

Notwithstanding the fact that the “privileged tax regime” concept was enacted in connection with Brazilian transfer pricing and thin capitalization rules, there is no assurance that Brazilian tax authorities will not attempt to apply the concept of privileged tax regimes to other types of transactions, such as investments in the Brazilian financial and capital markets. We recommend that prospective investors consult their own tax advisors from time to time to verify any possible tax consequences of Law No. 11,727/2008 and Ordinance 488/2014.

#### ***Interest Attributed to Shareholders' Equity***

According to Brazilian laws and our bylaws, we may opt to distribute income as interest attributed to shareholders' equity as an alternative to the payment of dividends.

Distribution of an interest on equity charge attributed to shareholders' equity with respect to common shares or ADSs as an alternative form of payment to shareholders, including non-Brazilian holders of common shares or ADSs, is subject to Brazilian withholding income tax at the rate of 15% or 25%, in case of a Nil or Low Taxation Jurisdiction holder.

Such payments, subject to certain limitations and requirements, are deductible for Brazilian income tax purposes. This interest is limited to the daily *pro rata* variation of the Federal Government's long-term interest rate, as determined by the Central Bank from time to time, and cannot exceed the greater of:

- (a) 50% of net income (after the social contribution on net profits and before the provision for corporate income tax, and the amounts attributable to shareholders as interest on net equity) for the period with respect to which the payment is made; or
- (b) 50% of the sum of retained earnings and earnings reserves as of the date of the beginning of the period with respect to which the payment is made.



### ***Other Brazilian Taxes***

There are no Brazilian inheritance, gift or succession taxes applicable to the ownership, transfer or disposition of common shares or ADSs by a non-Brazilian holder, except for gift and inheritance taxes, which are levied by some states of Brazil on gifts made or inheritances bestowed by a non-Brazilian holder to individuals or entities resident or domiciled within such states in Brazil. There is no Brazilian stamp, issue, registration, or similar taxes or duties payable by a non-Brazilian holder of common shares or ADSs.

### ***Tax on foreign exchange transactions (“IOF/Exchange”)***

Pursuant to Decree No. 6,306/2007, dated December 14, 2007, as amended, or Decree No. 6,306/2007, the conversion of Brazilian currency into foreign currency (e.g., for purposes of paying dividends and interest) and the conversion of foreign currency into Brazilian currency may be subject to the Tax on Foreign Exchange Transactions or IOF/Exchange. Currently, for most exchange transactions, the rate of IOF/Exchange is 0.38%. However, exchange transactions carried out for the inflow of funds in Brazil for investments in the Brazilian financial and capital market made by a foreign investor (including a Non-Resident Holder, as applicable) are subject to IOF/Exchange at a 0%. The IOF/Exchange rate will also be 0% for the outflow of funds from Brazil related to these types of investments, including payments of dividends and interest on shareholders' equity and the repatriation of funds invested in the Brazilian market.

The Brazilian government may increase the rate of the IOF/Exchange to a maximum of 25.0% of the amount of the foreign exchange transaction at any time, but such an increase would not apply retroactively.

### ***Tax on transactions involving bonds and securities (“IOF/Bonds Tax”)***

The IOF may also be imposed on any transactions involving bonds and securities, including those carried out on Brazilian futures and commodities stock exchanges. As a general rule, the rate of this tax for transactions involving common shares or ADSs is currently zero. The executive branch, also by a Presidential Decree, may increase the IOF rate by up to 1.5% per day, but only with respect to future transactions.]

### **U.S. Federal Income Tax Considerations**

The following discussion is a summary of certain U.S. federal income tax consequences of the acquisition, ownership and disposition of common shares or ADSs as of the date hereof. This discussion applies only to a beneficial owner of common shares or ADSs that is a “U.S. holder”. As used herein, the term “U.S. holder” means a beneficial owner of a common share or ADS that, for U.S. federal income tax purposes, is:

- an individual who is a citizen or resident of the United States;
- a corporation (or other entity treated as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States, any state thereof or the District of Columbia;
- an estate the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust if it (1) is subject to the primary supervision of a court within the United States and one or more U.S. persons have the authority to control all substantial decisions of the trust or (2) has a valid election in effect under applicable U.S. Treasury Department regulations to be treated as a U.S. person.

If a partnership (or other entity treated as a partnership for U.S. federal income tax purposes) holds common shares or ADSs, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. A U.S. holder that is a partner of a partnership holding common shares or ADSs should consult its tax advisors.

Except where noted, this discussion deals only with common shares or ADSs held as capital assets within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended, or the Code, and does not deal with U.S. holders that may be subject to special U.S. federal income tax rules, such as dealers in securities or currencies, traders in securities that elect to use a mark to market method of accounting for their securities holdings, banks or other financial institutions, tax exempt organizations, insurance companies, real estate investment trusts, regulated investment companies, persons holding common shares or ADSs as part of a hedging, integrated, conversion or constructive sale transaction or a straddle, persons liable for alternative minimum tax, pass through entities and investors in a pass through entity, persons owning 10% or more of our voting stock, or persons whose “functional currency” is not the U.S. dollar.

This discussion is based upon the provisions of the Code, and existing and proposed U.S. Treasury Department regulations, administrative pronouncements of the Internal Revenue Service, or the IRS, and judicial decisions as of the date hereof. Such authorities may be repealed, revoked or modified so as to result in U.S. federal income tax consequences different from those discussed below, possibly with retroactive effect. In addition, this discussion is based, in part, upon representations made by the Depositary to us and assumes that the deposit agreement, and all other related agreements, will be performed in accordance with their terms.

Except as specifically described below, this discussion assumes that we are not a passive foreign investment company, or PFIC, for U.S. federal income tax purposes. Please see the discussion under “—Passive Foreign Investment Company Rules” below. Further, this discussion does not address the U.S. federal estate and gift, alternative minimum tax, Medicare tax on net investment income, state, local or non U.S. tax consequences of acquiring, holding or disposing of common shares or ADSs.

### ***ADSs***

In general, for U.S. federal income tax purposes, U.S. holders of ADSs will be treated as the owners of the underlying common shares that are represented by such ADSs. Deposits or withdrawals of common shares by U.S. holders for ADSs will not be subject to U.S. federal income tax. However, the U.S. Treasury Department has expressed concerns that parties involved in transactions wherein depositary shares are pre-released may be taking actions that are inconsistent with the claiming of foreign tax credits by the holders of ADSs. Accordingly, the analysis of the creditability of Brazilian income taxes described herein could be affected by future actions that may be taken by the U.S. Treasury Department.

### ***Taxation of Dividends***

The gross amount of distributions paid to a U.S. holder (including Brazilian taxes that are withheld, if any, and any payments of interest on shareholders' equity, as described above under “—Brazilian Tax Considerations”) will be treated as dividend income to the extent paid out of our current or accumulated earnings and profits, as determined under U.S. federal income tax principles. Such income generally will be includable in a U.S. holder's gross income as ordinary income when actually or constructively received by the U.S. holder, in the case of common shares, or when actually or constructively received by the Depositary, in the case of ADSs. Such dividends will not be eligible for the dividends received deduction allowed to corporations under the Code. To the extent that the amount of any distribution exceeds our current and accumulated earnings and profits for a taxable year, the distribution will first be treated as a tax-free return of capital to the extent of the U.S. holder's adjusted tax basis in the common shares or ADSs, causing a reduction in such adjusted tax basis (and thereby increasing the amount of gain, or decreasing the amount of loss, to be recognized on a subsequent disposition of our common shares or ADSs), and thereafter as capital gain recognized on a sale or exchange. Because we do not expect to maintain calculations of earnings and profits in accordance with U.S. federal income tax principles, U.S. holders should expect that a distribution will generally be treated as a dividend for U.S. federal income tax purposes. Distributions of additional common shares or ADSs to U.S. holders that are part of a pro rata distribution to all of our shareholders generally will not be subject to U.S. federal income tax.

The amount of any dividend paid in *reais* will equal the U.S. dollar value of the *reais* received calculated by reference to the exchange rate in effect on the date the dividend is received by the U.S. holder, in the case of common shares, or by the Depositary, in the case of ADSs, regardless of whether the *reais* are converted into U.S. dollars. If the *reais* received as a dividend are not converted into U.S. dollars on the date of receipt, the U.S. holder will have a tax basis in the *reais* equal to their U.S. dollar value on the date of receipt. Any gain or loss realized on a subsequent conversion or other disposition of the *reais* will be foreign currency gain or loss that is treated as U.S. source ordinary income or loss. If dividends paid in *reais* are converted into U.S. dollars on the day they are received by the U.S. holder or the Depositary, as the case may be, U.S. holders generally should not be required to recognize foreign currency gain or loss in respect of the dividend income. U.S. holders should consult their own tax advisors regarding the treatment of any foreign currency gain or loss if any *reais* received by the U.S. holder or the Depositary or its agent are not converted into U.S. dollars on the date of receipt.

Certain dividends received by certain non corporate U.S. holders may be eligible for preferential tax rates so long as (1) specified holding period requirements are met, (2) the U.S. holder is not under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property, (3) the company paying the dividend is a “qualified foreign corporation” and (4) the company is not a PFIC for U.S. federal income tax purposes in the year of distribution or the prior year. We do not believe that we were classified as a PFIC for our prior taxable year nor do we expect to be classified as a PFIC for the current taxable year. We generally will be treated as a qualified foreign corporation with respect to our ADSs so long as the ADSs remain listed on the NYSE. Based on existing guidance, however, it is not entirely clear whether dividends received with respect to the common shares (to the extent not represented by ADSs) will be eligible for this treatment, because the common shares are not themselves listed on a U.S. exchange. U.S. holders should consult their own tax advisors about the application of this preferential tax rate to dividends paid directly on common shares.

Subject to certain complex limitations and conditions (including a minimum holding period requirement), Brazilian income taxes withheld on dividends, if any, may be treated as foreign income taxes eligible for credit against a U.S. holder’s U.S. federal income tax liability. Alternatively, if a U.S. holder does not elect to claim a foreign income tax credit for any foreign taxes paid during the taxable year, all foreign income taxes paid may instead be deducted in computing such U.S. holder’s taxable income. For purposes of calculating the foreign tax credit, dividends paid on our common shares or ADSs will be treated as income from sources outside the United States. For the purposes of the U.S. foreign tax credit limitations, the dividends paid by us should generally constitute “passive category income” for most U.S. holders. The rules governing the foreign tax credit are complex. U.S. holders should consult their tax advisors regarding the availability of the foreign tax credit under their particular circumstances.

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### ***Taxation of Capital Gains***

For U.S. federal income tax purposes, a U.S. holder generally will recognize taxable gain or loss on any sale, exchange or other taxable disposition of a common share or ADS in an amount equal to the difference between the U.S. dollar value of the amount realized for the common share or ADS and the U.S. holder's adjusted tax basis in the common share or ADS, determined in U.S. dollars. Such gain or loss will generally be capital gain or loss. The capital gain or loss will be long term capital gain or loss if at the time of sale, exchange or other taxable disposition the U.S. holder has held our common shares or ADSs for more than one year. Capital gains of individuals derived with respect to capital assets held for more than one year are eligible for reduced rates of taxation. The deductibility of capital losses is subject to limitations. Any gain or loss recognized by a U.S. holder will generally be treated as U.S. source gain or loss. Consequently, a U.S. holder may not be able to use the foreign tax credit arising from Brazilian income tax imposed, if any, on the disposition of a common share or ADS unless such credit can be applied (subject to applicable limitations) against U.S. federal income tax due on other income treated as derived from foreign sources.

### ***Passive Foreign Investment Company Rules***

Based upon our current and projected income, assets, activities and business plans, we do not expect the common shares or ADSs to be considered shares of a PFIC for our current fiscal year (although the determination cannot be made until the end of such fiscal year), and we intend to continue our operations in such a manner that we do not expect to be classified as a PFIC in the foreseeable future. However, because the determination of whether the common shares or ADSs constitute shares of a PFIC will be based upon the composition of our income, assets and the nature of our business, as well as the income, assets and business of entities in which we hold at least a 25% interest, from time to time, and because there are uncertainties in the application of the relevant rules, there can be no assurance that the common shares or ADSs will not be considered shares of a PFIC for any fiscal year. If the common shares or ADSs were shares of a PFIC for any fiscal year, U.S. holders (including certain indirect U.S. holders) may be subject to adverse tax consequences, including the possible imposition of an interest charge on gains or "excess distributions" allocable to prior years in the U.S. holder's holding period during which we were determined to be a PFIC. If we are deemed to be a PFIC for a taxable year, dividends on our common shares or ADSs would not be qualified dividend income eligible for preferential rates of U.S. federal income taxation. In addition, a U.S. holder that owns common shares or ADSs during any taxable year that we are treated as a PFIC would generally be required to file IRS form 8621. U.S. holders should consult their own tax advisors regarding the application of the PFIC rules (including any information reporting requirements in connection therewith) to the common shares or ADSs.

### ***Information Reporting and Backup Withholding***

In general, information reporting requirements will apply to dividends in respect of our common shares or ADSs or the proceeds received on the sale, exchange, or redemption of our common shares or ADSs, in each case to the extent treated as being paid within the United States (and in certain cases, outside of the United States) to a U.S. holder unless a U.S. holder establishes its status as an exempt recipient, and backup withholding (currently at a rate of 28 percent) may apply to such amounts if the U.S. holder does not establish its status as an exempt recipient or fails to provide a correct taxpayer identification number and certify that such U.S. holder is not subject to backup withholding. The amount of any backup withholding from a payment to a U.S. holder will be allowed as a refund or credit against such U.S. holder's U.S. federal income tax liability provided the U.S. holder timely furnishes the required information to the IRS.

In addition, U.S. holders should be aware that additional reporting requirements apply with respect to the holding of certain foreign financial assets, including stock of foreign issuers which is not held in an account maintained by a financial institution, if the aggregate value of all of such assets exceeds US\$50,000. U.S. holders should consult their own tax advisors regarding the application of the information reporting rules to our common shares and ADSs and the application of these additional reporting requirements for foreign financial assets to their particular situation.

**F. Dividends and Payments Agents**

Not applicable.

**G. Statements by Experts**

Not applicable.

**H. Documents on Display**

We are subject to the periodic reporting and other informational requirements of the U.S. Securities Exchange Act of 1934, as amended and supplemented, or the Exchange Act. Accordingly, we are required to file reports and other information with the SEC. You may inspect and copy reports and other information filed by us at the public reference facilities maintained by the SEC at 100 F Street, N.W., Washington D.C. 20549. Our filings will also be available at the SEC's website at <http://www.sec.gov>. Reports and other information may also be inspected and copied at the offices of the NYSE at 20 Broad Street, New York, New York 10005.

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Our website is located at <http://www.sabesp.com.br> and our investor relations website is located at <http://www.sabesp.com.br/investors>. (These URLs are intended to be an inactive textual reference only. They are not intended to be an active hyperlink to our website. The information on our website, which might be accessible through a hyperlink resulting from this URL is not, and shall not be deemed to be, incorporated into this annual report.)

We also furnish to the depositary annual reports in English including audited annual financial statements and reviewed quarterly financial statements in English for each of the first three quarters of the fiscal year. We also furnish to the depositary English translations or summaries of all notices of shareholders' meetings and other reports and communications that are made generally available to holders of common shares.

## I. Subsidiary Information

Not applicable.

## ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Market Risk

We are exposed to various market risks, in particular, foreign currency risk and interest rate risk. We are exposed to foreign currency risk because a substantial portion of our financial indebtedness is denominated in foreign currencies, primarily the U.S. dollar, while we generate all of our net operating revenues in *reais*. Similarly, we are subject to interest rate risk based upon changes in interest rates, which affect our net financial expenses. For further information on our market risks, see Note 5 to our financial statements included in this annual report.

### Exchange Rate Risk

As of December 31, 2018 and 2017, R\$6,669.4 million and R\$5,672.8 million, or 50.7% and 46.9%, respectively, of our debt obligations were denominated in foreign currencies. As a result, we are exposed to exchange rate risks that may adversely affect our financial condition and results of operations, as well as our ability to meet debt service obligations.

### Exchange Rate Sensitivity

We estimate that the potential loss to us in connection with U.S. dollar and yen-denominated debt that would have resulted as of December 31, 2018, 2017 and 2016 from each hypothetical instantaneous and unfavorable 1% change in the U.S. dollar and yen against the *real* would have been approximately R\$66.7 million, R\$56.7 million and R\$56.6 million, respectively. Consistent with these estimates, a hypothetical instantaneous and unfavorable 10% change in this exchange rate would have resulted in losses of approximately R\$666.9 million, R\$567.3 million and R\$566.0 million as of December 31, 2018, 2017 and 2016, respectively.

The fluctuation of the *real* in relation to the U.S. dollar and yen for the years ended December 31, 2018, 2017 and 2016 were as follows:

|   | 2018 | Year ended December 31,<br>2017<br>(in percentages) | 2016   |
|---|------|---|--------|
| Depreciation (appreciation) of the <i>real</i> in relation to the | 17.1 | 1.5   | (16.5) |

|   |      |     |        |
|---|------|-----|--------|
| U.S. dollar   |      |     |        |
| Depreciation (appreciation)<br>of the <i>real</i> in relation to the<br>yen | 20.0 | 5.4 | (13.8) |

We have not contracted derivative financial instruments in the years ended December 31, 2018, 2017 and 2016.

For further information regarding foreign currency risk, see Note 5.1(a) to our 2018 financial statements included in this annual report.

As of December 31, 2018, 2017 and 2016, we had no short term indebtedness outstanding, other than the current portion of long term debt.

### ***Interest Rate Risk***

As of December 31, 2018 and 2017, R\$1,642.4 million, or 12.5%, and R\$1,579.7 million, or 13.1%, respectively, of our total debt outstanding balance denominated in *reais* was based on variable rates of interest based on the UPR, which is equivalent to the TR. In addition, as of December 31, 2018 and 2017, R\$1,261.7 million, or 9.6%, and R\$1,149.2 million, or 9.5%, respectively, of our total debt denominated in *reais* was subject to interest rates based on the CDI. As of December 31, 2018 and 2017, R\$2,982.0 million and R\$2,317.0 million, respectively, of our foreign-currency denominated debt was based on the IADB and the IBRD variable rates of interest, which are determined based on the cost of funding of these multilateral organizations in each period.

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As of December 31, 2018 and 2017, we did not have any derivative contracts outstanding which limited exposure to changes in the UPR or the CDI or in the IADB or IBRD variable rates. However, we are obliged by law to invest our excess cash with financial institutions controlled by the Brazilian government. We invest these excess funds, which totaled R\$3,029.2 million and R\$2,283.0 million as of December 31, 2018 and 2017, respectively, mainly in short-term instruments. As a result, our exposure to Brazilian interest rate risk is partially limited by our *real*-denominated floating interest time deposits investments, which generally earn interest based on the CDI. In addition to our exposure with respect to existing indebtedness, we may become exposed to interest rate volatility with respect to indebtedness incurred in the future.

We estimate that we would have suffered a loss over periods of one year, respectively, of up to R\$131.5 million, R\$121.0 million and R\$119.6 million if a hypothetical instantaneous and unfavorable change of 100 basis points in the interest rates applicable to financial liabilities as of December 31, 2018, 2017 and 2016, respectively, had occurred. Consistent with these estimates, a hypothetical instantaneous and unfavorable 1000 basis points change in these interest rates would have resulted in losses of approximately R\$1,315.3 million, R\$1,210.1 million and R\$1,196.4 million as of December 31, 2018, 2017 and 2016, respectively. This sensitivity analysis is based on the assumption of an unfavorable 100 basis point movement of the interest rates applicable to each homogeneous category of financial liabilities and sustained over a period of one year, as applicable, and that such movement may or may not affect interest rates applicable to any other homogenous category of financial liabilities.

A homogeneous category is defined according to the currency in which financial liabilities are denominated and assumes the same interest rate movement within each homogeneous category (i.e., U.S. dollars). As a result, our interest rate risk sensitivity model may overstate the effect of interest rate fluctuation on these financial instruments, as consistently unfavorable movements of all interest rates are unlikely.

The tables below provide information about our interest rate-sensitive instruments. For variable interest rate debt, the rate presented is the weighted average rate calculated as of December 31, 2018. For the foreign currency denominated obligations, these amounts have been converted at the selling rates as of December 31, 2018 and do not represent amounts which may actually be payable with respect to such obligations on the dates indicated.

|   | As of December 31, 2018                  |       |       |                | Total   | Average annual interest rate |
|---|--|-------|-------|----------------|---------|------------------------------|
|   | 2019                                     | 2020  | 2021  | 2022 and after |         |                              |
|   | <i>(in millions, except percentages)</i> |       |       |                |         |                              |
| <b>Assets</b>   |  |       |       |                |         |                              |
| Cash equivalents denominated in <i>reais</i>                    | 3,029.2                                  | -     | -     | -              | 3,029.2 |                              |
| <b>Liabilities</b>  |  |       |       |                |         |                              |
| <b>Long term debt (current and noncurrent portion)</b>          |  |       |       |                |         |                              |
| Floating rate, denominated in <i>reais</i> indexed by TR or UPR | 196.4                                    | 171.9 | 148.8 | 807.0          | 1,324.1 | 8.9%                         |
|   | 126.6                                    |       | 127.6 | 1,264.7        | 1,642.4 | 7.8%                         |
|   |  | 123.5 |       |                |         |                              |

|  |                |                |                |                |                 |             |
|--|----------------|----------------|----------------|----------------|-----------------|-------------|
| Floating rate,<br>denominated in <i>reais</i><br>indexed by TJLP |                |                |                |                |                 |             |
| Floating rate,<br>denominated in <i>reais</i><br>indexed by IPCA | 759.7          | 326.6          | 115.2          | 485.0          | 1,686.5         | 9.9%        |
| Floating rate,<br>denominated in <i>reais</i><br>indexed by CDI  | 263.3          | 149.8          | 274.8          | 573.8          | 1,261.7         | 7.9%        |
| Fixed rate, denominated<br>in <i>reais</i>                       | 19.1           | 36.9           | 38.7           | 474.0          | 568.7           |             |
| Floating rate,<br>denominated in<br>U.S. dollars                 | 569.1          | 255.3          | 217.3          | 2,233.2        | 3,274.9         | 4.3%        |
| Fixed rate, denominated<br>in Yen                                | 165.6          | 140.4          | 140.4          | 1,589.7        | 2,036.1         | 1.5%        |
| Fixed rate, denominated<br>in U.S. dollars                       | 3.8            | 1,354.6        | -              | -              | 1,358.4         | 3.3%        |
| <b>Total long term debt</b>                                      | <b>2,103.6</b> | <b>2,559.0</b> | <b>1,062.8</b> | <b>7,427.4</b> | <b>13,152.8</b> | <b>6.1%</b> |

UPR stands for Standard Reference Unit (*Unidade Padrão Referência*) and is equal to TR, which was 0.00% per month as of December 31, 2018; CDI stands for Interbank Deposit Rate (*Certificado de Depósitos Interbancários*), which was 6.40% per annum as of December 31, 2018; IGP M was 7.54% per annum as of December 31, 2018; TJLP stands for Long term Interest Rate (*Taxa de Juros a Longo Prazo*), published quarterly by the Central Bank, which was 6.98% per annum as of December 31, 2018.

The percentage of our indebtedness subject to fixed and floating interest rate is as follows:

|                             | As of December 31, |               |               |
|-----------------------------|--------------------|---------------|---------------|
|                             | 2018               | 2017          | 2016          |
| <b>Floating rate debt:</b>  |                    |               |               |
| Denominated in U.S. dollars | 22.2%              | 23.3%         | 24.3%         |
| Denominated in <i>reais</i> | 45.0%              | 48.5%         | 48.1%         |
| <b>Fixed rate debt:</b>     |                    |               |               |
| Denominated in <i>reais</i> | 4.3%               | 4.6%          | 4.6%          |
| Denominated in Yen          | 15.5%              | 14.1%         | 13.5%         |
| Denominated in U.S. dollars | 13.0%              | 9.5%          | 9.5%          |
| <b>Total</b>                | <b>100.0%</b>      | <b>100.0%</b> | <b>100.0%</b> |

**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

**A. Debt Securities**

Not applicable.

**B. Warrants and Rights**

Not applicable.

**C. Other Securities**

Not applicable.

**D. American Depositary Shares**

In the United States, our common shares trade in the form of ADS. Following a ratio change effected on January 24, 2013, each ADS represents one common share of our company. Following a stock split which took place on April 25, 2013, we issued two new ADSs for each ADS currently trading and distributed them to our holders on April 29, 2013. The ADSs are issued by The Bank of New York Mellon, as Depositary pursuant to a Deposit Agreement. The ADSs commenced trading on the NYSE on May 10, 2002.

***Fees and Expenses***

The following table summarizes the fees and expenses payable by holders of ADRs:

**Persons depositing common shares or ADR holders must pay:**

**For:**

|  |   |
|--|---|
| US\$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)   | Issuance of ADSs, including issuances resulting from a distribution of common shares or rights or other property  |
| Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates  |   |
| US\$0.05 (or less) per ADS or portion thereof (to the extent not prohibited by the rules of any stock exchange on which the ADSs are listed for trading)                       | Any cash distribution to you  |
| A fee equivalent to the fee that would be payable if securities distributed to you had been common shares and the common shares had been deposited for issuance of ADSs        | Distribution of securities distributed to holders of deposited securities which are distributed by the depositary to ADR holders                                      |
| US\$0.05 (or less) per ADS or portion thereof per calendar year (in addition to the cash distribution fee of \$0.02 per ADS that the depositary has collected during the year) | Depositary services   |
| Registration or transfer fees  | Transfer and registration of common shares on our common share register to or from the name of the depositary or its agent when you deposit or withdraw common shares |

Cable, telex and facsimile transmissions expenses (when expressly provided in the deposit agreement)

Expenses of the depositary in converting foreign currency to U.S. dollars

Expenses of the depositary

Taxes and other governmental charges the depositary or the custodian have to pay on any ADR or common share underlying an ADR, for example, stock transfer taxes, stamp duty or withholding taxes

As necessary

Any charges incurred by the depositary or its agents for servicing the deposited securities

No charges of this type are currently made in the Brazilian market

### ***Payment of Taxes***

The depositary may deduct the amount of any taxes owed from any payments to you. It may also sell deposited securities, by public or private sale, to pay any taxes owed. You will remain liable if the proceeds of the sale are not sufficient to pay the taxes. If the depositary sells deposited securities, it will, if appropriate, reduce the number of ADSs to reflect the sale and pay to you any proceeds, or send to you any property, remaining after it has paid the taxes.

### ***Reimbursement of Fees***

The Bank of New York Mellon, as depositary, has agreed to reimburse us for expenses we incur that are related to establishment and maintenance expenses of the ADS program. The depositary has agreed to reimburse us for our continuing annual stock exchange listing fees. The depositary has also agreed to pay the standard out of pocket maintenance costs for the ADRs, which consist of the expenses of postage and envelopes for mailing annual and interim financial reports, printing and distributing dividend checks, electronic filing of United States federal tax information, mailing required tax forms, stationery, postage, facsimile, and telephone calls. It has also agreed to reimburse us annually for certain investor relationship programs or special investor relations promotional activities. In certain instances, the depositary has agreed to provide additional payments to us based on any applicable performance indicators relating to the ADR facility. There are limits on the amount of expenses for which the depositary will reimburse us, but the amount of reimbursement available to us is not necessarily tied to the amount of fees the depositary collects from investors.

The depositary collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deduction from cash distributions or by directly billing investors or by charging the book entry system accounts of participants acting for them. The depositary may generally refuse to provide fee attracting services until its fees for those services are paid.

***Reimbursement of Fees Incurred in 2018***

From January 1, 2018 to December 31, 2018, we received reimbursements in the amount of US\$2.5 million for standard out of pocket maintenance costs for the ADRs, any applicable performance indicators relating to the ADR facility, marketing fees and legal fees.

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## **Part II**

### **ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

Not applicable.

### **ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

Not applicable.

### **ITEM 15. CONTROLS AND PROCEDURES**

#### **A. Disclosure Controls and Procedures**

We carried out an evaluation under the supervision of and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer and Investor Relations Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, including those defined in the United States Exchange Act Rule 13(a) 15(e), as of the year ended December 31, 2018.

As a result of this evaluation, our Chief Executive Officer and Chief Financial Officer and Investor Relations Officer concluded, that our disclosure controls and procedures, as of December 31, 2018, were not effective due to a deficiency in the maintenance of our controls regarding privileged access to our Information Technology (“IT”) environment, as described in item B below.

#### **B. Management Report on Internal Control over the Preparation of Financial Reports**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting.

Our internal controls over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS, as issued by the IASB.

Our internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS, as issued by the IASB, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer and Investor Relations Officer, our management conducted an assessment of our internal control over financial reporting as of December 31, 2018 based on the criteria established in “Internal Control - Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in 2013.

Based on such assessment and criteria, our management has identified control deficiency, as of December 31, 2018, that represent a material weakness in our internal control over financial reporting. The ineffectiveness of this internal control has not resulted in a misstatement or omission in our consolidated financial statements as of December 31, 2018 and for the year then ended

### **Material Weakness in Internal Control over Financial Reporting**

A material weakness is a deficiency, or a combination of deficiencies, in the internal control over financial reporting, such that there is a reasonable possibility that a material misstatement in the company’s annual or interim financial statements will not be prevented or detected on a timely basis.

Our management has identified a service account (ERP system support) with privileged access. This account, if used improperly, could have had access to system transactions and made undue changes.

Additionally, this access control deficiency could have affected the effectiveness of business process automated controls and manual controls with an automated component.

Although there was a possibility of improper access, we carried out an analysis of the System Access Logs, which demonstrated that the actions carried out were limited to those necessary to maintain the system, without any impact on our financial reporting for 2018.

#### **Actions for Remediation of Material Weakness**

Our management immediately established actions and efforts to remediate the material weakness identified in relation to the service account. These actions included:

- Removing the privileged access;
- Analyzing the access logs of the relevant account;
- Actions to ensure that privileged access occurs only on an exceptional basis and for the necessary time, subject to due justification and based on the authorization of two managers; and
- Periodic monitoring of privileged user actions.

Our independent registered public accounting firm has issued an attestation report on the effectiveness of our internal control over financial reporting, as described below.

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### **C. Certification Report of the Independent Audit Firm**

#### **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Shareholders, Board of Directors and Management of Companhia de Saneamento Básico do Estado de São Paulo - SABESP São Paulo - SP

#### **Opinion on Internal Control Over Financial Reporting**

We have audited Companhia de Saneamento Básico do Estado de São Paulo - SABESP (the Company) internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, because of the effect of the material weakness, described below, on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission”.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the statements of financial position of the Company as of December 31, 2018 and 2017, the related statements of profit or loss, other comprehensive income, changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively, the financial statements) and our report dated April 26, 2019 expressed an unqualified opinion on those financial statements.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company’s annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management’s assessment.

- There were ineffective general information technology controls (GITC) due to the existence of a user with privileged access to the information technology (IT) that support the Company’s financial reporting process. As a result, business process automated controls and manual controls with an automated component were also considered ineffective because they could have been adversely impacted.

The material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2018 financial statements and this report does not affect our report on those financial statements.

### **Basis for Opinion**

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Controls over Financial Reporting appearing under Item 15 of the Company's Annual Report on Form 20-F. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

### **Definition and Limitations of Internal Control Over Financial Reporting**

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ KPMG Auditores Independentes

São Paulo – Brazil

April 26, 2019

#### **D. Changes in internal control over disclosure of financial information**

There have been no changes in our internal control over financial reporting that occurred during the fiscal year ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### **ITEM 16. [Reserved]**

#### **ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

At our board meeting held on June 26, 2006, we established an audit committee, as defined under section 3(a)(58) of the Exchange Act. Our board of directors has determined that Ernesto Rubens Gelbcke qualifies as an “audit committee financial expert” as defined for the purposes of this Item 16A in Item 16 of Form 20 F. Ernesto Rubens Gelbcke is an “independent director” within the meaning of the SEC rules.

#### **ITEM 16B. CODE OF ETHICS**

We have adopted a code of business conduct and ethics called the Code of Conduct and Integrity, which applies to all of our employees, including our directors, chief executive officer, chief financial officer and investor relations and head of accounting, as well as our suppliers and third party contractors. To ensure compliance with the Code of Conduct and Integrity, we have an Ethics Commission and an internal Whistle-Blower Channel, as well as a Corporate Accountability Procedure and an Ombudsman Office as well as a Customer Service that receive external complaints. The internal channel can receive anonymous whistle blowing. The results of the investigations are forwarded to the Audit Committee. Recurring cases are reported to the Ethics Commission, which urges the related departments to develop preventive actions. In 2018, 164 events were reported to the Whistle-Blower Channel. During 2018, 48 of our employees or outsourced employees received penalties (11 warnings, one suspension and 36 dismissals). Our Ethics Commission is also responsible for addressing relevant inquiries and interpreting the norms of the Code of Conduct and Integrity for all of our employees. Our Code of Conduct and Integrity is available on our

web site at <http://www.sabesp.com.br> at the following location: Investor Relations – Corporate Governance. If we amend the provisions of our Code of Conduct and Integrity, or if we grant any waiver of such provisions, we will disclose the amendment or waiver on our web site at the same address. You can obtain copies of our Code of Conduct and Integrity, without charge, upon request to [sabesp.ri@sabesp.com.br](mailto:sabesp.ri@sabesp.com.br).

Federal Law No. 13,303/16, State Decree 62,349/16 and the new *Novo Mercado* rules require the adoption of a Code of Conduct that should include, among other provisions, guidelines to avoid conflicts of interests, forbiddance of fraudulent acts and corruption, whistleblowing channels, protective measures to avoid retaliation regarding whistleblowers, periodic training on the content of such code and sanctions in case of code violations. See “Item 16G—Corporate Governance—Required Changes to Corporate Governance Practices of Brazilian Government-Controlled Companies”. We will disclose the amendment on our web site at the address listed above.

#### ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

KPMG Auditores Independentes served as our independent registered public accounting firm for the year ended December 31, 2018. KPMG Auditores Independentes’ activity began with the review of our interim financial information reporting for the second quarter of 2016.

Deloitte Touche Tohmatsu Auditores Independentes served as our independent registered public accounting firm for the years ended December 31, 2015 and 2014.

The following table presents the aggregate fees for professional services and other services rendered to us by KPMG Auditores Independentes and Deloitte Touche Tohmatsu Auditores Independentes in 2018 and 2017:

|                               | Year ended December 31,       |            |
|-------------------------------|-------------------------------|------------|
|                               | 2018                          | 2017       |
|                               | <i>(in millions of reais)</i> |            |
| Audit Fees <sup>(1)</sup>     | 2.8                           | 3,0        |
| Audit Related Fees            | -                             | -          |
| Tax Fees                      | -                             | -          |
| All Other Fees <sup>(2)</sup> | -                             | 0.0        |
| <b>Total</b>                  | <b>2.8</b>                    | <b>3.0</b> |

(1) Audit Fees are the fees billed by our independent auditors for the audit of our annual financial statements, reviews of interim financial statements and attestation services that are provided in connection with statutory and regulatory filings or engagements.

(2) Includes the amount of R\$0.04 million referring to non-material, non-audit services in 2017.

### **Pre approval policies and procedures**

Pursuant to Brazilian law, our board of directors is responsible, among other matters, for the selection, dismissal and oversight of our independent registered public accounting firm. Our management is required to obtain the board of directors' approval before engaging an independent registered public accounting firm to provide any audit or permitted non-audit services to us. The Brazilian Federal and State Public Bidding Laws also apply to us with respect to obtaining services from third parties for our business, including the services provided by our independent registered public accounting firm. As part of the bidding process, the independent registered public accounting firm is required to submit proposals, and is then selected by us based on certain criteria including technical expertise and cost.

Except as disclosed above, KPMG Auditores Independentes did not provide any non-audit services to us in 2016, 2017 or 2018. Deloitte Touche Tohmatsu Auditores Independentes did not provide any non-audit services to us in 2016.

### **ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES**

None

### **ITEM 16E. PURCHASES OF EQUITY SECURITIES BY ISSUER AND AFFILIATED PURCHASERS**

Not applicable.

### **ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT**

As previously disclosed in our annual report on Form 20-F for the fiscal year ended December 31, 2016, we engaged KPMG Auditores Independentes as our independent registered public accounting firm on June 22, 2016. Our financial statements as of and for the years ended December 31, 2015 and 2014, which are not included in this annual report, were audited by Deloitte Touche Tohmatsu Auditores Independentes.

### **ITEM 16G. CORPORATE GOVERNANCE**

#### **Required Changes to Corporate Governance Practices of Brazilian Government-Controlled Companies**

On June 30, 2016, Federal Law No. 13,303/16 came into force in Brazil. This law sets new corporate governance standards for Brazilian government-owned and mixed capital companies like our company, as well as their subsidiaries. Federal Law No. 13,303/16 also sets new rules that these companies must follow in public bidding procedures and when contracting third parties.

Although the federal law gave the companies concerned two years in which to comply with the new standards, the State of São Paulo decided that companies controlled by the State, like our company, had to revise their bylaws to bring them into compliance by the end of 2017. However, taking into account State Law No. 16,525, of September 15, 2017, which regulates our corporate reorganization and the new *Novo Mercado* requirements, the State of São Paulo enacted Decree No. 63,089/2017, which allowed us to implement the necessary changes to our bylaws by June 30, 2018, as required by Federal Law No. 13,303/16. The revisions to our bylaws were approved at our General Shareholders' Meeting held on April 27, 2018.

In terms of corporate governance, Federal Law No. 13,303/16 requires significant changes to internal controls and strengthens the rights not only of our shareholders, but also of any interested party, to inspect the finances and running of the company. It requires us to publish periodically a series of documents and reports to demonstrate our level of commitment to our business objectives, the financial impact of those commitments, and our policies and practices in terms of corporate governance and sustainability, among other things. Those documents and reports must be accompanied by further explanations, in plain language, that can be understood by the general public.

Among other requirements, this law sets out the following rules:

- At least 25% of the members of the Board of Directors must be independent, in accordance with the definition of director independence set by Brazilian law (or, for companies whose minority shareholders exercise multiple votes, at least one of the directors must be independent).
- All directors and officers must have the same term of office, which may not be longer than two years. They may be re-elected up to a maximum of three times consecutively.
- The performance of the executive officers, directors and members of board committees must be subjected to yearly evaluation with respect to, at a minimum, the following matters:

- a. the lawfulness and effectiveness of their management performance;
- b. their contribution to the company's income for the year; and
- c. their contribution to furthering the objectives in the company's business plan and compliance with its long-term strategy.

The federal law requires that all officers and directors of the company must satisfy certain technical standards, in addition to the general requirement that they be of good reputation and have knowledge of the business sector concerned. These technical standards include satisfying both Point 1 and Point 2 below:

1. The individual must satisfy **at least** one of the requirements under (a), (b) or (c) of this Point 1:
  - a. a minimum of 10 years' experience in an appointed position, in either the public or private sector, in a business area that is similar or related to the company's business purpose; or
  - b. a minimum of four years' exercise of any one of (i), (ii) or (iii) below:
    - i. a senior management position in a company with a similar business purpose or similar size; or
    - ii. a position in the public sector that involves a high degree of trust (i.e., at level DAS-4 or higher); or
    - iii. a position as professor or researcher in the company's business sectors; or
  - c. a minimum of four years' practice as an independent professional in one or more areas that are directly or indirectly related to the company's business sectors;

**and:**

2. The individual must satisfy the requirements of **both** (a) and (b) of this Point 2:
  - a. the individual must have received sufficient training for the position for which she or he has been nominated; and
  - b. the individual must not have been declared ineligible for such position in accordance with applicable law.

In order to comply with this law, we have implemented certain changes in our corporate governance structure and governing documents, such as our bylaws, Board of Director's Internal Charter, Executive Board's Internal Charter and Fiscal Council's Internal Charter.

Additionally, we have certain corporate policies, such as the Nominating Policy for the appointment and assessment of directors, officers and Fiscal Council members, as well as the Policy for Compensation of directors, officers, as well as members of the Fiscal Council and statutory committees.

These policies also aim to comply with the Novo Mercado Regulation and the State Decree No. 62,349/2016.

For a description of new corporate governance obligations imposed by Brazilian law on companies listed on the *Novo Mercado* segment, see “Item 9.C. Markets—Trading on the Brazilian Stock Exchange—The *Novo Mercado* Segment”.

### **Significant Differences between our Current Corporate Governance Practices and NYSE Corporate Governance Standards**

We are subject to the NYSE corporate governance listing standards. As a foreign private issuer, the standards applicable to us are considerably different than the standards applied to U.S. listed companies. Under the NYSE rules, we are required only to: (a) have an audit committee or audit board, pursuant to an applicable exemption available to foreign private issuers, that meets certain requirements, as discussed below, (b) provide prompt certification by our chief executive officer of any material non-compliance with any corporate governance rules, and (c) provide a brief description of the significant differences between our corporate governance practices and the NYSE corporate governance practice required to be followed by U.S. listed companies.

In view of Brazilian Law 13.303/16 and new requirements of Novo Mercado Listing Regulations, the following discussion summarizes the significant differences between our current corporate governance practices and those required of U.S. listed companies:

#### ***Majority of Independent Directors***

The NYSE rules require that a majority of the board must consist of independent directors. Independence is defined by various criteria, including the absence of a material relationship between the director and the listed company. While the Brazilian Corporate Law did not previously have a similar requirement, Federal Law No. 13,303/16 established that at least 25% of the members of the board of directors must be independent. Under the Novo Mercado Regulations, our board of directors must evaluate the independence of directors before their election to the board. Such evaluation shall be based on a declaration prepared by the nominee. Additionally, Brazilian Corporate Law, Federal Law No. 13,303/16 and the CVM have established rules that require directors to meet certain qualification requirements applicable to a company’s directors. However, they do not require that we have a majority of independent directors, as required under the NYSE rules. Under our current bylaws, approved on April 27, 2018, our board of directors must have a minimum of seven members, and 25% of the board must be independent, as established by Federal Law No. 13,303/16 and as defined under Novo Mercado Regulations. Currently, six of our nine directors are independent, pursuant to the Novo Mercado Listing Regulations and Federal Law No. 13,303/16. We believe these rules provide adequate assurances that our directors are independent.



### ***Executive Sessions***

NYSE rules require that the non management directors must meet at regularly scheduled executive sessions without management present. The Brazilian Corporate Law does not have a similar provision. According to this Law, up to one third of the members of the board of directors can be elected from management. Our bylaws provide that the CEO shall integrate the Board of Directors, while holding such position. All other members of our board of directors meet the NYSE's definition of "non management" directors. There is no requirement in the Brazilian Corporate Law that non-management directors meet regularly without management. However, the Internal Charter of the Board of Directors establishes that, by resolution of the Chairman of the Board, meetings may be held exclusively for external directors, without the presence of executives. Our board of directors consists of seven non-management directors.

### ***Fiscal Council***

Under the Brazilian Corporate Law, the *Conselho Fiscal*, or fiscal council, is a corporate body independent of management and a company's external auditors. The fiscal council may be either permanent or non permanent, in which case it is appointed by the shareholders to act during a specific fiscal year. A fiscal council is not equivalent to, or comparable with, a U.S. audit committee. The primary responsibility of the fiscal council is to review management's activities and a company's financial statements, and to report its findings to the company's shareholders. The Brazilian Corporate Law requires fiscal council members to receive as compensation at least 10% of the average annual amount paid to a company's executive officers. The Brazilian Corporate Law requires a fiscal council to be composed of a minimum of three and a maximum of five sitting members and respective alternates.

Under the Brazilian Corporate Law, the fiscal council may not contain members that (i) are on our board of directors, (ii) are on the board of executive officers, (iii) are employed by us or a controlled company, or (iv) are spouses or relatives of any member of our management, up to the third degree.

Currently, our fiscal council consists of four sitting members and his/her alternates. The fiscal council members generally meet once a month.

### ***Audit Committee***

NYSE rules require that listed companies have an audit committee that (i) is composed of a minimum of three independent directors who are all financially literate, (ii) meets the SEC rules regarding audit committees for listed companies, (iii) has at least one member who has accounting or financial management expertise and (iv) is governed by a written charter addressing the committee's required purpose and detailing its required responsibilities. However, as a foreign private issuer, we need only to comply with the requirement that the audit committee meet the SEC rules regarding audit committees for listed companies to the extent compatible with Brazilian Corporate Law and Federal Law No. 13,303/16 (the Brazilian State-owned Companies Law). Our audit committee, which is not equivalent to, or comparable with, a U.S. audit committee, provides assistance to our board of directors on matters involving accounting, internal controls, financial reporting and compliance. The audit committee is mainly responsible for assisting and advising the board of directors in its responsibilities to ensure the quality, transparency and integrity of our published financial information and financial statements. The audit committee is also responsible for supervising all matters relating to the Code of Conduct and Integrity, accounting, internal controls, the internal and independent audit functions, compliance, risk management and internal policies, such as the related parties transaction policy. The audit committee comprises three members appointed by the board of directors, and, pursuant to our bylaws, the members of our audit committee may be appointed simultaneously to their election to the board of directors or by a subsequent resolution. The members of the audit committee shall perform their duties for the duration of their respective terms as board members or until otherwise decided by the shareholders' meeting or by the board of

directors. In the event that an audit committee member resigns or is removed from office after exercising any portion of his or her term, such member may only rejoin the audit committee at least three years from the end of his or her term. The current members of our audit committee are Ernesto Rubens Gelbcke, Lucas Navarro Prado and Luís Eduardo Alves de Assis. All members meet the independent membership requirements of the SEC and NYSE as well as other NYSE requirements. Ernesto Rubens Gelbcke is the committee's "financial expert" within the scope of the SEC rules covering the disclosure of financial experts on audit committees in periodic filings pursuant to the U.S. Securities Exchange Act of 1934.

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### *Nomination/Corporate Governance and Compensation Committees*

NYSE rules require that listed companies have a nomination/corporate governance committee and a compensation committee composed entirely of independent directors and governed by a written charter addressing the committee's required purpose and detailing its required responsibilities. Required responsibilities for the nomination/corporate governance committee include, among other things, identifying and selecting qualified board member nominees and developing a set of corporate governance principles applicable to the company. Required responsibilities for the compensation committee include, among other things, reviewing corporate goals relevant to the chief executive officer's compensation, evaluating the chief executive officer's performance, approving the chief executive officer's compensation levels and recommending to the board non chief executive officer compensation, incentive compensation and equity based plans.

Under the Brazilian Corporate Law, we are not required to have a nomination/corporate governance committee or compensation committee. However, Federal Law No. 13,303/16 and State Decree No. 62,349/16 established the requirement of a committee with the responsibilities of verifying the nomination process of the members of the management and of the fiscal council. In our annual shareholders' meeting, held on April 27, 2018, our bylaws were amended in order to, among other things, create the Eligibility and Advisory Committee in compliance with Federal Law No. 13,303/16 and State Decree No. 62,349/16.

This committee must be composed of up to three members, elected by a general shareholders' meeting, without a fixed term of office. Members must have at least three years' professional experience in public administration, or three years' experience in the private sector in an area in which, or related to which, we operate. Currently, our Eligibility and Advisory Committee is composed of three members, which are representatives from our legal, human resources and compliance departments.

Candidates are assessed based on the CODEC Resolution No. 03/2018 and on our nomination policy, approved by the Board of Directors, which follows the guidelines defined by Federal Law No. 13,303/16, State Decree No. 62,349/16 and Novo Mercado Listing Regulations.

Members of the Eligibility and Advisory Committee may attend board of directors' meetings where matters related to this committee are discussed and will have the right to speak, but not to vote, in accordance with our bylaws.

This committee is also responsible for verifying the compliance of the evaluation process of the members of the management and of the fiscal council, as well as providing methodological and procedural support to the board of directors to evaluate the performance of officers and other members of statutory committees.

The performance evaluation, individual and collective, held annually, of the members of the management and the members of committees, observing the following minimum requirements, according to the terms of Federal Law No. 13,303/16:

- (a) presentation of the acts of management, regarding the lawfulness and effectiveness of the management;
- (b) contribution to the earnings for the year; and
- (c) achievement of the purposes established in the business plan and fulfillment of the long-term strategy.

We expect that a written charter addressing the committee's purpose and detailing its required responsibilities will be approved by the board of directors.

Under the Brazilian Corporate Law, the total amount available for compensation of our directors and executive officers and for profit sharing payments to our executive officers is established by our shareholders at the annual general meeting. The individual compensation and profit sharing of each executive officer, as well as the compensation of our board and committee members is set out according to our remuneration policy, approved by the Board of Directors, which follows the guidelines from the São Paulo State Government and the CODEC (State Capital Protection Board).

### ***Shareholder Approval of Equity Compensation Plans***

NYSE rules require that shareholders be given the opportunity to vote on all equity compensation plans and material revisions thereto, with limited exceptions. We do not currently have any equity compensation plan. If such a plan were to be implemented, there is no requirement under Brazilian Corporate Law for the plan to be approved by our shareholders. However, if the issuance of new shares in connection with any equity compensation plan exceeded the authorized capital under our bylaws, the increase in capital would require shareholder approval.

### ***Corporate Governance Guidelines***

NYSE rules require that listed companies adopt and disclose corporate governance guidelines. We are in compliance with the adoption of corporate governance provisions and guidelines required under the Novo Mercado Regulations, Federal Law No. 13,303/16 and State Decree 62,349/16. See “Item 9.C Markets—Trading on the Brazilian Stock Exchange—The Novo Mercado Segment” and “Item 16.G—Corporate Governance—Required Changes to Corporate Governance Practices of Brazilian Government-Controlled Companies”, our Report on Brazilian Code of Corporate Governance and our policies available on “Corporate Governance” section of our Investor Relations website. We believe that such corporate governance guidelines applicable to us do not conflict with the guidelines established by the NYSE. Our corporate governance guidelines and practices are available on our website at [www.sabesp.com.br](http://www.sabesp.com.br) at the following location: Investor Relations – Corporate Governance.

### ***Code of Business Conduct and Ethics***

NYSE rules require that listed companies adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers. The adoption and disclosure of a formal code is not required under the Brazilian Corporate Law.

However, Federal Law No. 13,303/16, State Decree 62,349/16 and the *Novo Mercado* Regulations require the adoption of a Code of Conduct and Integrity that should include, among other provisions, guidelines to avoid conflicts of interests, forbiddance of fraudulent acts and corruption, whistleblowing channels, protective measures to avoid retaliation regarding whistleblowers, periodic training on the content of such code and sanctions in case of code violations. We adopt and disclose a Code of Conduct and Integrity and believe that this code complies with the requirements made by the Brazilian laws and regulations, as well as addresses the matters required to be addressed by the applicable NYSE and SEC rules.

### ***Internal Audit Function***

NYSE rules require that listed companies maintain an internal audit function to provide management and the audit committee with ongoing assessments of the company's risk management processes and system of internal control. Our internal audit department is connected to the Board of Directors through the audit committee and reports to our Chief Executive Officer. Our internal audit is responsible for evaluating (i) the adequacy of internal controls, (ii) the effectiveness of the risk management and of the governance processes, (iii) the reliability of the process of collecting, measuring, classifying, accumulating, recording and disclosing events and transactions, to prepare financial statements, and (iv) the proper application of the principle of segregation of duties, to avoid the occurrence of conflicts of interest and fraud.

### ***Anticorruption Compliance***

Law No. 12,846, of August 1, 2013 (the "Anticorruption Law" or the "Clean Company Act"), as further regulated by Decree No. 8,420/2015, introduced to the Brazilian legal system the concept of strict liability for legal entities involved in harmful acts against the national and foreign public administration, as defined in the Anticorruption Law, subjecting the violation company to penalties both in administrative and civil law. Similar to the Foreign Corrupt Practices Act of the United States, to which we are also subject, the Anticorruption Law considers that an effective implementation of Compliance Programs may be used to mitigate the administrative penalties to be applied as a consequence of a harmful act against the public administration, which can be up to 20% of the company's annual gross revenue. The program currently consists of a set of internal mechanisms and procedures related to integrity, monitoring and incentives to report irregularities. The program also focuses on the effective implementation of the Code of Conduct and Integrity as well as other policies and guidelines aimed at preventing fraud, corruption and other harmful acts against public administration. In 2018, we circulated communications directed to the entire company, reinforcing the importance of acting in accordance with laws, regulations and internal policies.

As a mixed capital company, our Compliance Program encompasses two distinct situations – active corruption and passive corruption, as predicted in the Brazilian legislation – and follows the recommendations of the Organization for Economic Cooperation and Development, the United Nations Office on Drugs and Crimes, and the World Bank to establish an ethical culture. Our program incorporates and focuses on high management, structural functioning, the provision of complaint hotlines, monitoring of third-party relationships, governance and internal controls, risk management, training and communication.

### ***Citizens' Access to Information at Sabesp***

Federal Law No. 12,527/2011 (LAI), regulated by State Decree No. 58.052/2012 and State Decree No. 61.559/2015 determines that government entities must create Citizen Information Services – SIC units which receive and manage information requests from the public, and make available to citizens information requested or otherwise provided the reasons for denial of such information requests.

In order to comply with LAI, we implemented the Citizen Information Service – SIC, structuring the internal flow of information to serve citizens within the terms provided by this law. We also made a Transparency Portal (*Portal da Transparência*) available on our website, which includes basic information required by law, software for citizens to request information and a list of frequently requested information, according to the standards of the São Paulo State Government.

These duties are linked to the Risk Management area whose main assumption is the transparency, quality of information and compliance with strategic rules of a listed company.

**ITEM 16H. MINE SAFETY DISCLOSURE**

Not applicable.

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### Part III

#### ITEM 17. FINANCIAL STATEMENTS

Not applicable.

#### ITEM 18. FINANCIAL STATEMENTS

The following financial statements, together with the reports of the independent registered public accounting firms, are filed as part of this annual report. See “Index to Financial Statements”.

#### ITEM 19. EXHIBITS

| <b>Item</b> | <b>Description</b>   |
|-------------|--|
| 1.1*        | Bylaws of the Registrant (English translation) (incorporated by reference to the Form 6-K filed on May 25, 2018).  |
| 4.1*        | Agreement between the Registrant and the State Department of Water and Energy (Departamento de Águas e Energia Elétrica—DAEE), dated April 24, 1997 (English translation) (incorporated by reference to Exhibit 10.1 to the Registrant’s Registration Statement on Form F 1 filed on April 8, 2002 (the “April 8, 2002 Form F 1”). |
| 4.2*        | Protocol of Understanding between the Registrant and the State of São Paulo, dated September 30, 1997 (English translation) (incorporated by reference to Exhibit 10.2 to the April 8, 2002 Form F 1).   |
| 4.3*        | Agreement between the Registrant and the State of São Paulo, through the Secretariat of Finance, dated September 10, 2001 (English translation) (incorporated by reference to Exhibit 10.3 to the April 8, 2002 Form F 1).   |
| 4.4*        | Agreement between the Registrant and the State of São Paulo, through the Secretariat of the Treasury, dated December 11, 2001 (English translation) (incorporated by reference to Exhibit 10.4 to the April 8, 2002 Form F 1).   |
| 4.5*        | Amendment to the Agreement, dated April 24, 1997, between the Registrant and the DAEE, dated March 16, 2000 (English translation) (incorporated by reference to Exhibit 10.5 to the April 8, 2002 Form F 1).   |
| 4.6*        | Amendment to the Agreement, dated April 24, 1997, between the Registrant and the DAEE, dated November 21, 2001 (English translation) (incorporated by reference to Exhibit 10.6 to the April 8, 2002 Form F 1).  |
| 4.7*        | First Amendment to the Agreement, dated December 11, 2001, between the Registrant and the State of São Paulo, dated March 22, 2004. (English translation) (incorporated by reference to Exhibit 4.7 to the Form 20 F filed on June 28, 2004).  |
| 4.8*        | Second Amendment to the Agreement, dated December 11, 2001, between the Registrant and the State of São Paulo, dated December 28, 2007. (English translation) (incorporated by reference to the Form 6 K filed on February 25, 2008).  |

|             |  |
|-------------|--|
| 4.9*        | Third Amendment to the Agreement, dated December 11, 2001, between the Registrant and the State of São Paulo, dated November 17, 2008. (English translation) (incorporated by reference to the Form 6 K filed on December 23, 2008).       |
| 4.10*       | Commitment Agreement, between the Registrant and the State of São Paulo, dated March 26, 2008. (English translation) (incorporated by reference to the Form 6 K filed on April 28, 2008).  |
| 4.11*       | Agreement Executed between the Registrant and the São Paulo City Government, dated November 14, 2007 (English Translation) (incorporated by reference to the Form 6 K filed on March 12, 2008).  |
| 4.12*       | Amendment to the Agreement Executed between the Registrant and the São Paulo City government, dated February 10, 2008 (English translation) (incorporated by reference to the Form 6 K filed on May 12, 2008).                             |
| 4.14*       | The Audit Committee Charter dated September 20, 2018 (English translation) (incorporated by reference to the Form 6 K filed on November 30, 2018).   |
| 4.15*       | Convention between the State and the city of São Paulo, dated June 23, 2010, with the intermediation and consent of the Registrant and of ARSESP (English translation) (incorporated by reference to the Form 6 K filed on July 13, 2010). |
| 4.16*       | Contract to provide public water supply and sewage services, among the Registrant, the State and the city of São Paulo, dated June 23, 2010 (English translation) (incorporated by reference to the Form 6 K filed on July 13, 2010).      |
| 4.17*       | Term of Agreement between the Registrant, the State of São Paulo and the DAEE, dated March 18, 2015 (English translation) (incorporated by reference to the Form 6 K filed on April 15, 2015).   |
| 4.18*       | Notice of Transactions with Related Parties, dated November 9, 2016, (English translation) (incorporated by reference to the Form 6-K filed on November 16, 2016).   |
| 4.19*       | First Amendment to the Private Instrument of Settlement and Other Covenants between the Registrant and EMAE, dated October 19, 2017 (English translation) (incorporated by reference to the Form 6-K filed on November 9, 2017).           |
| 11.1*       | Code of Conduct and Integrity dated July 27, 2018 (English translation) (incorporated by reference to the Form 6-K filed on August 10, 2018).  |
| <u>12.1</u> | <u>Certification of Benedito Pinto Ferreira Braga Junior, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>  |
| <u>12.2</u> | <u>Certification of Rui de Britto Álvares Affonso, Chief Financial Officer and Investor Relations Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>  |
| <u>13.1</u> | <u>Certification of Benedito Pinto Ferreira Braga Junior, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>   |
| <u>13.2</u> | <u>Certification of Rui de Britto Álvares Affonso, Chief Financial Officer and Investor Relations Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>                   |
| 101.INS     | XBRL Instance Document   |
| 101.SCH     | XBRL Taxonomy Extension Schema Document  |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF     | XBRL Taxonomy Extension Definition Linkbase Document   |



101.LAB

XBRL Taxonomy Extension Label Linkbase Document

101.PRE

XBRL Taxonomy Extension Presentation Linkbase Document

(\*) Previously filed.

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**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20 F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

**COMPANHIA DE SANEAMENTO BÁSICO DO ESTADO DE SÃO PAULO SABESP**

By: /s/ Benedito Pinto Ferreira Braga Junior  
Name: Benedito Pinto Ferreira Braga Junior  
Title: Chief Executive Officer

By: /s/ Rui de Britto Álvares Affonso  
Name: Rui de Britto Álvares Affonso  
Title: Chief Financial Officer and Investor  
Relations Officer

Date: April 26, 2019

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

**Financial Statements as at December 31, 2018 and 2017**

**And for the years ended**

**December 31, 2018, 2017 and 2016**

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders, Board of Directors and Management of

Companhia de Saneamento Básico do Estado de São Paulo - SABESP

São Paulo - SP

Opinion on the Financial Statements

We have audited the accompanying Statements of financial position of Companhia de Saneamento Básico do Estado de São Paulo – SABESP (the Company) as of December 31, 2018 and 2017, the related statements of profit or loss, other comprehensive income, changes in equity, and cash flows for each of the years in the three year period ended December 31, 2018, and the related notes (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2018, in conformity with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company’s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated April 26, 2019 expressed an adverse opinion on the effectiveness of the Company’s internal control over financial reporting.

*Basis for Opinion*

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company's auditor since 2016.

/s/ KPMG Auditores Independentes

São Paulo – SP

April 26, 2019

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Statement of Financial Position as of December 31, 2018 and 2017****Amounts in thousands of reais**

| <b>Assets</b>                            | <b>Note</b> | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|--|-------------|--------------------------|--------------------------|
| <b>Current assets</b>                    |             |                          |                          |
| Cash and cash equivalents                | 7           | 3,029,191                | 2,283,047                |
| Trade receivables                        | 9 (a)       | 1,843,333                | 1,672,595                |
| Accounts receivable from related parties | 10 (a)      | 174,148                  | 180,773                  |
| Inventories                              |             | 65,596                   | 85,671                   |
| Restricted cash                          | 8           | 31,900                   | 18,822                   |
| Recoverable taxes                        | 18 (a)      | 380,703                  | 276,585                  |
| Other receivables                        |             | 77,371                   | 56,592                   |
| <b>Total current assets</b>              |             | <b>5,602,242</b>         | <b>4,574,085</b>         |
| <b>Noncurrent assets</b>                 |             |                          |                          |
| Trade receivables                        | 9 (a)       | 209,083                  | 215,910                  |
| Accounts receivable from related parties | 10 (a)      | 669,102                  | 634,387                  |
| Escrow deposits                          |             | 152,018                  | 122,686                  |
| Water National Agency – ANA              | 11          | 49,136                   | 70,487                   |
| Other receivables                        |             | 103,310                  | 113,123                  |
| Investments                              | 12          | 44,587                   | 36,932                   |
| Investment properties                    | 13          | 47,620                   | 57,652                   |
| Contract asset                           | 14          | 7,407,948                | -                        |
| Intangible assets                        | 15          | 29,012,460               | 33,466,132               |
| Property, plant and equipment            | 16          | 267,612                  | 255,050                  |
| <b>Total noncurrent assets</b>           |             | <b>37,962,876</b>        | <b>34,972,359</b>        |
| <b>Total assets</b>                      |             | <b>43,565,118</b>        | <b>39,546,444</b>        |

The accompanying notes are an integral part of these financial statements.

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Statement of Financial Position as of December 31, 2018 and 2017****Amounts in thousands of reais**

| <b>Liabilities and equity</b>                         | <b>Note</b> | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|---|-------------|--------------------------|--------------------------|
| Current assets  |             |                          |                          |
| Trade payables and contractors                        |             | 465,993                  | 344,947                  |
| Current portion of long-term borrowings and financing | 17          | 2,103,612                | 1,746,755                |
| Accrued payroll and related taxes                     |             | 564,830                  | 588,073                  |
| Taxes and contributions                               | 18 (b)      | 200,563                  | 183,965                  |
| Interest on capital                                   | 24 (c)      | 673,765                  | 598,612                  |
| Provisions  | 20 (a)      | 458,387                  | 607,959                  |
| Services payable                                      | 22          | 454,022                  | 408,275                  |
| Public-Private Partnership - PPP                      | 15 (g)      | 137,827                  | 60,007                   |
| Program Contract Commitments                          | 15 (c) (iv) | 230,695                  | 128,802                  |
| Other liabilities                                     |             | 108,938                  | 104,485                  |
| Total current liabilities                             |             | 5,398,632                | 4,771,880                |
| Noncurrent liabilities                                |             |                          |                          |
| Borrowings and financing                              | 17          | 11,049,184               | 10,354,211               |
| Deferred income tax and social contribution           | 19          | 261,242                  | 36,754                   |
| Deferred Cofins and PASEP                             |             | 140,830                  | 130,182                  |
| Provisions  | 20 (a)      | 434,475                  | 470,245                  |
| Pension obligations                                   | 21 (b)      | 2,970,009                | 2,932,338                |
| Public-Private Partnership - PPP                      | 15 (g)      | 3,275,297                | 3,011,409                |
| Program Contract Commitments                          | 15 (c) (iv) | 142,314                  | 110,698                  |
| Other liabilities                                     |             | 341,447                  | 215,718                  |
| Total noncurrent liabilities                          |             | 18,614,798               | 17,261,555               |
| Total liabilities                                     |             | 24,013,430               | 22,033,435               |
| Equity  |             |                          |                          |
| Capital stock   |             | 15,000,000               | 10,000,000               |
| Earnings reserves                                     |             | 5,100,783                | 8,051,110                |
| Other comprehensive loss                              |             | (549,095)                | (538,101)                |
| Total equity  | 24          | 19,551,688               | 17,513,009               |
| Total equity and liabilities                          |             | 43,565,118               | 39,546,444               |

The accompanying notes are an integral part of these financial statements.

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Income Statements for the****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of reais, unless otherwise indicated**

|   | <b>Note</b> | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|---|-------------|-------------|-------------|-------------|
| <b>Net operating income</b>   | 28 (b)      | 16,085,094  | 14,608,233  | 14,098,208  |
| Cost of services  | 29          | (9,086,456) | (8,778,963) | (9,013,120) |
| <b>Gross profit</b>   |             | 6,998,638   | 5,829,270   | 5,085,088   |
| Selling expenses  | 29          | (693,480)   | (686,012)   | (639,559)   |
| Allowance for doubtful accounts   | 29          | (166,727)   | (82,681)    | (90,488)    |
| Administrative expenses   | 29          | (996,877)   | (1,098,990) | (934,896)   |
| Other operating income (expenses), net  | 31          | 28,591      | (5,679)     | 4,722       |
| Equity results of investments in affiliates   | 12          | 6,510       | 5,760       | 4,740       |
| <b>Profit from operations before finance income (expenses) and income tax and social contribution</b> |             | 5,176,655   | 3,961,668   | 3,429,607   |
| Financial expenses  | 30          | (807,967)   | (688,280)   | (839,891)   |
| Financial revenues  | 30          | 446,302     | 326,244     | 448,710     |
| Exchange result, net  | 30          | (902,671)   | (96,018)    | 1,090,628   |
| <b>Financial result, net</b>  |             | (1,264,336) | (458,054)   | 699,447     |
| <b>Profit before income tax and social contribution</b>   |             | 3,912,319   | 3,503,614   | 4,129,054   |
| Income tax and social contribution  |             |             |             |             |
| Current   | 19 (d)      | (852,655)   | (882,787)   | (1,121,289) |
| Deferred  | 19 (d)      | (224,596)   | (101,517)   | (60,667)    |
|   |             | (1,077,251) | (984,304)   | (1,181,956) |
| <b>Profit for the year</b>  |             | 2,835,068   | 2,519,310   | 2,947,098   |
| <b>Earnings per share – basic and diluted (in reais)</b>  | 25          | 4.15        | 3.69        | 4.31        |



The accompanying notes are an integral part of these financial statements.

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Statements of Comprehensive Income for the****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of reais**

|  | <b>Note</b> | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|--|-------------|-------------|-------------|-------------|
| Profit for the year  |             | 2,835,068   | 2,519,310   | 2,947,098   |
| Other comprehensive income (loss)  |             | (10,994)    | 287,547     | (472,266)   |
| Items which will not be subsequently reclassified to the income statement: |             |             |             |             |
| Actuarial gains and (losses) on defined benefit plans                      | 21 (b)      | (10,994)    | 287,547     | (472,266)   |
| Total comprehensive income for the year                                    |             | 2,824,074   | 2,806,857   | 2,474,832   |

The accompanying notes are an integral part of these financial statements.

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## Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Statements of Changes in Equity for the

Years ended December 31, 2018, 2017 and 2016

Amounts in thousands of reais, unless otherwise indicated

|   |        | Earnings reserves |               |                    |                              |                   |                          |            |
|---|--------|-------------------|---------------|--------------------|------------------------------|-------------------|--------------------------|------------|
|   | Note   | Capital stock     | Legal Reserve | Investment reserve | Additional dividend proposed | Retained earnings | Other comprehensive loss | Total      |
| <b>Balances as of December 31, 2015</b>   |        | 10,000,000        | 784,955       | 3,273,580          | 11,453                       | -                 | (353,382)                | 13,716,606 |
| Net income for the year   |        | -                 | -             | -                  | -                            | 2,947,098         | -                        | 2,947,098  |
| Actuarial gains (losses)  | 21 (b) | -                 | -             | -                  | -                            | -                 | (472,266)                | (472,266)  |
| Total comprehensive income for the year   |        | -                 | -             | -                  | -                            | 2,947,098         | (472,266)                | 2,474,832  |
| Legal reserve   | 24 (d) | -                 | 147,355       | -                  | -                            | (147,355)         | -                        | -          |
| Interest on capital (R\$1.0240 per share)   | 24 (c) | -                 | -             | -                  | -                            | (699,936)         | -                        | (699,936)  |
| 2015 additional proposed dividends, approved (R\$0.0330 per share)                        |        | -                 | -             | -                  | (11,453)                     | -                 | -                        | (11,453)   |
| Additional proposed dividends   | 24 (c) | -                 | -             | -                  | 123,557                      | (123,557)         | -                        | -          |
| Withholding income tax on interest on capital attributable as minimum mandatory dividends |        | -                 | -             | -                  | (60,838)                     | -                 | -                        | (60,838)   |
| Transfer to investments reserve   |        | -                 | -             | 1,976,250          | -                            | (1,976,250)       | -                        | -          |
| <b>Balances as of December 31, 2016</b>   |        | 10,000,000        | 932,310       | 5,249,830          | 62,719                       | -                 | (825,648)                | 15,419,211 |
| Net income for the year   |        | -                 | -             | -                  | -                            | 2,519,310         | -                        | 2,519,310  |
| Actuarial gains (losses)  | 21 (b) | -                 | -             | -                  | -                            | -                 | 287,547                  | 287,547    |
| Total comprehensive income for the year   |        | -                 | -             | -                  | -                            | 2,519,310         | 287,547                  | 2,806,857  |
| Legal reserve   | 24 (d) | -                 | 125,965       | -                  | -                            | (125,965)         | -                        | -          |
| Interest on capital (R\$0.87539 per share)  | 24 (c) | -                 | -             | -                  | -                            | (598,336)         | -                        | (598,336)  |
|   |        | -                 | -             | -                  | (62,719)                     | -                 | -                        | (62,719)   |

|   |        |            |           |             |          |              |           |            |  |
|---|--------|------------|-----------|-------------|----------|--------------|-----------|------------|--|
| 2016 additional proposed dividends, approved (R\$0.09176 per share)                       |        |            |           |             |          |              |           |            |  |
| Additional proposed dividends   | 24 (c) | -          | -         | -           | 105,543  | (105,543)    | -         | -          |  |
| Withholding income tax on interest on capital attributable as minimum mandatory dividends | 24 (c) | -          | -         | -           | (52,004) | -            | -         | (52,004)   |  |
| Transfer to investments reserve   |        | -          | -         | 1,689,466   |          | (-1,689,466) | -         | -          |  |
| <b>Balances as of December 31, 2017</b>   |        | 10,000,000 | 1,058,275 | 6,939,296   | 53,539   | -            | (538,101) | 17,513,009 |  |
| Net income for the year   |        | -          | -         | -           | -        | 2,835,068    | -         | 2,835,068  |  |
| Actuarial gains (losses)  | 21 (b) | -          | -         | -           | -        | -            | (10,994)  | (10,994)   |  |
| Total comprehensive income for the year   |        | -          | -         | -           | -        | 2,835,068    | (10,994)  | 2,824,074  |  |
| Legal Reserve   | 24 (d) | -          | 141,755   | -           | -        | (141,755)    | -         | -          |  |
| Investments reserve capitalized   | 24 (a) | 5,000,000  |           | (5,000,000) |          |              |           |            |  |
| Interest on capital (R\$0.9851 per share)   | 24 (c) | -          | -         | -           | -        | (673,328)    | -         | (673,328)  |  |
| 2016 additional proposed dividends, approved (R\$0.07833 per share)                       |        | -          | -         | -           | (53,539) | -            | -         | (53,539)   |  |
| Additional proposed dividends   | 24 (c) | -          | -         | -           | 118,859  | (118,859)    | -         | -          |  |
| Withholding income tax on interest on capital attributable as minimum mandatory dividends | 24 (c) | -          | -         | -           | (58,528) | -            | -         | (58,528)   |  |
| Transfer to investments reserve   | 24 (f) | -          | -         | 1,901,126   |          | (-1,901,126) | -         | -          |  |
| <b>Balances as of December 31, 2018</b>   |        | 15,000,000 | 1,200,030 | 3,840,422   | 60,331   | -            | (549,095) | 19,551,688 |  |

The accompanying notes are an integral part of these financial statements.

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Statements of Cash Flows for the****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of  
reais**

|  | <b>December 31, D</b> |
|--|-----------------------|
|  | <b>2018</b>           |
| <b>Cash flow from operating activities</b>   |                       |
| <b>Profit before income tax and social contribution</b>  | <b>3,912,319</b>      |
| <b>Adjustments for:</b>  |                       |
| Depreciation and amortization  | 1,392,541             |
| Residual value of property, plant and equipment, intangible assets and investment properties written-off | 24,974                |
| Bad debt expense   | 165,433               |
| Agreement signed with the municipality of Guarulhos  | (928,014)             |
| Provisions and inflation adjustment  | 111,940               |
| Pension plan liabilities – early reduction (curtailment)   | -                     |
| Interest calculated on borrowings and financing payable  | 563,902               |
| Inflation adjustment and exchange gains (losses) on borrowings and financing                             | 982,072               |
| Interest and inflation adjustment on liabilities   | 30,103                |
| Interest and inflation adjustment on assets  | (64,046)              |
| Finance charges from customers   | (289,321)             |
| Margin of fair value on intangible assets arising from concession  | (63,013)              |
| Provision for Consent Decree (TAC)   | 80,245                |
| Share of profit of investees   | (6,510)               |
| Provision from São Paulo agreement   | 135,735               |
| Provision for pension plan - Sabesprev Mais  | -                     |
| Pension obligations  | 243,569               |
| Other adjustments  | 33,349                |
|  | <b>6,325,278</b>      |
| <b>Changes in assets</b>   |                       |
| Trade receivables  | (71,679)              |
| Accounts receivable from related parties   | 39,919                |
| Inventories  | 20,075                |

|   |                    |
|---|--------------------|
| Recoverable taxes                                   | (104,118)          |
| Escrow deposits                                     | (1,639)            |
| Other receivables                                   | 11,760             |
| <b>Changes in liabilities</b>                       |                    |
| Trade payables and contractors                      | (176,826)          |
| Services payable                                    | (89,988)           |
| Accrued payroll and related taxes                   | (103,488)          |
| Taxes and contributions payable                     | (4,829)            |
| Deferred Cofins/PASEP                               | 10,648             |
| Provisions  | (297,282)          |
| Pension obligations                                 | (217,000)          |
| Other liabilities                                   | 122,214            |
| <b>Cash generated from operations</b>               | <b>5,463,045</b>   |
| Interest paid                                       | (732,048)          |
| Income tax and social contribution paid             | (888,077)          |
| <b>Net cash generated from operating activities</b> | <b>3,842,920</b>   |
| <b>Cash flows from investing activities</b>         |                    |
| Acquisition of contract asset and intangible assets | (2,132,559)        |
| Restricted cash                                     | (13,078)           |
| Investment increase                                 | (1,136)            |
| Purchase of property, plant and equipment           | (50,645)           |
| Dividends received                                  | 8,131              |
| <b>Net cash used in investing activities</b>        | <b>(2,189,287)</b> |

The accompanying notes are an integral part of these financial statements.

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Statements of Cash Flows for the****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of  
reais****(continued)**

|  | <b>December 31,</b> | <b>December 31,</b> | <b>December 31,</b> |
|--|---------------------|---------------------|---------------------|
|  | <b>2018</b>         | <b>2017</b>         | <b>2016</b>         |
| <b>Cash flows from financing activities</b>            |                     |                     |                     |
| Borrowings and financing                               |                     |                     |                     |
| Proceeds from loans                                    | 1,634,553           | 1,007,572           | 1,250,524           |
| Payment of loans                                       | (1,678,748)         | (1,098,558)         | (1,535,312)         |
| Payment of interest on capital                         | (653,393)           | (765,933)           | (139,399)           |
| Public-Private Partnership - PPP                       | (178,333)           | (31,758)            | (30,498)            |
| Program Contract Commitments                           | (31,568)            | (44,935)            | (171,180)           |
| <b>Net cash used in financing activities</b>           | <b>(907,489)</b>    | <b>(933,612)</b>    | <b>(625,865)</b>    |
| <b>Increase in cash and cash equivalents</b>           | <b>746,144</b>      | <b>396,826</b>      | <b>247,007</b>      |
| <b>Represented by :</b>                                |                     |                     |                     |
| Cash and cash equivalents at the beginning of the year | 2,283,047           | 1,886,221           | 1,639,214           |
| Cash and cash equivalents at the end of the year       | 3,029,191           | 2,283,047           | 1,886,221           |
| <b>Increase in cash and cash equivalents</b>           | <b>746,144</b>      | <b>396,826</b>      | <b>247,007</b>      |

The accompanying notes are an integral part of these financial statements.





## **Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

### **Notes to the Financial Statements**

**Years ended December 31, 2018, 2017 and 2016**

**Amounts in thousands of reais, unless otherwise indicated**

#### **1 Operations**

Companhia de Saneamento Básico do Estado de São Paulo ("SABESP" or the "Company") is a mixed-capital company headquartered in São Paulo, at Rua Costa Carvalho, 300, CEP 05429-900, controlled by the São Paulo State Government. The Company is engaged in the provision of basic and environmental sanitation services in the State of São Paulo, as well as it supplies treated water and sewage services on a wholesale basis.

In addition to providing basic sanitation services in the State of São Paulo, SABESP may performs these activities in other states and countries, and can operate in drainage, urban cleaning, solid waste handling and energy markets. SABESP aims to be a world reference in the provision of sanitation services, in a sustainable, competitive and innovative manner, with a focus on customers.

As of December 31, 2018, the Company operated water and sewage services in 369 municipalities of the State of São Paulo. Most of these municipalities operations are based on 30-year concession, program and services contracts. The Company has two partial contracts with the municipality of Mogi das Cruzes, however, since most of municipality is serviced by wholesale, it was not included in the 369 municipalities. The municipalities of Guarulhos and Aguaí signed contracts on December of 2018, however their operations will begin only in 2019 (in January and June, respectively). As of December 31, 2018, the Company had 373 contracts.

SABESP is not temporarily operating in the municipalities of Macatuba and Cajobi due to judicial orders. The lawsuits are in progress and the carrying amount of these municipalities' intangible assets was R\$4,345 as of

December 31, 2018 (R\$4,345 as of December 31, 2017).

As of December 31, 2018, 35 concession agreements (51 as of December 31, 2017) had expired and are being negotiated. From 2019 to 2030, 31 concession agreements will expire. Management believes that concession agreements expired and not yet renewed will result in new contracts, disregarding the risk of discontinuity in the provision of municipal water supply and sewage services. By December 31, 2018, 307 program and services contracts were signed (287 contracts as of December 31, 2017).

As of December 31, 2018, the carrying amount of the underlying assets used in the 35 concessions of the municipalities under negotiation totaled R\$4,485,203, accounting for 12.32% of the total of intangible assets, and the related gross revenue for the year ended December 31, 2018 totaled R\$1,035,906, accounting for 6.07% of the total of gross revenue.

The Company's operations are concentrated in the municipality of São Paulo, which represents 51.52% of the gross revenues as of December 31, 2018 (55.38% as of December 31, 2017 and 55.46% as of December 31, 2016) and 46.97% of intangible assets (46.92% on December 31, 2017).

## **Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

### **Notes to the Financial Statements**

**Years ended December 31, 2018, 2017 and 2016**

**Amounts in thousands of reais, unless otherwise indicated**

On June 23, 2010, the State of São Paulo, the Municipality of São Paulo, the Company and the regulatory agency “Sanitation and Energy Regulatory Agency – ARSESP” signed an agreement to share the responsibility for water supply and sewage services to the Municipality of São Paulo based on a 30-year concession agreement. This agreement is extendable for another 30 years, pursuant to the law. This agreement sets forth SABESP as the exclusive service provider and designates ARSESP as regulator, establishing prices, controlling and monitoring services. On the same date, the State of São Paulo, the Municipality of São Paulo and SABESP signed the “Public service provision agreement of water supply and sewage services”, a 30-year concession agreement which is extendable for another 30 years. This agreement involves the following activities:

- i. protection of the sources of water in collaboration with other agencies of the State and the City;
- ii. capture, transport and treatment of water;
- iii. collect, transport, treatment and final dispose of sanitary sewage; and
- iv. adoption of other actions of basic and environmental sanitation.

The Company operates under an authorization by public deed in some municipalities in the Santos coast region and in the Ribeira Valley, where the Company started to operate after the merger of the companies that formed it. In September 2015, the Company entered into a water supply and sewage public utility services agreement with the municipality of Santos; the gross revenue calculated in the year ended December 31, 2018 totaled R\$ 326.276 (R\$294,658 as of December 31, 2017 and R\$280,689 as of December 31, 2016) and the intangible asset was R\$307,566 in the year ended December 31, 2018 (R\$310,577 as of December 31, 2017).

Public deeds are valid and governed by the Brazilian Civil Code.

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

**Notes to the Financial Statements**

**Years ended December 31, 2018, 2017 and 2016**

**Amounts in thousands of reais, unless otherwise indicated**

The Company's shares have been listed in the Novo Mercado (New Market) segment of B3 under the ticker symbol SBSP3 since April 2002 and on the New York Stock Exchange (NYSE) as American Depositary Receipts (“ADRs”) Level III, under the SBS code, since May 2002.

Since 2008, the Company has been setting up partnerships with other companies, which resulted in the following companies: Sesamm, Águas de Andradina, Saneaqua Mairinque, Aquapolo Ambiental, Águas de Castilho, Attend Ambiental and Paulista Geradora de Energia. Although SABESP has no majority interest in the capital stock of these companies, the shareholders’ agreements provide for the power of veto and casting vote in certain issues jointly with associates, indicating the shared control in the management of investees.

As of March 3, 2018, the Jaguari-Atibainha interconnection was inaugurated; this interconnection allow the transfer of an average annual outflow of 5.13 cubic meters per second (m<sup>3</sup>/s) and a maximum outflow of 8.5 m<sup>3</sup>/s from the Paraíba do Sul Basin to the Cantareira System. Inaugurated in April 2018, the São Lourenço Production System expand water production and capacity by 6.4 m<sup>3</sup>/s. With the conclusion of this system the Company has nine large production systems available to supply the São Paulo Metropolitan Region. These two important works aim at expand water security in the São Paulo Metropolitan Region.

Management expects that with improved water security, due to the works carried out, the generation of operating cash and the credit lines available for investment, the Company will have sufficient funds to meet its commitments and not compromise its necessary investments.

The financial statements were approved by Management on April 25, 2019.

**2 Basis of preparation and presentation of the financial statements**

The financial statements of the Company have been prepared in accordance with the International Financial Reporting Standards – IFRS as issued by the International Accounting Standards Board – IASB. All material information related to the financial statements, and this information alone, is being disclosed and corresponds to the information used by the Company’s Management in its administration.

The financial statements have been prepared under the historical cost except for certain financial instruments measured at fair value when required by the standards.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires Management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree to judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are described in Note 6.

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

**Notes to the Financial Statements**

**Years ended December 31, 2018, 2017 and 2016**

**Amounts in thousands of reais, unless otherwise indicated**

**3 Summary of Significant Accounting Policies**

The main accounting policies applied in the preparation of these financial statements are defined below. These policies have been applied consistently in all years presented, except for the adoption of new accounting standards as described below.

**3.1 Cash and cash equivalents**

Cash and cash equivalents include cash in hand, bank deposits, overdraft accounts and other short-term highly liquid investments with original maturities less than three months as of the investment date, with an insignificant risk of changing value.

**3.2 Financial assets and liabilities**

**Financial Asset - Classification**

As of December 31, 2017, the Company classified its financial assets according to the following categories: measured at fair value through profit or loss, borrowings and receivables, held-to-maturity and available for sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of the financial assets at inception. As of December 31, 2017, the Company did not have financial assets classified under the fair value through profit or loss, held-to-maturity and available-for-sale financial instruments.

- Borrowings and receivables

These comprise receivables, which are non-derivative financial assets with fixed or determinable payments, not quoted in an active market. Borrowings and receivables are presented in current assets, except for those with maturity of more than 12 months after the reporting date (these are classified as noncurrent assets). The Company's borrowings and receivables include cash and cash equivalents, restrict cash, balances of trade receivables, accounts receivable from related parties, other receivables, receivables from the Water National Agency – ANA. Borrowings and receivables are recorded at fair value and subsequently at amortized cost, under the effective interest rate method.

Starting January 1, 2018, the Company adopted IFRS 9, which establishes principles for the financial reporting of financial assets and financial liabilities involving all three accounting aspects: classification and measurement, impairment and hedge accounting.

As of December 31, 2018, the Company classifies its financial assets according to the following categories: measured at amortized cost, measured at fair value through other comprehensive income and measured at fair value through profit or loss. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of the financial assets at inception. As of December 31, 2018, the Company did not have financial assets classified as fair value through other comprehensive income and fair value through profit or loss.



## **Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

### **Notes to the Financial Statements**

**Years ended December 31, 2018, 2017 and 2016**

**Amounts in thousands of reais, unless otherwise indicated**

- Amortized cost

This comprises financial assets that meet the following conditions: (i) it is held within the business model whose objective is to hold financial assets to collect contractual cash flows; and (ii) the contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Presented as current assets, except for those with maturity of more than 12 months after the reporting date (these are classified as noncurrent assets). The Company's financial assets measured at amortized cost include cash and cash equivalents, restricted cash, balances of trade receivables, accounts receivable from related parties, other receivables, receivables from the Water National Agency – ANA. Financial assets measured at amortized cost are recorded at fair value and subsequently at amortized cost, under the effective interest rate method.

### **Financial Liabilities - Classification**

As of December 31, 2017, the Company classified its financial liabilities into the following categories: measured at fair value through profit or loss and amortized cost. Classification depends on the purpose to which the financial liabilities were assumed. As of December 31, 2017, the Company did not have liabilities classified into the “fair value through profit or loss” category.

- Amortized cost

This category comprises balances payable to contractors and suppliers, borrowings and financing, services payable, balances payable from public-private partnership (PPP), and program contract commitments.

The effective interest rate method is adopted to calculate the amortized cost of a financial liability and allocate its interest expense under the respective period. The effective interest rate exactly deducts the estimated future cash flows (including fees, transaction costs and other issue costs) throughout the financial liability's estimated life or, when appropriate, during a shorter period, for initial recognition of the net carrying amount.

As of December 31, 2018, with the adoption of IFRS 9, the Company classifies its financial liabilities measured at amortized cost. Classification depends on the purpose to which the financial liabilities were assumed. This category comprises balances payable to contractors and suppliers, borrowings and financing, services payable, balances payable from public-private partnership (PPP), and program contract commitments.

## **Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

### **Notes to the Financial Statements**

**Years ended December 31, 2018, 2017 and 2016**

**Amounts in thousands of reais, unless otherwise indicated**

The effective interest rate method is adopted to calculate the amortized cost of a financial liability and allocate its interest expense under the respective period. The effective interest rate exactly deducts the estimated future cash flows (including fees, transaction costs and other issue costs) throughout the financial liability's estimated life or, when appropriate, during a shorter period, for initial recognition of the net carrying amount.

### **Impairment**

IFRS 9 – Financial Instruments introduces a new impairment model, replacing the incurred loss model for the expected credit loss model, which requires the recording of provision upon initial recognition of asset exposed to credit risk.

### **Trade receivables**

Due to the characteristics of the Company's accounts receivable such as (i) insignificant financial component, (ii) non-complex receivables portfolio, and (iii) low credit risk, the Company adopted the simplified approach of expected credit loss, which consists in recognizing expected credit loss based on the total asset's useful life.

As of December 31, 2017, the methodology to calculate the allowance for doubtful accounts was carried out based on historical loss. The methodology used consisted of using an estimate per maturity range through the average weighted loss of the last 12 months. The calculation also considered a segregation of clients by nature and maturity date. The Company also concluded that the macroeconomic indicators did not have significant impact on its estimates. In order to support this understanding, the Company carried out several analyses of the correlation between indicators that could potentially have some influence the sanitation sector and its history of losses on doubtful accounts, such as Gross Domestic Product (GDP), Unemployment Rate and the Extended Consumer Price Index (IPCA).

After analysis, the Management concluded that the methodology already adopted by the Company complies with the expected credit loss model and, for this reason, the first-time adoption of IFRS 9 as from January 1, 2018 did not have significant impacts on the measurement of allowance for doubtful accounts.

**Deposit transactions and financial investments measured at amortized cost**

The Company analyzes changes in the rates of investments in bank deposits certificates and information obtained from regulatory agencies about the financial institutions. The likelihood of delinquency over 12 months and during the terms of these investments was based on historical data provided by credit rating agencies for each credit level and analyzed in terms of sensitivity based on current returns.

These deposits and financial investments are subject to an insignificant risk of change in value.

## **Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

### **Notes to the Financial Statements**

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### **3.3 Operating income**

#### **(a) Revenue from sanitation services**

Revenue from water supply and sanitation services are recognized as the water is consumed and services are provided. Revenues, including revenues unbilled, are recognized at the fair value of the consideration received or receivable for the sale of those services. Revenue is shown net of value-added tax, rebates and discounts. Unbilled revenues represent incurred revenues in which the services were provided, but not yet billed until the end of the each period and are recorded as trade receivables based on monthly estimates of the completed services. The average term between the issue and the maturity of the bill is ten business days. Concerning revenues of wholesale municipal governments (wholesale sale), which do not pay the full invoice, the Company records allowance for doubtful accounts upon invoicing in revenue reduction account.

As of December 31, 2017, the Company recognized revenue when: i) products were delivered or services were rendered; ii) the amount of revenue could be reliably measured, iii) it was probable that future economic benefits would flow to the Company, and iv) it was probable that the amounts will be collected. The amount of revenue was not considered to be reliably measurable until all conditions relating to the sale had been satisfied. Amounts in dispute were recognized as revenue when collected.

As of December 31, 2018, with the adoption of IFRS 15, since 1 January, 2018, which establishes a five-step model applicable over revenue from a contract with a customer, as a result, the Company started to recognize revenue when: i) it identifies the contracts with customers; ii) it identifies the different obligations in the contract; iii) it determines the transaction price; iv) it allocates the transaction price to the performance obligations in the contracts; and (v) it satisfies all performance obligations. Amounts in dispute are recognized as revenue when collected.

The Company analyzed sales transactions to private sector, government entities and wholesale customers and concluded IFRS 15 did not have significant impacts.

The Company adopted IFRS 15 using the cumulative effect method, with application and recognition as from first-time adoption, i.e. January 1, 2018. Consequently, the Company did not apply the requirements of IFRS 15 for comparison purposes. Accordingly, data relating to 2017 is presented based on information previously reported and prepared in accordance with IAS 18 Revenue and related interpretations.

**(b) Construction revenue**

As of December 31, 2017, revenue from concession construction contracts was recognized in accordance with IFRIC 12 (Concession Arrangements) and IAS 11 (Construction Contracts), using the percentage-of-completion method, provided that the applicable conditions for application were fulfilled, with non-cash effect. The percentage of completion was calculated from the ratio of the actual costs incurred on the balance sheet date to the planned total costs (cost-to-cost method). Revenue from cost plus contracts was recognized by reference to the construction costs incurred during the period plus a fee earned. The fee represents the additional margin related to the work performed by the Company in relation to such construction contracts and it is added construction costs, resulting in the construction revenue.

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As of December 31, 2018, revenue from concession construction contracts is recognized in accordance with IFRS 15 (Revenue from Contracts with Customers) and IFRIC 12 (Concession Contracts), as all performance obligations are satisfied over time. During the construction of the contract, an asset is classified as contract asset, as the Company estimates that the fair value of its consideration is equivalent to expected construction costs plus margin (the effects from the first-time adoption of IFRS 15 are presented according to Note 4.1). The fee represents the additional margin related to the work performed by the Company in relation to such construction contracts and it is added to construction costs, resulting in the construction revenue.

#### **3.4 Trade receivables and allowance for doubtful accounts**

Trade receivables are amounts due from customers for services performed in the ordinary course of business. These are classified as current assets, except when maturity exceeds 12 months after the end of the reporting period. In these cases, they are presented as noncurrent assets.

The Company establishes an allowance for doubtful accounts for receivable balances at an amount that Management considers to be sufficient to cover eventual losses. The analysis is carried out based on objective accounts receivable data, past receipts, existing guarantees, and as from January 1, 2018, with the adoption of IFRS 9, it considers expected future losses.

#### **3.5 Inventories**

Inventories of supplies for consumption and maintenance of the water and sewage systems are stated at the lower of average cost of acquisition or net realizable value, and are classified in current assets.

### **3.6 Investment properties**

The investment properties are recorded at the acquisition or construction cost, less accumulated depreciation, except for the land group, calculated by the straight-line method at rates that consider the estimated useful life of assets. Expenditures related to repairs and maintenance are recorded in the income statement when incurred.

The Company also maintains few assets for undetermined use in the future, i.e., it is not defined if the Company will use these assets in the operation or sell them in the short term during the ordinary course of business.

### **3.7 Property, plant and equipment**



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**Years ended December 31, 2018, 2017 and 2016**

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Property, plant and equipment comprise mainly administrative facilities not composing the assets, subject-matter of the concession agreements. Those assets are stated at historical acquisition or construction cost less depreciation, net of impairment charge, when necessary. Interest, other finance charges and inflationary effects deriving from financing effectively applied to construction in progress are recorded as cost of respective property, plant and equipment, in this case, for the qualifying assets, as applicable. Qualifying assets are assets that, necessarily, take a substantial period to get ready for its intended use or sale. The Company considers that substantial period means a period greater than 12 months. This period was established by considering the completion period of the majority of its constructions, which is greater than 12 months, which corresponds to one fiscal year of SABESP.

Subsequent costs included in the existing asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that the future economic benefit associated with the item will flow to the Company and the cost of the item can be measured reliably. Repairs and maintenance are charged to the income statement during the financial period in which they were incurred.

Depreciation is calculated using the straight-line method to allocate their cost and is described in Note 16(c).

Residual values and the useful life of assets are revised and adjusted, where applicable, at the end of each year.

Gain and losses on disposals are determined by the difference between the proceeds with the carrying amount and are recognized within other operating income (expenses) in the income statement.

### **3.8 Intangible assets**

Intangibles are stated at acquisition cost and/or construction of the underlying assets, including construction margin, interest and other finance charges capitalized during the construction period, in this case, for the qualifying assets. Qualifying assets are assets that, necessarily, take a substantial period to get ready for its intended use or sale. The Company considers that substantial period means a period greater than 12 months. This period was established by considering the completion period of the majority of its constructions, which is greater than 12 months, which corresponds to one fiscal year of SABESP.

The intangible has its amortization initiated when the intangible assets are available for use in location and the necessary condition when this asset becomes operational.

The amortization of intangible assets reflects the period over the expected future economic benefits generated by the intangible asset are consumed by the Company and can be the period of the contract or the useful life of the asset.

The amortization of the intangible assets is discontinued when the asset is totally consumed or it is disposed of, whatever occurs first.

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Donations in assets, received from third parties and governmental entities, to allow the Company to render water and sewage services are not recorded in the Company's financial statements, since these assets are controlled by the concession grantor.

Financial resources received as donations for the construction of infrastructure are recorded under "Other operating income".

**(a) Concession arrangements/program**

The Company operates concession agreements including the rendering of basic sanitation, environmental, water supply and sewage services signed with the concession grantor. The infrastructure used by SABESP subject to service concession arrangements is considered to be controlled by the concession grantor when:

- (i) The grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
- (ii) The grantor controls the infrastructure, i.e., retains the right to take back the infrastructure at the end of the concession.

SABESP's rights over infrastructure operated under concession arrangements is accounted for as an intangible asset as SABESP has the right to charge for use of the infrastructure assets, and users (consumers) have the primary responsibility to pay SABESP for the services.

The fair value of construction and other work on the infrastructure is recognized as revenue, as its fair value, when the infrastructure is built, provided that this work is expected to generate future economic benefits. The accounting policy to recognize construction revenue is described in Note 3.3 (b).

Intangible assets related to Concession Agreements and Program Contracts, when there is no right to receive the residual value of the assets at the end of the contract, are amortized on a straight-line basis over the period of the contract, or the useful life of the underlying asset, whichever occurs first.

Investments made and not recovered through rendering of services, in cases where there is the right to receive the residual value of the assets at the end of the contract, must be indemnified by the concession grantor, (1) with cash or cash equivalents or also, in general (2) with the contract extension. These investments are amortized by the useful life of asset.

The details referring to amortization of intangible arising from concession arrangements/program are described in Note 16 (c).

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Law 11,445/07 indicates, whenever possible, that basic sanitation public utilities will have the economic and financial sustainability ensured through the remuneration due to service collection, preferably as tariffs and other public prices, which may be established for each service or both jointly. Therefore, investments made and not recovered through services rendered, within original term of the contract, are recorded as intangible assets and amortized by the useful life of the asset, taking into consideration a solid track record of concession renewal and, therefore, the continuity of services.

#### **(b) Software licenses**

Software licensing is capitalized based on the acquisition costs and other implementation costs. Amortizations are recorded according to the useful lives and the expenses associated with maintaining these are recognized as expenses when incurred.

### **3.9 Impairment of non-financial assets**

Property, plant and equipment, intangibles and other noncurrent assets with definite useful lives, are yearly reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company does not record assets with indefinite useful life and assessed that there are no indications of impairment losses, mainly supported by Law 11,445/07, which ensures that basic sanitation public utilities will have assured its economic and financial sustainability through tariffs or via indemnity.

### **3.10 Trade accounts payable and contractors**

Accounts payable to contractors and suppliers are obligations to pay for goods or services purchased from suppliers in the ordinary course of business and are classified as current liabilities if the payment is due in the period up to one year. Otherwise, the accounts payable are presented as noncurrent liabilities and are initially measured at fair value, which generally correspond to the bill and subsequently at amortized cost.

### **3.11 Borrowings and financing**

Borrowings and financing are initially recognized at fair value, upon receipt of funds, net of transaction costs. Subsequently, borrowings and financing are stated at amortized cost, as presented in Note 17. Borrowings and financing are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.

Nonconvertible bonds issued by the Company are recognized in a similar manner to borrowings.

### **3.12 Borrowing costs**

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Borrowings and financing are initially recognized at fair value, upon receipt of funds, net of transaction costs. Subsequently, borrowings and financing are stated at amortized cost, as presented in Note 17. Borrowings and financing are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.

Nonconvertible bonds issued by the Company are recognized in a similar manner to borrowings.

#### **3.12 Borrowing costs**

Borrowing costs attributable to acquisition, construction or production of an asset, which, necessarily, requires a substantial time period to be ready for use or sale are capitalized as part of the cost of these assets. Other borrowing costs are recognized as expenses in the period they are incurred. Borrowing costs are interest rates and other charges incurred by the Company related to borrowings, including exchange variation, as described below.

The capitalization occurs during the period in which the asset has been built, considering the weighted average rate of borrowings effective on the capitalization date.

For foreign currency-denominated borrowings or financing, the Company analyzes them as if they were contracted in local currency, restricting the capitalization of interest and/or exchange variation by the amount that would be capitalized if these were contracted in the domestic market in similar lines of credit and loans.

#### **3.13 Payroll, related charges and contributions**

Salaries, vacations and the 13<sup>th</sup> salary and additional payments negotiated in collective labor agreements plus related charges and contributions are recorded on the accrual basis.

### **3.14 Profit sharing**

The profit sharing plan for its employees is based on operational and financial targets of the Company as a whole. The Company recognizes a provision when it is contractually required or when there is a practice in the past that created a constructive obligation. The accrual for profit sharing is recorded on the accrual basis period as operating cost, selling and administrative expenses.

### **3.15 Provisions, legal liabilities, escrow deposits and contingent assets**

Provisions related to claims are recognized when: i) the Company has a present (legal or constructive) obligation as a result of past event; ii) it is probable that an outflow of resources that comprise economic benefits will be required to settle the obligation; and iii) the amount can be reliably estimated. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

Provisions are measured at the present value of the disbursements expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

For financial statement presentation purposes, the provision is stated net of the related escrow deposits based on the legal right to offset. The bases and the nature of the provisions for civil, tax, labor and environmental risks are described in Note 20.





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Escrow deposits not linked to related liabilities are recorded in noncurrent assets. Escrow deposits are adjusted for inflation.

Contingent assets are not recognized in the statements of financial position.

**3.16 Environmental costs**

Costs related to ongoing environmental programs are expensed in the income statement, when there is any indication of an event. Ongoing programs are designed to minimize the environmental impact of the operations and to manage the environmental risks inherent to the Company's activities.

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#### **3.17 Income taxes – current and deferred**

Income taxes expenses comprise current and deferred income tax and social contributions.

##### Current tax

The provision for income tax and social contribution is based on the taxable income for the year. The income tax was accrued at rate 15%, plus 10% surtax on taxable income exceeding R\$ 240. The social contribution was accrued at rate 9% over adjusted net income. Taxable income differs from net income (profit presented in the income statement), because it excludes income and expenses taxable or deductible in other years, and excludes items not permanently taxable or not deductible. Income tax and social contribution are accrued based on legislation in place in the end of the year. Management periodically evaluates and measures the positions taken in the income tax return with respect to situations in which applicable tax regulations are subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

##### Deferred tax

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax basis of assets and liabilities and their carrying amounts in the financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction that at the time of the transaction affects neither accounting nor taxable profit nor loss, except for business combinations. Deferred income tax is determined using tax rates (and laws) effective at the end of the reporting period and expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax and social contribution assets are recognized only to the extent that it is probable that future taxable profit will be available for which temporary differences can be utilized and tax losses can be carryforward.

Deferred taxes assets and liabilities are offset when there is a legally enforceable right of offsetting current tax assets against current tax liabilities and when deferred income tax assets and liabilities are related to income taxes levied by same tax authority over the tax entity.

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## **Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

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#### **3.18 Taxes on revenues**

Revenues from sanitation services are recognized on accrual basis for PASEP and Cofins, calculated at the rates of 1.65% and 7.60%, respectively.

In addition, revenues from sanitation services are also subject to the Regulatory, Control and Inspection Fee (TRCF - Taxa de Regulação, Controle e Fiscalização), whose taxable event is the performance of regulation, control and monitoring activities by ARSESP, calculated at 0.50% of the annual revenue directly generated by the service provided less taxes levied on the service.

The taxes related to PASEP and Cofins incident on amounts invoiced to public entities are due when invoices are received.

These taxes are calculated by the non-cumulativeness regime and presented net, as deductions from gross revenues. Tax debts calculated over “other operating income” are presented as deductions from the respective operating income.

#### **3.19 Pension obligations**

##### **(a) Defined benefit**

The Company makes contributions to defined benefit plans on a contractual basis and sponsored thereby, managed by Fundação Sabesp de Seguridade Social (“Sabesprev”), a supplementary private pension closely-held entity. The regular contributions comprise the net administrative expenses and are recognized in the income statement for the period.

Liabilities from defined benefit pension plan obligations correspond to the present value of the defined benefit obligation at the end of the reporting period, less the fair value of the plan’s assets. The defined benefit obligation (G1) and (G0) are calculated on an annual basis by independent actuaries, using the projected unit credit method. The estimated future cash outflows is discounted to its present value, using the interest rates of Government bonds with maturities that approximate the maturity of the related liability.

Referring to actuarial gains and losses deriving from adjustments based on the experience and changes in actuarial assumptions are directly recorded under equity, as other comprehensive income (OCI), so that the plan's net assets or liabilities are recognized in the statement of financial position in order to reflect the full amount of plan’s deficit or surplus.

The expenses related to pension plan are recognized in profit and loss of the year as operating cost, selling expenses or administrative expenses, according to employee’s allocation.

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In an event where a curtailment relates to only some of the employees covered by a plan, or where only part of an obligation is settled, the gain or loss includes a proportionate share of the past service cost and actuarial gains and losses. The proportionate share is determined on the basis of the present value of the obligations before and after the curtailment or settlement.

**(b) Defined contribution**

The Company makes contributions to defined contribution plans (Sabesprev Mais) on a contractual basis and sponsored thereby, managed by Sabesprev, a supplementary private pension closely-held entity that provides post-employment benefits to its employees.

A defined contribution plan is a pension plan according to which the Company makes fixed contributions to a separate entity. The Company has no obligation of making contributions if the fund has no sufficient funds to pay to all employees the benefits related to employee's services in current and previous period.

**3.20 Financial revenues and expenses**

Financial revenue is primarily comprised of interest, inflation adjustments and exchange rate changes resulting from financial investments, escrow deposits and negotiations with customer to pay by installments, using the effective interest rate method.

Financial expenses are primarily comprised of interest, inflation adjustments and exchange rate changes on borrowings and financing, provisions, public-private partnership and program contract commitments. These financial income and expenses are calculated using the effective interest rate method.

Inflation adjustments and exchange gains and losses derive from the collection or payment to third parties, as contractually required by law or court decision, and recognized on an accrual basis pro rata temporis. Inflation adjustments included in the agreements are not considered embedded derivatives, since they are deemed as inflation adjustment rates for the Company's economic scenario.

### **3.21 Leases**

Lease agreements are classified as finance lease when property, risks and rewards inherent to the ownership of asset to the lessee are transferred. Other leases are classified as operational lease, recognized as expenses in the income statement on a straight-line basis during the lease term.

Finance lease agreements are measured based on the lower amount between the present value of minimum mandatory payments of the agreement or the fair value of asset on the start date the lease agreement. The amounts payable deriving from considerations of finance lease agreements are impacted by financial expenses and amortization of finance lease payables so that to obtain a constant interest rate. The corresponding lessor's liability is recorded as current and noncurrent debt.



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**3.22 Other current and noncurrent assets and liabilities**

Other assets are stated at cost of acquisition, net of any impairment loss, where applicable. The amounts recognized as other liabilities are stated at known or estimated amounts, including, where applicable, related charges and inflation adjustments.

**3.23 Dividends and interest on capital**

The Company uses the tax benefits of distributing dividends as interest on capital, as permitted by Brazilian Law. This distribution of dividend is accounted for in accordance with Brazilian Law 9,249/95 for tax deductibility purposes, limited to the daily pro rata fluctuation of the Long-term Interest Rate (TJLP). The benefit attributed to the shareholders is recognized in the current liability against Equity, based on its by-laws. Dividends and interest on capital over the minimum established in the by-laws are recognized when approved by the shareholders in the shareholders' meeting, except for taxes incurring in the distribution of interest on capital. The tax benefit of the interest on capital are accrued in the income statement of the year, under the same recognition basis of expenses with interest on capital.

**3.24 Present value adjustment**

Current and noncurrent financial assets and liabilities are adjusted to present value based on discount rate at current market rate as of the transaction date, when the effects are relevant.

### **3.25 Segment information**

Operating segments are determined in a manner consistent with the internal reporting to the Company's chief operating decision maker ("CODM"), which, in the case of SABESP, is the Board of Executive Officers, to make strategic decisions, allocate resources and evaluate performance.

Consequently, the Company determined that it has one operating segment (sanitation services).

The accounting policies used to determine segment information are the same as those used to prepare the Company's financial statements.

The measure of the segment's profit or loss is operating income before other operating expenses, net and equity accounting, which excludes construction revenue and related costs.

The CODM analyzes asset and liability information on a consolidated basis. Consequently, the Company does not disclose segment information on assets and liabilities.

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Substantially all of the Company's noncurrent assets and revenue generated from customers are located in São Paulo State. Consequently, financial information is not disclosed by geographic area.

**3.26 Translation into foreign currency**

**(a) Functional and reporting currency**

Items included in the financial statements are measured using the currency of the primary economic environment in which the company operates ("the functional currency"). The financial statements are presented in Brazilian reais (R\$), which is also the Company's functional currency. All financial information has been stated in reais and rounded to the next thousand, except where otherwise indicated.

**(b) Foreign currency translation**

Foreign currency-denominated transactions are translated into Brazilian reais using the exchange rates prevailing at the transaction dates. Statement of financial position accounts are translated by the exchange rate prevailing at reporting date.

Exchange gains and losses resulting from the settlement of these transactions and the translation of foreign currency-denominated cash assets and liabilities are recognized in the income statement, except for borrowings and financing referring to property, plant and equipment or intangible assets in progress, where exchange losses are recognized as corresponding entry to the asset while construction is in progress, as described in Note 3.12.

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**4 Changes in accounting practices and disclosures**

**4.1 New standards, amendments and interpretations effective for periods beginning on or after January 1, 2018**

**New standards and revisions**

| <b>Standard</b>                                 | <b>Description</b>   | <b>Impact</b>   |
|---|--|---|
| IFRS 9 - Financial Instruments                  | Changes in the classification and measurement requirements, mainly for impairment and hedge accounting.  | Except for the impact of the disclosure of allowance for doubtful accounts in the income statements, which is demonstrated as a separate item, the application of this standard did not impact materially the disclosures or amounts recognized in the annual financial statements. |
| IFRS 15 - Revenue from Contracts with Customers | Establishes a single comprehensive framework to determine if and when a revenue is recognized and how revenue is measured.<br><br>IFRS 15 supersedes the current revenue recognition guidance including IAS 18 Revenue, IAS 11 | (*). See impact analysis below.   |

Construction Contracts and IFRIC 13  
 Interpretation A – Customer Loyalty  
 Programmes.

|  |   |  |
|--|---|--|
| <p>Amendments to IFRS 2 – Classification and measurement of share-based payment transactions</p> | <p>Describe about modifications of settled options of shares.</p>   | <p>The application of this amendment did not impact the disclosures or amounts recognized in the annual financial statements.</p>      |
| <p>Amendments to IAS 40 – Transfers of investment properties</p>                                 | <p>The amendments clarify that a transfer to or from investment properties require an assessment of whether a property match, or no longer match, the definition of investment properties, supported by observable evidence of a change in use, and that a change in use is possible for properties under construction.</p>               | <p>The application of this amendment did not impact the disclosures or amounts recognized in the annual financial statements.</p>      |
| <p>Annual improvements to IFRSs: 2014-2016 cycle</p>   | <p>The amendments clarify that the option made by a venture capital organization and other similar entities</p>   | <p>The application of this amendment did not impact the disclosures or amounts recognized in the annual financial statements.</p>      |
| <p>Amendments to IAS 28 Investments in Associates and Joint Ventures</p>                         | <p>to measure investments in associates and joint ventures at fair value through profit or loss is separately available for each associate or joint venture, and this choice should be made in the inception.</p>   | <p>The application of this amendment did not impact the disclosures or amounts recognized in the annual financial statements.</p>      |
| <p>IFRIC 22 – Foreign Currency Transactions and Advance Consideration</p>                        | <p>Describes how the transaction date should be defined in order to determine the exchange rate applicable to the initial recognition of an asset, expense or income when the consideration of that item has been paid or received in advance in foreign currency, resulting in the recording of non-monetary assets and liabilities.</p> | <p>The application of this interpretation did not impact the disclosures or amounts recognized in the annual financial statements.</p> |



**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Notes to the Financial Statements****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of reais, unless otherwise indicated****(\* IFRS 15 – Revenue from Contracts with Customers**

As established by IFRS 15 - Revenue from Contracts with Customers, assets related to the concession under construction, recorded under the scope of IFRIC 12 - Service Concession Arrangements, should be classified as Contract Asset during the construction period and transferred to Intangible Assets only after completion of the works.

With the adoption of this new accounting standard, SABESP started to record the Contract Asset in the balance sheet. This amount was previously recognized as part of Intangible Assets and was, therefore, reclassified, with no impact in the income statement. Due to the transition methods adopted by the Company in the application of this standard, the comparative information of the financial statements was not restated and the impact of the adoption on January 1, 2018 is as follows:

| <b>Assets</b>                            | <b>Note</b> | <b>January 1, 2018</b> | <b>Impact of IFRS 15</b> | <b>January 1, 2018</b> |
|--|-------------|------------------------|--------------------------|------------------------|
| <b>Current assets</b>                    |             |                        |                          |                        |
| Cash and cash equivalents                | 7           | 2,283,047              | -                        | 2,283,047              |
| Trade receivables                        | 9 (a)       | 1,672,595              | -                        | 1,672,595              |
| Accounts receivable from related parties | 10 (a)      | 180,773                | -                        | 180,773                |
| Inventories                              |             | 85,671                 | -                        | 85,671                 |
| Restricted cash                          | 8           | 18,822                 | -                        | 18,822                 |
| Recoverable taxes                        | 18 (a)      | 276,585                | -                        | 276,585                |
| Other receivables                        |             | 56,592                 | -                        | 56,592                 |
| <b>Total current assets</b>              |             | <b>4,574,085</b>       | <b>-</b>                 | <b>4,574,085</b>       |
| <b>Noncurrent assets</b>                 |             |                        |                          |                        |
| Trade receivables                        | 9 (a)       | 215,910                | -                        | 215,910                |
| Accounts receivable from related parties | 10 (a)      | 634,387                | -                        | 634,387                |
| Escrow deposits                          |             | 122,686                | -                        | 122,686                |



|                               |    |            |              |            |
|-------------------------------|----|------------|--------------|------------|
| Water National Agency – ANA   | 11 | 70,487     | -            | 70,487     |
| Other receivables             |    | 113,123    | -            | 113,123    |
| Investments                   | 12 | 36,932     | -            | 36,932     |
| Investment properties         | 13 | 57,652     | -            | 57,652     |
| Contract asset                | 14 | -          | 10,387,715   | 10,387,715 |
| Intangible assets             | 15 | 33,466,132 | (10,387,715) | 23,078,417 |
| Property, plant and equipment | 16 | 255,050    | -            | 255,050    |
| Total noncurrent assets       |    | 34,972,359 | -            | 34,972,359 |
| Total assets                  |    | 39,546,444 | -            | 39,546,444 |

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Notes to the Financial Statements****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of reais, unless otherwise indicated****4.2 New standards, amendments and interpretations to existing standards that are not yet effective**

The Company did not early adopt these standards and is assessing the impacts of the new and revised IFRS below on the disclosures or amounts recognized in the financial statements:

| <b>Standard</b>  | <b>Description</b>   | <b>Impact</b>  |
|--|--|--|
| IFRS 16 – Leases   | Establishes a single model for the accounting of leases in the balance sheet for lessees. A lessee recognizes a right of use asset that represents his right to use the leased asset and a lease liability that represents his obligation to make lease payments. The lessor's accounting remains similar to the current standard, that is, the lessors continue to classify the leases as financial or operating.<br><br>IFRS 16 will supersede the current leases guidance including IAS 17 Leases and IFRIC 4, SIC 15 and SIC 27 Determining Whether an Arrangement Contains a Lease. | (**) See impact analysis below.  |
| IFRIC 23 – Uncertainty over Income Tax Treatments <sup>1</sup> | Clarify accounting when there are uncertainties about the treatment of taxes on profit.  | The Company is assessing the impacts and effects of the amendments, however it does not expect material effects from adopting this standard. |

<sup>1</sup> Effective for annual periods beginning on or after January 1, 2019.

**(\*) IFRS 16 – Leases**

The new standard supersedes IAS 17 - "Leases" and corresponding interpretations, introducing significant changes to lessees, as it requires lessees to recognize the liability of future payments and the right of use of leased assets to virtually all leases agreements, including operating leases, specific short-term contracts or contracts with small amounts may be excluded from the scope of this new standard.

The Company's financial statements will be impacted as follows:

a) recognition of right-of-use assets and lease liabilities in the statement of financial position, initially measured at the present value of future lease payments;

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b) recognition of amortization expenses of right-of-use assets and interest expenses on lease liabilities in the income statement; and

c) segregation of the total cash paid in these transactions between principal (recorded in financing activities) and interest (recorded in operating activities) in the statement of cash flows.

SABESP will apply the requirements of IFRS 16 as of the fiscal year beginning on January 1, 2019. To this end, the transition method selected by the Company was the modified retrospective approach, whereby the amount referring to the Right-of-Use Asset (“Lease Asset”) equals to the Lease Liability, without the cumulative effect of the initial application of this new standard recorded as an adjustment to the opening balance of the equity and without the restatement of comparative periods.

The new lease definitions were applied to all contracts in effect on the transition date. The change in the definition of a lease refers mainly to the concept of control. IFRS 16 establishes whether a contract contains a lease based on the fact that customer has the right to control the use of an identified asset for a defined period of time in exchange of consideration.

The Company's Management analyzed the contracts (out of a total of approximately 20,000 contracts), evaluating whether they contained leases in accordance with IFRS 16. This analysis identified impacts mainly related to vehicles and properties leased from third parties, corresponding to approximately 95% of the total amount, and less representative amounts arising from other transactions in which we identified assets leased individually or in combination in service contracts.

The recognition of lease expenses of short-term leases (12 months or less) and leases of low-value assets (below US \$ 5,000.00) will remain on a linear basis as permitted by IFRS 16.

On January 1, 2019, the measurement of lease liabilities corresponds to the total of fixed lease payments, adjusted to present value, considering an incremental rate on borrowings, which corresponds to the average rate applicable to borrowings or debt issues in the local capital market, which represent the financing of these assets classified as right of use, allocating the assets based on useful life at the average rate per maturity term of each borrowing contract.

The Company decided to use the practical expedient of using a single real discount rate based on the respective terms for contracts with similar characteristics.

Regarding renewals, the Company considered the assumptions, policies and internal regulations, whose term cannot be automatically renewed, and for which extensions will only occur based on an agreement between the parties in cases proven to be advantageous and necessary to attain SABESP's interests, i.e., when it is reasonable sure that the option will be exercised.

## **Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

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After carrying out analysis, the Company concluded that only 70 agreements will fall under the scope of IFRS 16, and, on January 1, 2019, the Company's Management will recognize a right-of-use asset and a lease liability at the present value of R\$ 64,955.

As of December 31, 2018, the analyses and internal controls associated with the measurement and accounting of the lease agreements were substantially concluded and under customization, with conclusion pending the definition of certain assumptions. Therefore, considering the existence of significant judgment components in the new accounting pronouncement, the Company believe that there may be changes in the reported amounts, but in amounts deemed not significant with the context of the financial statements.

The Company intends to apply the practical expedient related to the definition of leases during transition. This means that it will apply IFRS 16 to all agreements signed before January 1, 2019 identified as lease, in accordance with IAS 17 and IFRIC 4.

There are no other standards and interpretations not yet adopted that may, in the opinion of Management, have a significant impact on the result for the year of equity disclosed by the Company in its financial statements.

## **5 Risk Management**

### **5.1 Financial Risk Management**

#### **Financial risk factors**

The Company's activities are affected by Brazilian economic scenario, making it exposed to market risk (exchange rate and interest rate), credit risk and liquidity risk. The Company's financial risk management is focused on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance.

The Company has not utilized derivative instruments in any of the reported periods.

**(a) Market risk**

**Foreign currency risk**

SABESP's foreign exchange exposure implies market risks associated with currency fluctuations, since the Company has foreign currency-denominated liabilities, mainly US dollar and yen-denominated short and long-term borrowings.

The management of SABESP's foreign currency exposure considers several current and projected economic factors, besides market conditions.

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This risk arises from the possibility that the Company may incur in losses due to exchange rate fluctuations that would impact liability balances of foreign currency-denominated borrowings and financing raised in the market and related financial expenses. The Company does not maintain hedge or swap contracts or any derivative financial instrument to hedge against this risk.

A significant amount of the Company's financial debt is indexed to the US dollar and Yen, in the total amount of R\$ 6,694,912 as of December 31, 2018 (R\$5,702,375 as of December 31, 2017). Below, the Company's exposure to exchange risk:

|   | <b>December 31, 2018</b>    |            | <b>December 31, 2017</b>    |            |
|---|-----------------------------|------------|-----------------------------|------------|
|   | <b>Foreign<br/>currency</b> | <b>R\$</b> | <b>Foreign<br/>currency</b> | <b>R\$</b> |
| Borrowings and financing – US\$                           | 1,191,152                   | 4,615,476  | 1,200,786                   | 3,972,200  |
| Borrowings and financing – Yen                            | 57,463,173                  | 2,026,726  | 57,575,271                  | 1,692,713  |
| Interest and charges from borrowings and financing – US\$ |                             | 40,193     |                             | 26,628     |
| Interest and charges from borrowings and financing – Yen  |                             | 12,517     |                             | 10,834     |
| Total exposure  |                             | 6,694,912  |                             | 5,702,375  |
| Borrowing cost – US\$                                     |                             | (22,390)   |                             | (26,454)   |
| Borrowing cost – Yen                                      |                             | (3,113)    |                             | (3,100)    |
| Total foreign-currency denominated borrowings (Note 17)   |                             | 6,669,409  |                             | 5,672,821  |



The 17.6% increase in foreign currency-denominated debt from December 31, 2017 to December 31, 2018 was mainly due to:

Exchange rates, as a result of:

- 1) 17.6% increase of the US dollar against the real, from R\$3.3080 as of December 31, 2017 to R\$3.8748 as of December 31, 2018; and
- 2) 20.0% increase of the Yen-denominated, from R\$0.02940 as of December 31, 2017 to R\$0.03527 as of December 31, 2018.

As of December 31, 2018, if the Brazilian real had depreciated or appreciated by 10 percentage points, in addition to the impacts mentioned above, against the US dollar and Yen with all other variables held constant, effects on results before taxes on the year would have been R\$669,491 (R\$570,238 as of December 31, 2017), lower or higher, mainly as a result of exchange losses or gains on the translation of foreign currency-denominated loans.

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**Interest rate risk**

This risk arises from the possibility that the Company could incur losses due to fluctuations in interest rates, increasing the financial expenses related to borrowings and financing.

The Company has not entered into any derivative contract to hedge against this risk; however continually monitors market interest rates, in order to evaluate the possible need to replace its debt.

The table below provides the Company's borrowings and financing subject to variable interest rate:

|                       | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|-----------------------|--------------------------|--------------------------|
| CDI <sup>(i)</sup>    | 1,250,000                | 1,144,391                |
| TR <sup>(ii)</sup>    | 1,637,290                | 1,574,564                |
| IPCA <sup>(iii)</sup> | 1,614,595                | 1,699,747                |
| TJLP <sup>(iv)</sup>  | 1,322,854                | 1,354,987                |
| LIBOR <sup>(v)</sup>  | 3,259,295                | 2,814,399                |
| Interest and charges  | 134,725                  | 125,172                  |
| Total                 | 9,218,759                | 8,713,260                |

(i) CDI – (Certificado de Depósito Interbancário), an interbank deposit certificate

(ii) TR – Interest Benchmark Rate

(iii) IPCA – (Índice Nacional de Preços ao Consumidor Amplo), a consumer price index

(iv) TJLP – (Taxa de Juros a Longo Prazo), a long-term interest rate index

(v) LIBOR – London Interbank Offered Rate

Another risk to which the Company is exposed, is the mismatch of monetary restatement indices of its debts with those of its service revenues. Tariff adjustments of services provided by the Company do not necessarily follow the increases in the inflation indexes to adjust loans, financing and interest rates affecting indebtedness

As of December 31, 2018, if interest rates on borrowings and financing had been 1 percentage point higher or lower with all other variables held constant, the effects on profit before taxes would have been R\$ 92,188 (R\$ 87,133 as of December 31, 2017) lower or higher, mainly as a result of lower or higher interest expense on floating rate borrowings and financing.

**(b) Credit risk**

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Credit risk arises from cash and cash equivalents, deposits in banks and financial institutions, as well as credit exposures to wholesale basis and retail customers, including outstanding accounts receivable, restricted cash and accounts receivable from related parties. Credit risk exposure to customers is mitigated by sales to a dispersed base.

The maximum exposures to credit risk as of December 31, 2018 are the carrying amounts of instruments classified as cash equivalents, deposits in banks and financial institutions, restricted cash, trade receivables and accounts receivable from related parties in the balance sheet date. See additional information in Notes 7, 8, 9 and 10.

Regarding the financial assets held with financial institutions, the credit quality that is not past due or subject to impairment can be assessed by reference to external credit ratings (if available) or to historical information about the bank's default rates. The credit quality of the banks, such as deposits and financial investments, the Company considers the lower rating published by three main international rating agencies (Fitch, Moody's and S&P), according to internal policy of market risk management:

|  | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|--|--------------------------|--------------------------|
| Cash at banks and short-term bank deposits |                          |                          |
| AA+(bra)                                   | 2,966,080                | 2,222,001                |
| AAA(bra)                                   | 45,430                   | 43,978                   |
| Other (*)                                  | 17,681                   | 17,068                   |
|  | 3,029,191                | 2,283,047                |

(\*) This category includes current accounts and investment funds in banks whose balances were not significant, and after assessing the impact of IFRS 9, concluded that expected losses are not material.

The available credit rating information of the banks, as at December 31, 2018, in which the Company made deposit transactions and financial investments in local currency (R\$ - domestic rating) during the year is as follows:

| <b>Banks</b>                   | <b>Fitch</b> | <b>Moody's</b> | <b>Standard Poor's</b> |
|--------------------------------|--------------|----------------|------------------------|
| Banco do Brasil S/A            | AA(bra)      | Aa1.br         | -                      |
| Banco Santander Brasil S/A     | -            | Aaa.br         | brAAA                  |
| Brazilian Federal Savings Bank | AA(bra)      | Aa1.br         | brAAA                  |
| Banco Bradesco S/A             | AAA(bra)     | Aa1.br         | brAAA                  |
| Itaú Unibanco Holding S/A      | AAA(bra)     | Aa1.br         | brAAA                  |

**(c) Liquidity risk**

The Company's liquidity is primarily reliant upon cash provided by operating activities, loans from Brazilian

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federal and state governmental financial institutions, and financing in the domestic and international capital markets. The liquidity risk management considers the assessment of its liquidity requirements to ensure it has sufficient cash to meet its operating and capital expenditures needs, as well as the payment of debts.

The funds held by the Company are invested in interest-bearing current accounts, time deposits and securities, selecting instruments with appropriate maturity or liquidity sufficient to provide margin as determined by projections mentioned above.

The table below shows the financial liabilities of the Company, by relevant maturities, including the installments of principal and future interest to be paid according to the agreement. Future interest was calculated based on the contractual clauses for all agreements. For agreements with floating interest rate, the interest rates used correspond to the base dates above.

| <b>As of December 31, 2018</b>                 | <b>2019</b> | <b>2020</b> | <b>2021</b> | <b>2022</b> | <b>2023</b> | <b>2024<br/>onwards</b> | <b>Total</b> |
|--|-------------|-------------|-------------|-------------|-------------|-------------------------|--------------|
| <b>Liabilities</b>                             |             |             |             |             |             |                         |              |
| Borrowings and financing                       | 2,581,359   | 3,073,006   | 1,427,558   | 1,468,221   | 1,189,927   | 6,364,235               | 16,104,306   |
| Accounts payables to suppliers and contractors | 465,993     | -           | -           | -           | -           | -                       | 465,993      |
| Services payable                               | 454,022     | -           | -           | -           | -           | -                       | 454,022      |
| Public-Private Partnership – PPP               | 405,263     | 377,196     | 377,196     | 377,196     | 377,196     | 4,889,573               | 6,803,620    |
| Program contract commitments                   | 244,446     | 45,608      | 45,741      | 30,991      | 30,991      | 14,417                  | 412,194      |

**Cross default**

The Company has borrowings and financing agreements including cross default clauses, e.g., the early maturity of any debt, may imply the early maturity of these agreements. The indicators are continuously monitored in order to avoid

the execution of these clauses.

## **5.2 Capital management**

The Company's objectives when managing capital are ensure its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders, and to maintain an optimal capital structure to reduce the cost of capital.

The Company monitors capital based on the leverage ratio. This ratio corresponds to net debt divided by total capital. Net debt corresponds to total borrowings and financing less cash and cash equivalents. Total capital is calculated as total equity as shown in the statement of the financial position plus net debt.

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|  | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|--|--------------------------|--------------------------|
| Total borrowings and financing (Note 17) | 13,152,796               | 12,100,966               |
| (-) Cash and cash equivalents (Note 7)   | (3,029,191)              | (2,283,047)              |
| Net debt                                 | 10,123,605               | 9,817,919                |
| Total equity                             | 19,551,688               | 17,513,009               |
| Total capital                            | 29,675,293               | 27,330,928               |
| Leverage ratio                           | 34%                      | 36%                      |

As of December 31, 2018, the leverage ratio decreased to 34% from the 36% as of December 31, 2017, mainly due to the increase in equity generated by the 2018 earnings retention, mitigated by the increase of the net debt mainly as a result of the appreciation of the dollar (17.1%) and the yen (20.0%) against the real.

**5.3 Fair value estimates**

The Company considers that balances from trade receivables (current) and accounts payable to suppliers by carrying amount, less impairment approximate their fair values, considering the short maturity. Long-term trade receivables also approximate their fair values, as they will be adjusted by inflation and/or will bear contractual interest rates over time.



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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Notes to the Financial Statements****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of reais, unless otherwise indicated****5.4 Financial instruments**

With the changes introduced by IFRS 9 (Financial Instruments), as of December 31, 2018, the Company did not have financial assets classified as fair value through other comprehensive income and fair value through profit or loss. The Company's financial instruments included in the amortized cost category comprise cash and cash equivalents, restricted cash, trade receivables, balances with related parties, other receivables, and balances receivable from the Water National Agency – ANA, accounts payable to contractors and suppliers, borrowings and financing, services payable, balances payable deriving from the Public Private Partnership-PPP and program contract commitments, which are non-derivative financial assets and liabilities with fixed or determinable payments, not quoted in an active market.

The estimated fair values of financial instruments are as follows:

## Financial assets

|                             | <b>December 31, 2018</b> |                   | <b>December 31, 2017</b> |                   |
|-----------------------------|--------------------------|-------------------|--------------------------|-------------------|
|                             | <b>Carrying amount</b>   | <b>Fair value</b> | <b>Carrying amount</b>   | <b>Fair value</b> |
| Cash and cash equivalents   | 3,029,191                | 3,029,191         | 2,283,047                | 2,283,047         |
| Restricted cash             | 31,900                   | 31,900            | 18,822                   | 18,822            |
| Trade receivables           | 2,052,416                | 2,052,416         | 1,888,505                | 1,888,505         |
| Water National Agency – ANA | 49,136                   | 49,136            | 70,487                   | 70,487            |
| Other receivables           | 180,681                  | 180,681           | 169,715                  | 169,715           |

Additionally, SABESP has financial instrument assets receivables from related parties, in the amount of R\$843,250 as of December 31, 2018 (R\$815,160 as of December 31, 2017), which were calculated in accordance with the conditions negotiated between related parties. The conditions and additional information referring to these financial instruments are disclosed in Note 10 to the financial statements. Part of this balance, in the amount of R\$737,503 (R\$709,208 as of December 31, 2017), refers to reimbursement of additional retirement and pension plan - G0 and is indexed by IPCA plus simple interest of 0.5% p.m. This interest rate approximates that one practiced by federal government bonds (NTN-b) with terms similar to those of related-party transactions.

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## Financial liabilities

|  | <b>December 31, 2018</b> |                   | <b>December 31, 2017</b> |                   |
|--|--------------------------|-------------------|--------------------------|-------------------|
|  | <b>Carrying amount</b>   | <b>Fair value</b> | <b>Carrying amount</b>   | <b>Fair value</b> |
| Borrowings and financing                       | 13,152,796               | 13,116,684        | 12,100,966               | 11,967,909        |
| Accounts payables to suppliers and contractors | 465,993                  | 465,993           | 344,947                  | 344,947           |
| Services payable                               | 454,022                  | 454,022           | 408,275                  | 408,275           |
| Program contract commitments                   | 373,009                  | 373,009           | 239,500                  | 239,500           |
| Public-Private Partnership - PPP               | 3,413,124                | 3,413,124         | 3,071,416                | 3,071,416         |

To obtain fair value of borrowings and financing, the following criteria have been adopted:

- (i) Agreements with Banco do Brasil and CEF (Brazilian Federal Savings Bank) were projected until their final maturities, at contractual rates (projected TR + spread) and discounted at present value by TR x DI, both rates were obtained from B3.
- (ii) Debentures were projected up to the final maturity date according to contractual rates (IPCA, DI, TJLP or TR), and discounted to present value considering the future interest rate published by ANBIMA in the secondary market, or by market equivalent rates, or the Company's share traded in the Brazilian market.
- (iii) BNDES loans are financial instruments valued at carrying amount plus contractual interest rate until the maturity date, and are indexed by long term interest rate – TJLP.

These financing have specific characteristics and the conditions defined in the financing agreements with BNDES between independent parties, and reflect the conditions for those types of loan. In Brazil, a consolidated market of long-term debts does not exist with the same characteristics of BNDES financing, the offering of credit to the entities in general, with this long-term characteristic, usually is restricted to BNDES.

- (iv) Other financing in local currency are considered by carrying amount plus contractual interest rate until maturity date, discounted to present value considering a future interest rate published by B3.
- (v) Agreements with BID and IBRD, were projected until final maturity in origin currency, applying interest rates contracted, discounted at present value at Libor futures rate, obtained from Bloomberg. Eurobonds was priced at market value through quotes published by Bloomberg. All the amounts obtained were translated into Brazilian reais at the exchange rate of December 31, 2018.

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## **Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

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- (vi) Agreements with JICA, were projected until final maturity in origin currency, using interest rates contracted and discounted at present value, at Tibor futures rate obtained from Bloomberg. The amounts obtained were translated into Brazilian reais at the exchange rate of December 31, 2018.
- (vii) Leases are financial instruments considered by face value restated until maturity date, whose characteristic is the indexation by fixed contractual rate. Thus, the Company discloses as market value, the amount recorded as of December 31, 2018.

Financial instruments referring to investments and borrowings and financing are classified as Level 2 in the fair value hierarchy.

Considering the nature of other financial instruments, assets and liabilities of the Company, the balances recognized in the statement of financial position approximate the fair values, taking into account the maturities close to the end of the reporting period, comparison of contractual interest rates with market rates in similar operations at the end of the reporting periods, their nature and maturity terms.

## **6 Key accounting estimates and judgments**

Estimates and judgments are continually evaluated and are based on historical experience and on other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates, by definition, may differ from actual results. The estimates and assumptions that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below:

### **(a) Allowance for doubtful accounts**

The Company establishes an allowance for doubtful accounts in an amount that Management considers sufficient to cover expected losses (see Note 9 (c) ), based on an analysis of trade receivables, in accordance with the accounting policy stated in Note 3.4.

The methodology for determining the allowance for doubtful accounts receivable requires significant estimates, considering a number of factors including historical receipt experience, current economic trends, estimates of forecast write-offs, the aging of the accounts receivable portfolio and expectation of future losses. While the Company believes that the assumptions used are reasonable, actual results could be different.

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**(b) Intangible assets arising from concession and program contracts**

The Company recognizes as intangible assets arising from concession agreements. The Company estimates the fair value of construction and other work on the infrastructure to recognize the cost of the intangible asset, upon completion of the construction and provided that it will generate future economic benefits. The great majority of the Company's contracts for service concession arrangements entered with each grantor is under service concession agreements in which the Company has the right to receive, at the end of the contract, a payment equivalent to the unamortized asset balance of the concession intangible asset, which in this case, are amortized over the useful life of the underlying physical assets, thus at the end of the contract, the remaining value of the intangible would be equal to the residual value of the related fixed asset.

Concession intangible assets under Concession agreements and Program contracts, in which, at the end of the contract, the Company has no right to receive a payment equivalent to the unamortized asset balance of the concession intangible, are amortized on a straight-line basis over the useful life of asset or contract period, which occurs first. Additional information on the accounting for intangible assets arising from concession agreements are described in Notes 3.8 and 15.

The recognition of fair value for the intangible assets arising on concession agreements is subject to assumptions and estimates, and the use of different assumptions could affect the balances recorded. Different assumptions and estimates and changes in the useful lives of the intangible assets may have relevant impacts on the results of operations.

**(c) Pension benefits**



The Company sponsors the defined benefit plan and the defined contribution plan, as described in Note 21.

The liability recognized in the balance sheet in relation to defined benefit pension plans is the present value of defined benefit obligation on the balance sheet date, less the fair value of plan assets. The benefit obligation is calculated yearly by independent actuaries, applying the projected credit unit method. The present value of defined benefit obligation is determined by discounting the estimated future cash outflows, using interest rates compatible with the market, which are denominated in currency in which benefits will be paid and with maturity terms close to those of corresponding pension plan obligation.

**(d) Deferred income tax and social contribution**

The Company recognizes and settles taxes on income based on the results of operations verified according to the Brazilian Corporation Law, taking into consideration the provisions of the tax laws. The Company recognizes deferred tax assets and liabilities based on the differences between the accounting balances and the tax bases of assets and liabilities.

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The Company regularly reviews the recoverability of deferred tax assets and recognizes a provision for impairment if it is probable that these assets will not be realized, based on the historic taxable income, in the projection of future taxable income and the estimated period of reversing temporary differences. These calculations require the use of estimates and assumptions. The use of different estimates and assumptions could result in provision for impairment of all or a significant amount of deferred tax assets. Additional information related to taxes are described in Note 19.

**(e) Provisions**

The Company is party to a number of legal proceedings involving significant claims. These legal proceedings include, but are not limited to, tax, labor, civil, environmental, disputes with customers and suppliers. The Company recognizes a provision for lawsuits when it has a present obligation (legal or constructive) arising from a past event, it is probable that an outflow of resources embodying economic benefits will be necessary to settle the liability and the amount of such obligation can be reliably estimated. Judgments regarding future events may differ significantly from actual estimates and could exceed the amounts provisioned. Provisions are revised and adjusted to take into consideration changes in circumstances involved. Additional information of these legal proceedings are disclosed in Note 20.

**7 Cash and cash equivalents**

|                  | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|------------------|--------------------------|--------------------------|
| Cash and banks   | 151,558                  | 171,951                  |
| Cash equivalents | 2,877,633                | 2,111,096                |
|                  | 3,029,191                | 2,283,047                |

Cash and cash equivalents include cash, bank deposits and high-liquidity short-term financial investments, mainly represented by repurchase agreements (accruing CDI interest rates), deposited at Banco do Brasil, whose original maturities are lower than three months, which are convertible into a cash amount and subject to an insignificant risk of

change in value.

The average yield of financial investments corresponds to 98.28% of CDI in December 2018 (98.88% in December 2017).

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

**Notes to the Financial Statements**

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**Amounts in thousands of reais, unless otherwise indicated**

**8 Restricted cash**

|   | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|---|--------------------------|--------------------------|
| Current   |                          |                          |
| Agreement with the São Paulo municipal government (i) | 19,977                   | 12,055                   |
| Brazilian Federal Savings Bank – escrow deposits (ii) | 5,880                    | 1,209                    |
| Other   | 6,043                    | 5,558                    |
|   | <b>31,900</b>            | <b>18,822</b>            |

(i) Refers to the amount deducted from the 7.5% of municipal revenue transferred to the Municipal Fund, corresponding to eventual amounts unpaid by direct management bodies, foundations and government agencies, as established in the agreement entered into with the municipal government of São Paulo; and

(ii) Refers to savings account for receiving escrow deposits regarding lawsuits with final and unappealable decisions in favor of the Company, which are blocked as per contractual clause.

**9 Trade receivables**

**(a) Financial position balances**

|   | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|---|--------------------------|--------------------------|
| Private sector:                                   |                          |                          |
| General and special customers (i) (ii)            | 1,372,667                | 1,248,979                |
| Agreements (iii)                                  | 347,679                  | 320,032                  |
|   | 1,720,346                | 1,569,011                |
| Government entities:                              |                          |                          |
| Municipal   | 575,733                  | 532,320                  |
| Federal   | 3,876                    | 3,547                    |
| Agreements (iii)                                  | 274,906                  | 285,614                  |
|   | 854,515                  | 821,481                  |
| Wholesale customers – Municipal governments: (iv) |                          |                          |
| Mogi das Cruzes                                   | 3,056                    | 2,670                    |
| São Caetano do Sul                                | 2,869                    | 2,604                    |
| Total wholesale customers – Municipal governments | 5,925                    | 5,274                    |
| Unbilled supply                                   | 571,072                  | 560,712                  |
| Subtotal  | 3,151,858                | 2,956,478                |
| Allowance for doubtful accounts                   | (1,099,442)              | (1,067,973)              |
| Total   | 2,052,416                | 1,888,505                |
| Current   | 1,843,333                | 1,672,595                |
| Noncurrent  | 209,083                  | 215,910                  |
|   | 2,052,416                | 1,888,505                |

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

**Notes to the Financial Statements**

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(i) General customers - residential and small and mid-sized companies

(ii) Special customers - large consumers, commercial, industries, condominiums and special billing consumers (fixed demand agreements, industrial waste, wells, etc.).

(iii) Agreements - installment payments of past-due receivables, plus monetary adjustment and interest, according to the agreements.

Wholesale customers – Municipal governments: (iv)

|   |           |           |
|---|-----------|-----------|
| Guarulhos (*)                                     | -         | 760,598   |
| Mauá  | 601,910   | 530,830   |
| Mogi das Cruzes                                   | 3,056     | 2,670     |
| Santo André                                       | 1,164,399 | 1,048,832 |
| São Caetano do Sul                                | 2,869     | 2,604     |
| Diadema   | 222,671   | 222,671   |
| Total wholesale customers – Municipal governments | 1,994,905 | 2,568,205 |

(iv) Wholesale basis customers - municipal governments - This balance refers to invoices issued as a result of services provided to municipalities, which are responsible for distributing to, billing and charging final customers. Some of these municipalities are questioning in court the tariffs charged by SABESP. The Company has not recognized revenue nor receivables from these municipalities according to the IFRS 15/IFRS 9, since it does not consider that it will be probable that it will collect the consideration to which it is entitled in exchange for the services transferred to the municipalities.

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

**Notes to the Financial Statements**

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(\*) Agreement with the municipality of Guarulhos

On December 12, 2018, an Agreement for debt payment and receipt was entered into by the municipality of Guarulhos (“Guarulhos”), the Guarulhos Autonomous Water and Sewage Service (SAAE) and SABESP, in order to settle SAAE’s existing debt through the transfer of sanitation services to SABESP for a period of 40 years.

On December 12, 2018, the São Paulo State, the city of Guarulhos and SABESP, with intervention of SAAE, signed a Public Utility Service Agreement to Provide Water Supply and Sewage Services in the municipality of Guarulhos, through which the São Paulo State and the municipality of Guarulhos granted SABESP the right to provide services for a period of 40 years.

Due to the signature of the service agreement, the amount due by SAAE, recorded as revenue loss, totaling R\$ 928,014, was recognized as revenue, reducing losses in receivables. As a result, the balance of receivables was used to pay for the transfer of sanitation services for a 40-year period, incorporated into intangible assets.

Due to the service transfer, the Company paid R\$ 50,000 to settle administrative costs and terminate the services provided by SAAE. It also allocated R\$ 150,000 to be transferred in five annual statements, adjusted by the IPCA index published by the Brazilian Institute of Geography and Statistics (IBGE); the first installment was paid in 2018 and the others will be paid from January 2020 to January 2023. The amounts must be allocated to sanitation initiatives. The total amount of R\$ 200,000 was adjusted to present value and registered in intangible assets by crediting current and noncurrent liabilities, in the amounts of R\$ 80,000 and R\$ 98,301, respectively.





**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

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From the sixth year after the signature of the agreement, four percent (4%) of gross revenue received by SABESP from the municipality of Guarulhos, less Cofins/Pasep, ARSESP's Regulation, Control and Oversight Fee (TRCF) and other taxes/fees levied on revenue will be invested in environmental sanitation, housing, drainage and other urban infrastructure projects of the municipality of Guarulhos.

Credits in court, in the form of Court-Order Debt Security, will be held as collateral of compliance with the Settlement Agreement. The payment of said Court-Order Debt Security held in court will be suspended for the period in which the Agreement remains in effect.

The collateral amount will be progressively reduced according to the following rules:

- The collateral amount will not be reduced until the fifth (5<sup>th</sup>) anniversary of the Agreement signature date;
- From the fifth (5<sup>th</sup>) to the fifteenth (15<sup>th</sup>) anniversary of the Agreement signature date, Credits 1 and 2 will be reduced by an amount equivalent to 1/120 per complete month;
- From the fifteenth (15<sup>th</sup>) to the twenty-third (23<sup>rd</sup>) anniversary of the Agreement signature date, Credits 3 and 4 will be reduced by an amount equivalent to 1/96 per complete month;
- From the twenty-third (23<sup>rd</sup>) to the fortieth (40<sup>th</sup>) anniversary of the Agreement signature date, Credit 5 will be reduced by an amount equivalent to 1/204 per complete month.

**(b) The aging of trade receivables is as follows**

|           | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|-----------|--------------------------|--------------------------|
| Current   | 1,449,927                | 1,434,097                |
| Past-due: |                          |                          |

|                      |           |           |
|----------------------|-----------|-----------|
| Up to 30 days        | 330,310   | 287,173   |
| From 31 to 60 days   | 145,153   | 100,383   |
| From 61 to 90 days   | 83,679    | 56,386    |
| From 91 to 120 days  | 54,486    | 34,685    |
| From 121 to 180 days | 89,740    | 70,609    |
| From 181 to 360 days | 44,856    | 47,241    |
| Over 360 days        | 953,707   | 925,904   |
| Total past-due       | 1,701,931 | 1,522,381 |
| Total                | 3,151,858 | 2,956,478 |

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Notes to the Financial Statements****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of reais, unless otherwise indicated**

The decrease in the overdue balance was mainly due to wholesale receivables from the municipality of Guarulhos, as a result of the agreement signed in December 2018.

**(c) Allowance for doubtful accounts**

|   | <b>December 31, 2018</b> | <b>December 31, 2017</b> | <b>December 31, 2016</b> |
|---|--------------------------|--------------------------|--------------------------|
| Balance at beginning of the year                  | 1,067,973                | 1,068,747                | 977,758                  |
| Private sector /government entities               | 61,315                   | 75,973                   | 144,217                  |
| Recoveries  | (29,846)                 | (76,747)                 | (25,272)                 |
| Net additions for the year                        | 31,469                   | (774)                    | 118,945                  |
| Write-offs of accounts receivable during the year | -                        | -                        | (27,956)                 |
| Balance at the end of the year                    | 1,099,442                | 1,067,973                | 1,068,747                |

**Reconciliation of estimated/historical losses**

| <b>of income</b>  | <b>December 31, 2018</b> | <b>December 31, 2017</b> | <b>December 31, 2016</b> |
|---|--------------------------|--------------------------|--------------------------|
| Write-offs  | (184,555)                | (171,729)                | (177,492)                |
| (Losses)/reversal with state entities - related parties | 1,294                    | 21,510                   | (7,292)                  |
| (Losses) with private sector / government entities      | (61,315)                 | (75,973)                 | (144,217)                |
| (Losses)/reversal with wholesale customers              | (29,458)                 | 9,781                    | (2,596)                  |
| Recoveries  | 107,307                  | 133,730                  | 241,109                  |
| Amount recorded as bad debt expense, net of recoveries  | (166,727)                | (82,681)                 | (90,488)                 |

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Notes to the Financial Statements****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of reais, unless otherwise indicated**

Losses from wholesale customers related to the municipalities of Santo André and Mauá, totalling R\$116,250 and R\$71,606, respectively, were recorded as revenue reduction in 2018 (R\$104,082 and R\$64,070, respectively, in 2017). Additionally, a revenue was recorded in the amount of R\$716,981 in the same account, related to the municipality of Guarulhos. Accordingly, as a result of these transactions, a revenue with wholesale services was recorded amounting to R\$529,125, in 2018 (R\$203,496 was recorded in 2017 as revenue reduction).

The Company does not have customers representing 10% or more of its total revenues.

**10 Related-Party Balances and Transactions**

The Company is a party to transactions with its controlling shareholder, the State Government, and companies related to it.

**(a) Accounts receivable, interest on capital payable, revenue and expenses with the São Paulo State Government**

|  | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|--|--------------------------|--------------------------|
| Accounts receivable                                    |                          |                          |
| Current:   |                          |                          |
| Sanitation services (i)                                | 122,522                  | 118,441                  |
| Allowance for losses (i)                               | (33,820)                 | (35,114)                 |
| Reimbursement for retirement and pension benefits paid |                          |                          |
| (G0):  |                          |                          |
| - monthly flow (payments) (ii)                         | 22,926                   | 22,968                   |
| - GESP Agreement – 2008 (ii)                           | -                        | 20,099                   |

|  |               |               |
|--|---------------|---------------|
| - GESP Agreement – 2015 (iv)                                     | <u>62,520</u> | <u>54,379</u> |
| Total current  | 174,148       | 180,773       |
| Noncurrent:  |               |               |
| Agreement for the installment payment of sanitation services     | 17,045        | 22,625        |
| Reimbursement for retirement and pension benefits paid (G0):     |               |               |
| - GESP Agreement – 2015 (iv)                                     | 652,057       | 611,762       |
| Total noncurrent   | 669,102       | 634,387       |
| Total receivables from shareholders                              | 843,250       | 815,160       |
| Assets:  |               |               |
| Sanitation services  | 105,747       | 105,952       |
| Reimbursement of additional retirement and pension benefits (G0) | 737,503       | 709,208       |
| Total  | 843,250       | 815,160       |
| Liabilities:   |               |               |
| Interest on capital payable to related parties                   | 338,407       | 300,717       |
| Other (g)  | 8,694         | 1,367         |

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

**Notes to the Financial Statements**

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|   | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|---|-------------|-------------|-------------|
| Revenue from sanitation services                        | 501,146     | 462,989     | 445,726     |
| Payments received from related parties                  | (509,672)   | (471,081)   | (424,549)   |
| Receipt of GESP reimbursement referring to Law 4,819/58 | (173,516)   | (192,889)   | (139,472)   |

(i) Sanitation services

The Company provides water supply and sewage services to the São Paulo State Government and other companies related to it in accordance with usual market terms and conditions, as considered by management, except for the settlement of credits which can be made according to items (iii), (iv) and (v), below.

The Company recognized R\$33,820 as of December 31, 2018 (R\$35,114 as of December 31, 2017) as allowance for losses in accordance of IFRS 9, applicable since January, 1 2018.





**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

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(ii) Reimbursement of additional retirement and pension benefits paid

Refers to amounts of supplementary retirement and pension benefits provided for in State Law 4,819/58 ("Benefits") paid by the Company to former employees and pensioners, referred to as Go.

Under the Agreement referred on item (iii) GESP recognizes its liability from charges arising from the Benefits, provided that the payment criteria set forth by the State Department of Personnel (DDPE), based on legal guidance of the Legal Consultancy of the Department of Finance and of the State Attorney General's Office (PGE).

As discussed on item (vi), during the assessment of the debt due from GESP to the Company there were certain divergences in the calculation and eligibility criteria of the benefits paid by the Company on behalf of GESP.

See additional information about the Go plan in Note 21 (b) (iii).

In January 2004, the payments of supplement retirement and pension benefits were transferred to the Department of Finance and would be made in accordance with the calculation criteria determined by the PGE. As a result of a court decision, the responsibility for making the payments returned to SABESP, as originally established.

(iii) GESP Agreement

On December 11, 2001, the Company, the São Paulo State Government (through the State Department of Finance Affairs, currently Department of Finance) and the Water and Electricity Department (DAEE), with the intermediation of the State Department of Sanitation and Energy (former Department of Water Resources, Sanitation and Construction Works), entered into the Obligations, Payment Commitment and Other Covenants Acknowledgement and Consolidation Agreement ("GESP Agreement") for the settlement of outstanding debts between GESP and the Company related to sanitation services and to the retirement benefits.

In view of the strategic importance of the Taiaçupeba, Jundiáí, Biritiba, Paraitinga and Ponte Nova reservoirs for ensuring and maintaining the Alto Tietê water volume, the Company agreed to receive them as partial repayment of the reimbursement related to the Benefits. The DAEE would transfer the reservoirs to the Company, replacing the amount owed by GESP. However, the São Paulo State Public Prosecution Office challenges the legal validity of this agreement, and its main argument is the lack of bidding and the absence of a specific legislative authorization for disposal of DAEE's assets. There is an unfavorable decision to SABESP not yet unappealable. . See additional information in item (iv) below.

On March 22, 2004, the Company signed the first amendment to the GESP Agreement, settling the amounts due by the São Paulo State Government for water supply and sewage services provided, monetarily adjusted through February 2004; and formally authorizing the offset of amounts due by the São Paulo State Government with interest on capital declared by the Company and any other debt owed to the São Paulo State Government as of December 31, 2003, monetarily adjusted through February 2004; and defining the payment conditions of the remaining liabilities of the São Paulo State Government for the receipt of the water supply and sewage services.

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

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On December 28, 2007, the Company and the São Paulo State Government, represented by the Department of Finance, signed the second amendment to the terms of the original GESP Agreement, agreeing upon the payment in installments of the remaining balance of the First Amendment. In December 2012 the last installment was paid.

On November 17, 2008, GESP, SABESP and DAEE signed the third amendment to the GESP Agreement, through which GESP recognized a debt balance payable to SABESP of R\$915,251, monetarily adjusted until September 2008 in accordance with the fluctuation of the IPCA-IBGE, corresponding to the Undisputed Reimbursement, determined by FIPECAFI. SABESP accepted on a provisional basis the reservoirs as part of the payment of the Undisputed Reimbursement and offered to GESP a provisional settlement, recognizing a credit totaling R\$696,283, corresponding to the value of the reservoirs in the Alto Tietê system. The remaining debtor balance of R\$ 218,967 was totally paid in 2018.

The Company did not recognize the reimbursement receivable of R\$696,283 related to the reservoirs, as it is not virtually certain that will be transferred by the State. In March 2015, Sabesp and GESP entered into an agreement to pay the amounts receivable, totaling R\$696,283 (more information in item (iv) of this note).

In addition, the third amendment provides for the regularization of the monthly flow of benefits. While SABESP is liable for the monthly payment of benefits, the State shall reimburse SABESP based on the criteria identical to those applied when determining the Undisputed Reimbursement. Should there be no preventive court decision, the State will assume the flow of monthly payment of benefits portion deemed as undisputed.

(iv) Agreement with the São Paulo State Government entered into in 2015

On March 18, 2015, the Company, the State of São Paulo and the Department of Water and Electricity (DAEE), and the Sanitation and Water Resources Department as the intervening party, entered into a Term of Agreement in the

amount of R\$1,012,310, of which R\$696,283 refer to the principal of the Undisputed Amount mentioned in item (vi) and R\$316,027 corresponding to the inflation adjustment of the principal until February 2015.

The Principal Amount will be paid in 180 installments, as follows:

- The first 24 installments were settled by immediately transferring 2,221,000 preferred shares issued by Companhia de Transmissão de Energia Elétrica Paulista - CTEEP, totaling R\$87,174, based on the share closing on March 17, 2015; and
- The amount of R\$609,109, payable in 156 monthly installments, was adjusted by IPCA (Extended Consumer Price Index) until the initial payment date, on April 5, 2017. As of this date, installments are being adjusted by IPCA plus simple interest of 0.5% per month.

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Considering the lawsuit which objects the possibility of transferring the reservoirs is pending final and unappealable court decision, the agreement also provides for the following situations:

- If transfer is possible and the Reservoirs are effectively transferred to SABESP and registered at the notary's office, SABESP will reimburse to the State the amounts paid in replacement of Reservoirs (Principal Amount) in 60 monthly installments adjusted by IPCA until the date of payment of each installment; and
- If the transfer of Reservoirs is not possible, the State will pay to SABESP, in addition to the Principal Amount, the inflation adjustment credit of R\$316,027 in 60 installments, starting these payments at the end of Principal Amount installment payment. The amount will be adjusted by IPCA to the start date of payments and, as of this date, IPCA will be incurred plus 0.5% simple interest rates/month over the amount of each installment.

The accounting impacts of the agreement generated a debit of R\$696,283 in accounts receivable from related parties and a credit in the same amount in administrative expenses on the transaction date. As of December 31, 2018, the balance receivable totaled R\$62,520 in current assets (R\$ R\$54,379 as of December 31, 2017) and R\$652,057 in noncurrent assets (R\$611,762 as of December 31, 2017) and CTEEP shares were disposed of on April 20, 2016 for R\$111.1 million.

(v) Disputed Amount of Benefits

As mentioned before, on November 17, 2008 the Company and the State signed the third amendment to the GESP Agreement, when the reimbursements called disputed and undisputed were quantified. The amendment established the efforts to calculate the so-called Disputed Reimbursement of the Benefits. Under the fourth clause of the

amendment, the Disputed Reimbursement represents the difference between the Undisputable Reimbursement and the amount actually paid by the Company as pension benefits and pensioners set out in Law 4,819/58, for which, the Company understands, the State of São Paulo is originally liable, but paid by SABESP under a court order.

By entering into the third amendment, the State's Legal Representative (PGE) agreed to reassess the differences that gave rise to the Disputed Amount of benefits set out in Law 4,819/58. At the time, the expectation was based on the willingness of the PGE to reanalyze the issue and the implied right of the Company to the reimbursement, including based on opinions from outside legal advisors.

However, the recent opinions issued by the PGE and received on September 4 and 22, 2009 and January 4, 2010, refute the reimbursement of previously defined as Disputed Amount.

Even though the negotiations with the State are still in progress, it is not possible to assure that the Company will recover the disputed receivables without dispute.

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As part of the actions intended to recover the receivables that management considers due by the State, related to discrepancies in the reimbursement of the pension benefits paid by the Company, SABESP: (i) on March 24, 2010, reported to the controlling shareholder the official letter approved by the executive committee, proposing that the matter be discussed at the São Paulo Stock Exchange (B3) Arbitration Chamber; (ii) in June 2010, presented to Department of Finance a proposal to solve the outstanding items, such proposal was not accepted; (iii) on November 9, 2010, filed a judicial action against the State of São Paulo pleading the entire reimbursement related to employee benefits set out in Law 4,819/58 to finalize the discussion between the Company and GESP. Despite the legal action, the expectation of which is a possible gain, the Company will persist to obtain an agreement with GESP since the management believes that it is the best course of action to the Company and to its shareholders than waiting until the end of the lawsuit.

The Company's Management decided to record allowance for losses of amounts receivables from the State; as of December 31, 2018 and 2017, the amounts related to the pension plan benefits paid and recorded for allowance for doubtful accounts totaled R\$ 1,107,104 and R\$ 1,021,657, respectively.

As a result, the Company also recognized the obligation related to the pension benefit obligations maintained with the beneficiaries, retirees and pensioners of Plan G0. As of December 31, 2018 and 2017, the pension benefit obligations of Plan G0 totaled R\$2,606,107 and R\$2,543,877, respectively. For detailed information on the pension benefit obligations refer to Note 21 (b) (iii).

**(b) Use of reservoirs – EMAE**



Empresa Metropolitana de Águas e Energia S.A. - EMAE planned to receive for the credit and obtain financial compensation for alleged past and future losses in electricity generation, due to water collection, and compensation for costs already incurred and to be incurred with the operation, maintenance and inspection of the Guarapiranga and Billings reservoirs used by SABESP in its operations.

Several lawsuits were filed by EMAE. An arbitration proceeding was in progress related to the Guarapiranga reservoir and a lawsuit related to the Billings reservoir, both pleading for financial compensation due to SABESP's water collection for public supply, alleging that this conduct has been causing permanent and growing loss in the capacity of generating electricity of Henry Borden hydroelectric power plant with financial losses.

As of October 28, 2016, the Company entered into an agreement based on a Private Transaction Agreement and Other Adjustments aimed to fully and completely settle the disputes involving the two companies. As of October 19, 2017, the conditions precedent were complied with and the agreement came into effect.

Based on a Private Transaction Agreement and Other Adjustments, the payments were established as follows:

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- R\$ 6,610 annually, adjusted for inflation, as of the execution date of this instrument, by the IPCA or any other index that may replace it, by the last business day of October of each fiscal year, with (i) the first of such annual payments due up to the last business day of October 2017 and (ii) the last payment due up to the last business day of October 2042; and

- R\$46,270, in five annual and successive installments, adjusted for inflation by the IPCA or any other index that may replace it, with the first installment of R\$9,254 due on April 30, 2017 and the subsequent ones in 4 (four) installments of same amount, adjusted for inflation, due on every April 30 of the subsequent years, or on the first subsequent business day.

By entering into the Agreement, all litigation between the parties will cease permanently and the Company will continue using the reservoirs.

In addition to the lawsuits that were part of the Agreement, on April 11, 2016, SABESP was named in the Indemnification proceeding commenced by EMAE's minority shareholders, who claimed compensation for damages suffered by EMAE, based on the amounts that the latter did not earn due to the decrease in the outflow of these reservoirs and in the generation of electricity as a result of the use of water of the Billings and Guarapiranga reservoirs by SABESP, and also requested that SABESP be sentenced to reimburse the loss of profits related to EMAE's unearned amounts resulting from the fact that water was not pumped from the Pinheiros and Tietê Rivers to the Henry Borden hydroelectric power plant. In summary, the company claims that the São Paulo State, in its capacity as controlling shareholder of EMAE, has acted unduly to EMAE's detriment and in favor of SABESP's interests by allowing and consenting water intake from the Billings and Guarapiranga reservoirs, in detriment to the output of these reservoirs and generation of electricity by EMAE, without the necessary financial compensation, making impracticable the satisfactory use of the Henry Borden hydroelectric power plant. Although this lawsuit was not the object of the agreement, the Company understands that the approval of the agreement by the Extraordinary Shareholders' Meeting would eliminate the risk that this proceeding would continue in the judicial level.

As of August 7, 2017, the Company was once again served with process in a citizen suit filed by Alvaro Luiz de Lima de Alvares Otero against ANEEL, EMAE and SABESP requesting the annulment of ANEEL order, which consents to the above transaction. The plaintiff claims that the act is illegal and harmful, compromises the operational feasibility of the Henry Borden hydroelectric power plant and jeopardizes the energy security of the São Paulo State, the Southeast region and Brazil. Finally, the plaintiff requests SABESP to indemnify EMAE, at an amount to be calculated. The suit was extinguished without judgment of merit. An appeal was lodged by the author awaiting judgment by the Court of Justice.

The agreement entered into with EMAE will not necessarily resolve these actions.

As of December 31, 2018, the Company recorded R\$16,055 and R\$90,518 in Other Liabilities, under current and noncurrent liabilities, respectively. In 2018, the Company paid the amount of R\$ 16,622.

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

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**(c) Agreements with reduced tariffs with State and Municipal Government Entities that joined the Rational Water Use Program (PURA)**

The Company has signed agreements with government entities related to the State Government and municipalities where it operates that benefit from a reduction of 25% in the tariff of water supply and sewage services when they are not in default. These agreements provide for the implementation of the rational water use program, which takes into consideration the reduction in water consumption.

**(d) Guarantees**

The State Government provides guarantees for some borrowings and financing of the Company and does not charge any fee with respect to such guarantees.

**(e) Personnel assignment agreement among entities related to the State Government**

The Company has personnel assignment agreements with entities related to the State Government, whose expenses are fully passed on and monetarily reimbursed. In 2018, the expenses related to personnel assigned by SABESP to other state government entities amounted to R\$8,903 (R\$9,853 in 2017 and R\$10,393 in 2016).

In 2018, the expenses related to personnel assigned by other entities to SABESP were R\$ 116 (In 2017 there were no expenses related to personnel assigned by other entities to SABESP and R\$10 in 2016).

**(f) Services obtained from state government entities**

As of December 31, 2018 and 2017, SABESP had an outstanding amounts payable of R\$8,694 and R\$1,367, respectively, for services rendered by São Paulo State Government entities.

**(g) Non-operating assets**

As of December 31, 2018 and December 31, 2017, the Company had an amount of R\$969 related to a free land lent to DAEE (Department of Water and Electricity).

**(h) Sabesprev**

The Company sponsors health plans managed by Sabesprev, according to Note 21 (a).

The Company sponsors a private defined benefit pension plan, which is operated and administered by Sabesprev. The net actuarial liability recognized as of December 31, 2018 amounted to R\$363,902 (R\$388,461 as of December 31, 2017), according to Note 21 (b) (i).

**(i) Compensation of Management Key Personnel**

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

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- Compensation:

SABESP's compensation policy for the Management and officers is set out according to guidelines of the São Paulo State Government, issued by the CODEC (State Capital protection Board), and are based on performance, market competitiveness, or other indicators related to the Company's business, and is subject to approval by shareholders at an Annual Shareholders' Meeting.

The Executive Officers' fees are also defined by government authorities. Management and Fiscal Council's compensation is equivalent to 30% and 20%, respectively, of the Executive Officers' fee, contingent on attendance of at least one monthly meeting.

The objective of the compensation policy is to set a private sector management paradigm to retain its staff and recruit competent, experienced and motivated professionals, considering the level of management efficiency currently required by the Company.

In addition to the monthly fee, the members of the Board of Directors, Fiscal Council and the Board of Executive Officers receive annual reward equivalent to a monthly fee, calculated on a prorated basis in December of each year. The purpose of this reward is to correspond to the thirteenth salary paid to the Company's employees, as officers and directors' relationship with the Company is governed by its bylaws and not the labor code.

Benefits paid only to Statutory Officers - meal ticket, basket of food staples, medical care, annual paid rest typified as a paid leave of 30 calendar days, and payment of a premium equivalent to one third of the monthly fee and bonuses.

SABESP pays bonuses for the purposes of compensating Executive Officers, in accordance with the guidelines of the São Paulo State government, as an incentive policy, as long as the Company records quarterly, semiannual, and yearly

profits, and distributes mandatory dividends to shareholders, even if in the form of interest on capital. Annual bonuses cannot exceed six times the monthly compensation of the officers/directors or 10% of the interest on capital paid by the Company, prevailing the shortest amount.

Expenses related to the compensation to the members of its Board of Directors, Fiscal Council and Board of Executive Officers amounted to R\$4,077, R\$3,813 and R\$3,912 for 2018, 2017 and 2016, respectively. An additional amount of R\$538, related to the bonus program, was recorded in 2018 (R\$556 in 2017 and R\$494 in 2016).

**(j) Loan agreement through credit facility**

The Company holds interest in certain Special Purpose Entities (SPEs), not holding the majority interest but with cast vote and power of veto in some issues, with no ability to use such power of veto in a way to affect returns over

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investments. Therefore, these SPEs are considered for accounting purposes as jointly arrangements.

The Company entered into a loan agreement through credit facility with the SPEs Aquapolo Ambiental S.A. and with Attend Ambiental S.A., to finance the operations of these companies, until the borrowings and financing requested with financial institutions is granted.

These agreements remain with the same characteristics, according to the table below:

| <b>SPE</b>         | <b>Principal<br/>disbursed amount</b> | <b>Interest balance</b> | <b>Total</b>  | <b>Interest rate</b> | <b>Maturity</b> |
|--------------------|---------------------------------------|-------------------------|---------------|----------------------|-----------------|
| Aquapolo Ambiental | 19,000                                | 13,857                  | 32,857        | CDI + 1.2% a.a.      | (i)             |
| <b>Total</b>       | <b>19,000</b>                         | <b>13,857</b>           | <b>32,857</b> |                      |                 |

(i) The loan agreement originally matured on April 30, 2015, but was extended to October 30, 2015 and on November 25, 2015 a new amendment changed the payment schedule for three annual installments, the first of which maturing on December 30, 2021 and the last on December 30, 2023.

As of December 31, 2018, the principal and interest balance of this agreement was R\$ 32,857, recorded in the non current assets under "Other Accounts Receivables" (December 31, 2017 - R\$ 50,617). In 2018 the financial income recognized was R\$ 2,772 (in 2017 - R\$ 5,017).



The contract amounting to R\$ 10,838 existed as of December 31, 2017, was fully paid on December 21, 2018.

Regarding the agreement entered into with Attend, in the amount of R\$ 5,400 (principal), which had been overdue since June 2015, an allowance for doubtful accounts of R\$ 9,596 (principal plus interest) was recorded, as a renegotiation agreement was not reached.

**(k) “Se Liga na Rede” (Connect to the Network Program)**

The State Government enacted the State Law no. 14,687/12, creating the pro-connection program, destined to financially subsidize the execution of household branches necessary to connect to the sewage collecting networks, in low income households which agreed to adhere to the program. The program expenditures, except for indirect costs, construction margin and borrowing costs are financed with 80% of funds deriving from the State Government and the remaining 20% invested by SABESP, which is also liable for the execution of works. As of December 31, 2018, the program total amount was R\$100,928 (R\$82,697 as of December 31, 2017), there was no balance receivable as of December 31, 2018 and 2017 from related parties (R\$6,148 as of December 31, 2016). The amount of R\$49,919 (R\$35,068 as of December 31, 2017) was recorded in the group of intangible assets and R\$51,009 was reimbursed by GESB (R\$47,629 as of December 31, 2017) from the beginning of the program until December 31, 2018.

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### **Notes to the Financial Statements**

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#### **11 Water National Agency - ANA**

The Company has agreements executed within the scope of the Hydrographic Basin Depollution Program (PRODES), also known as "Treated Sewage Purchase Program".

This program does not finance works or equipment, remunerates by results achieved, i.e., by effectively treated sewage. In this program, the Water National Agency (ANA) makes available funds, which are restricted to a specific current account and applied in investment funds at the Caixa Econômica Federal – Brazilian Federal Savings Banks (CEF), until the fulfillment of treated sewage volume is evidenced, as well as, the reduction of polluting cargoes of each agreement.

When resources are made available, liabilities are recorded until funds are released by ANA. After the evidence of targets stipulated in each contract, the revenue deriving from these funds is recognized, but if these targets are not met, funds will return to the National Treasury with the appropriate funds earnings. As of December 31, 2018, the balances of assets and liabilities were R\$49,136 (R\$70,487 as of December 31, 2017), and the liability is recorded in "other liabilities" under noncurrent liabilities.

#### **12 Investments**

The Company holds interest in certain Special Purpose Entities (SPE). Although SABESP has no majority shares of its investees, the shareholders' agreement provides for the power of veto in certain management issues, however, with

no ability to use such power of veto in a way to affect returns over investments, indicating participating shared control (joint venture – IFRS 11).

The Company holds interest recognized by the equity accounting in the following investees:

Sesamm

As of August 15, 2008, the Company, together with GS Inima Brasil Ltda (“GS Inima”), successor of Técnicas y Gestion Medioambiental S.A.U. (“TGM”) and GS Inima Environment S/A (currently OHL Medio Ambiente); and Estudos Técnicos e Projetos ETEP Ltda. (“ETEP”), succeeded by ECS Operações e Participações Ltda (“ECS”), incorporated Sesamm – Serviços de Saneamento de Mogi Mirim S/A for a period of 30 years from the date the concession agreement with the municipality for the purpose of providing complementary services to the sewage diversion system and implementing and operating sewage treatment system in the municipality of Mogi Mirim, including the disposal of solid waste.

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Sesamm's capital as of December 31, 2018, totaled R\$ 19,532, and was represented by 19,532,409 registered common shares without a par value. SABESP holds a 36% interest, GS Inima 57% and ECS 7%.

The operations initiated in June 2012.

Águas de Andradina

As of September 15, 2010, the Company, together with Companhia de Águas do Brasil – Cab Ambiental, currently Iguá Saneamento S/A (“Iguá”), incorporated Águas de Andradina S.A., with indefinite term, for the purpose of providing water supply and sewage services to the municipality of Andradina.

As of December 31, 2018, the capital of Águas de Andradina totaled R\$ 17,948, divided into 17,936,174 registered common shares without a par value. SABESP holds 30% of its equity interest and Iguá 70%. The amount of R\$ 12 is recorded under investee's equity, as advance for future capital increase.

As of April 26, 2016, the Annual and Extraordinary Shareholders' Meeting approved a capital increase in the amount of R\$ 2,290 upon the issue of 2,289,796 new registered common shares with no par value, fully subscribed and paid-in, R\$ 573 of which using the minimum mandatory dividends and R\$ 1,717 corresponding to additional dividends, both arising from the profit recorded in 2015.

In 2018, the Company contributed R\$ 910 in the investee, through the issuance of 910,006 registered common shares with no par value, subscribed and paid-in. The amount was recorded in current assets, under “Other receivables” and was reclassified into investments.

On May 4, 2018, the shareholders at an Annual and Extraordinary Shareholders’ Meeting approved the capital increase in the amount of R\$ 1,062, through the issuance of 1,061,935 new registered common shares with no par value, fully subscribed and paid-in, through the capitalization of the credits held by the shareholders as a result of the distribution of dividends. The Company holds 30% of this capital increase.

The Company pledges as guarantee 100% of its shares in Águas de Andradina.

The operations initiated in October 2010.

#### Águas de Castilho

As of October 29, 2010, the Company, together with Águas do Brasil – Cab Ambiental, currently Iguá Saneamento S/A (“Iguá”), incorporated Águas de Castilho, for the purpose of providing water supply and sewage services to the municipality of Castilho.

As of December 31, 2018, the company’s capital was R\$ 2,785, and was represented by 2,785,225 registered shares without a par value. SABESP holds a 30% interest and Iguá 70%.

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As of April 26, 2016, the Annual and Extraordinary Shareholders' Meeting approved a capital increase in the amount of R\$ 740 upon the issue of 740 new registered common shares with no par value, fully subscribed and paid-in, R\$ 184 of which using the minimum mandatory dividends and R\$ 556 corresponding to additional dividends, both arising from the profit recorded in 2015.

In 2018, the Company contributed R\$ 61 in the investee, through the issuance of 61,000 registered common shares with no par value, subscribed and paid-in. The amount was recorded in current assets, under "Other receivables" and was reclassified into investments.

On May 4, 2018, the shareholders at an Annual and Extraordinary Shareholders' Meeting approved the capital increase in the amount of R\$ 222, through the issuance of 221,613 new registered common shares with no par value, fully subscribed and paid-in, through the capitalization of the credits held by the shareholders as a result of the distribution of dividends. The Company holds 30% of this capital increase.

The Company pledges as guarantee 100% of its shares in Águas de Castilho.

The operations initiated in January 2011.

Saneaqua Mairinque

As of June 14, 2010, the Company, together with BRK Ambiental Participações S/A (“BRK”) currently Odebrecht Utilities S/A, former Foz do Brasil S.A., incorporated Saneaqua Mairinque S/A, with indefinite term, for the purpose of exploring water supply and sewage services of the municipality of Mairinque.

As of December 31, 2018, the capital of Saneaqua Mairinque totaled R\$ 4,183, and was represented by 3,141,239 registered common shares without a par value. SABESP holds a 30% interest and BRK 70%. In 2018, the investee received capital contribution of R\$ 2,183, by issuing 1,141,239 new registered common shares with no par value, which was recorded as advance for future capital increase in its noncurrent liabilities in 2017.

The Company pledges as guarantee 100% of its shares in Saneaqua Mairinque.

The operations initiated in October 2010.

#### Attend Ambiental

As of August 23, 2010, SABESP, jointly with Companhia Estre Ambiental S.A. (“Estre”), incorporated Attend Ambiental S.A., for constructing and operating a pretreatment of non-domestic effluent station, sludge transportation and related services in the city of São Paulo as well as implement similar structures in other areas in Brazil and abroad.

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As of December 31, 2018, the capital totaled R\$ 13,400, and was represented by 13,400,000 registered common shares without a par value. SABESP holds a 45% interest and Estre 55%.

The operations initiated in December 2014.

Aquapolo Ambiental S/A.

As of October 8, 2009, the Company, together with Odebrecht Utilities S/A, formerly Foz do Brasil S.A., incorporated Aquapolo Ambiental S.A., for the purpose of producing, providing and trading reused water for Quattor Química S.A., Quattor Petroquímica S.A., Quattor Participações S.A. and other companies comprising the Petrochemical Complex.

As of December 31, 2018, the capital of Aquapolo totaled R\$ 36,412, and was represented by 42,419,045 registered common shares without a par value. SABESP holds 49% of its equity interest. As of December 29, 2016, Odebrecht Utilities S/A transferred to Odebrecht Ambiental Participações em Negócios Industriais S/A (“OAPNI”) all its shares and control and the latter now holds 51% of the shares.

The Company pledges as guarantee 100% of its shares in Aquapolo Ambiental S/A.



The operations initiated in October 2012.

Paulista Geradora de Energia

As of April 13, 2015, the Company acquired shares from Empresa Paulista Geradora de Energia S/A - PGE, jointly with Servtec Investimentos e Participações Ltda ("Servtec) and Tecniplan Engenharia e Comércio Ltda ("Tecniplan"), which operational purpose is the implementation and commercial exploration of water potential in small hydroelectric power plants (PCHs), located at the Guaraú and Vertedouro Cascata Water Treatment Stations.

As of December 31, 2018, the capital of Paulista Geradora de Energia was R\$ 8,679, represented by 8,679,040 registered common shares without a par value, in which SABESP holds a 25% interest, Servtec holds 37.5% and Tecniplan 37.5%.

As of December 31, 2017, operations had not initiated yet.

Below is a summary of the investees' financial information and SABESP's equity interest:

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| Company                      | Equity |        |        | Capital increase | Dividends distributed | Profit (loss) for the year |       |       |       |  |
|------------------------------|--------|--------|--------|------------------|-----------------------|----------------------------|-------|-------|-------|--|
|                              | 2018   | 2017   | 2016   | 2018             | 2018                  | 2018                       | (*)   | 2017  | 2016  |  |
| Sesamm                       | 43,547 | 39,262 | 37,198 | -                | (1,336)               | 5,621                      | -     | 2,707 | 8,601 |  |
| Águas de Andradina (i)       | 24,832 | 19,392 | 16,161 | 3,033            | -                     | 2,425                      | (18)  | 4,471 | 1,772 |  |
| Águas de Castilho            | 6,084  | 4,880  | 3,706  | 203              | -                     | 1,060                      | (59)  | 933   | 631   |  |
| Saneaqua Mairinque           | 5,720  | 4,327  | 4,090  | 2,183            | -                     | (478)                      | (312) | 390   | 723   |  |
| Attend Ambiental             | 1,426  | 5,169  | 3,925  | -                | -                     | (4,731)                    | 988   | 1,324 | 841   |  |
| Aquapolo Ambiental           | 30,170 | 18,757 | 12,340 | -                | -                     | 11,410                     | 3     | 6,470 | 689   |  |
| Paulista Geradora de Energia | 7,625  | 8,447  | 8,469  | -                | -                     | (448)                      | (374) | (22)  | (40)  |  |

| Company            | Investments |        | Capital increase | Dividends distributed | Equity in the earnings of subsidiaries |      |      |       | Interest percentage |      |      |
|--------------------|-------------|--------|------------------|-----------------------|--|------|------|-------|---------------------|------|------|
|                    | 2018        | 2017   | 2018             | (*)                   | 2018                                   | (*)  | 2017 | 2016  | 2018                | 2017 | 2016 |
| Sesamm             | 15,677      | 14,135 | -                | (481)                 | 2,023                                  | -    | 975  | 3,096 | 36%                 | 36%  | 36%  |
| Águas de Andradina | 7,450       | 5,818  | 910              | -                     | 727                                    | (5)  | 729  | 532   | 30%                 | 30%  | 30%  |
|                    | 1,826       | 1,465  | 61               | -                     | 318                                    | (18) | 287  | 189   | 30%                 | 30%  | 30%  |

|  |        |        |     |   |         |      |       |     |     |     |     |
|--|--------|--------|-----|---|---------|------|-------|-----|-----|-----|-----|
| Águas de<br>Castilho<br>Saneaqua<br>Mairinque<br>Attend                  | 1,716  | 1,298  | 655 | - | (143)   | (94) | 71    | 217 | 30% | 30% | 30% |
| Ambiental<br>Aquapolo<br>Ambiental<br>Paulista<br>Geradora de<br>Energia | 642    | 2,326  | -   | - | (2,129) | 445  | 560   | 378 | 45% | 45% | 45% |
| Total  | 14,783 | 9,191  | -   | - | 5,591   | 1    | 3,144 | 338 | 49% | 49% | 49% |
| Other<br>investments   | 588    | 588    |     |   |         |      |       |     |     |     |     |
| Overall total  | 44,587 | 36,932 |     |   |         |      |       |     |     |     |     |

(\*). Refer to changes in the equity of investees, as their financial statements for the year ended December 31, 2017 were issued, including some adjustments, after the Company's financial statements.

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## Notes to the Financial Statements

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## 13 Investment properties

|                       | December 31, 2017 | Write-offs and disposals | Transfers | Depreciation | December 31, 2018 |
|-----------------------|-------------------|--------------------------|-----------|--------------|-------------------|
| Investment properties | 57,652            | (9,995)                  | 13        | (50)         | 47,620            |
| Total                 | 57,652            | (9,995)                  | 13        | (50)         | 47,620            |

|                       | December 31, 2016 | Write-offs and disposals | Depreciation | December 31, 2017 |
|-----------------------|-------------------|--------------------------|--------------|-------------------|
| Investment properties | 57,968            | (244)                    | (72)         | 57,652            |
| Total                 | 57,968            | (244)                    | (72)         | 57,652            |

|                       | December 31, 2015 | Transfers | Write-offs and disposals | Reversal of estimated losses | Depreciation | December 31, 2016 |
|-----------------------|-------------------|-----------|--------------------------|------------------------------|--------------|-------------------|
| Investment properties | 56,957            | 1,231     | (124)                    | 10                           | (106)        | 57,968            |
| Total                 | 56,957            | 1,231     | (124)                    | 10                           | (106)        | 57,968            |

As of December 31, 2018 and 2017, the market value of these properties is approximately R\$386,000 and R\$402,000, respectively.

**14 Contract asset**

Contract asset (works in progress) is the right to consideration in exchange for goods or services transferred to

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Notes to the Financial Statements****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of reais, unless otherwise indicated**

customers. As established by IFRS 15 - Revenue from contract with customer, assets related to the concession under construction, recorded under the scope of IFRIC 12 – Service Concession Arrangements, should be classified as contract asset during the construction period and transferred to intangible assets only after completion of the works.

A contract asset is initially recognized at fair value and includes borrowing costs capitalized during the period when the asset is under construction, based on the weighted average rate of borrowings in effect on the capitalization date, as described in Note 3.12.

|                                | <b>January 1,<br/>2018</b> | <b>Additions</b> | <b>Contract<br/>renewal</b> | <b>Transfers of<br/>Works (*)</b> | <b>December 31,<br/>2018</b> |
|--------------------------------|----------------------------|------------------|-----------------------------|-----------------------------------|------------------------------|
| Contract asset arising from:   |                            |                  |                             |                                   |                              |
| Agreements – equity value      | 1,303,552                  | 367,199          | (284,856)                   | (475,481)                         | 910,414                      |
| Agreements – economic value    | 233,361                    | 111,703          | -                           | (96,676)                          | 248,388                      |
| Program contracts              | 1,809,257                  | 806,554          | 284,856                     | (676,695)                         | 2,223,972                    |
| Services contracts – São Paulo | 6,733,732                  | 1,788,210        | -                           | (4,867,158)                       | 3,654,784                    |
| Software license               | 533                        | 52,183           | -                           | (52,700)                          | 16                           |
| Inventories                    | 298,340                    | 63,075           | -                           | -                                 | 361,415                      |
| Advance to suppliers           | 8,940                      | 19               | -                           | -                                 | 8,959                        |
| Total                          | 10,387,715                 | 3,188,943        | -                           | (6,168,710)                       | 7,407,948                    |

(\*) Work in progress transferred from contract asset to intangible asset.

**15 Intangible assets**

**(a) Statement of financial position details**

|                                 | <b>December 31, 2018</b> |                     |            | <b>December 31, 2017</b> |                     |            |
|---------------------------------|--------------------------|---------------------|------------|--------------------------|---------------------|------------|
|                                 | <b>Accumulated</b>       |                     | <b>Net</b> | <b>Accumulated</b>       |                     | <b>Net</b> |
|                                 | <b>Cost</b>              | <b>amortization</b> |            | <b>Cost</b>              | <b>amortization</b> |            |
| Intangible right arising from:  |                          |                     |            |                          |                     |            |
| Agreements – equity value       | 5,465,206                | (1,391,862)         | 4,073,344  | 8,893,296                | (1,751,682)         | 7,141,614  |
| Agreements – economic value     | 1,948,255                | (716,246)           | 1,232,009  | 2,068,402                | (634,465)           | 1,433,937  |
| Program contracts               | 12,710,937               | (3,933,008)         | 8,777,929  | 10,653,292               | (3,058,226)         | 7,595,066  |
| Program contracts – commitments | 1,320,106                | (240,555)           | 1,079,551  | 1,113,160                | (202,785)           | 910,375    |
| Services contracts – São Paulo  | 17,474,797               | (4,083,345)         | 13,391,452 | 19,388,751               | (3,471,736)         | 15,917,015 |
| Software license                | 748,962                  | (290,787)           | 458,175    | 688,712                  | (220,587)           | 468,125    |
| Total                           | 39,668,263               | (10,655,803)        | 29,012,460 | 42,805,613               | (9,339,481)         | 33,466,132 |

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## Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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## (b) Changes

|                                       | December<br>31, 2017 | Transfers to<br>contract<br>assets (*) | Additions | Contract<br>renewal | Transfers<br>of works<br>(**) | Transfers | Write-offs<br>and<br>disposals | Amortization | December<br>31, 2018 |
|---------------------------------------|----------------------|--|-----------|---------------------|-------------------------------|-----------|--------------------------------|--------------|----------------------|
| Intangible<br>right arising<br>from:  |                      |  |           |                     |                               |           |                                |              |                      |
| Agreements –<br>equity value          | 7,141,614            | (1,427,046)                            | 93        | (1,935,780)         | 499,002                       | (5,268)   | (1,406)                        | (197,865)    | 4,073,344            |
| Agreements –<br>economic<br>value     | 1,433,937            | (233,361)                              | 373       | -                   | 114,442                       | 88        | (1,031)                        | (82,439)     | 1,232,009            |
| Program<br>contracts                  | 7,595,066            | (2,019,461)                            | 928,818   | 1,935,780           | 681,742                       | 3,011     | (7,616)                        | (339,411)    | 8,777,929            |
| Program<br>contracts –<br>commitments | 910,375              | -                                      | 206,946   | -                   | -                             | -         | -                              | (37,770)     | 1,079,551            |
| Services<br>contracts – São<br>Paulo  | 15,917,015           | (6,707,847)                            | 3,724     | -                   | 4,818,734                     | 12        | (14,813)                       | (625,373)    | 13,391,452           |
| Software<br>license                   | 468,125              | -                                      | 4,774     | -                   | 54,790                        | 686       | -                              | (70,200)     | 458,175              |
| Total                                 | 33,466,132           | (10,387,715)                           | 1,144,728 | -                   | 6,168,710                     | (1,471)   | (24,866)                       | (1,353,058)  | 29,012,460           |

(\*) Work in progress transferred to contract asset due to adoption of IFRS 15, as of January 1, 2018, as described in Note 4.1.

(\*\*) Work in progress transferred from contract asset to intangible asset.



|                                    | <b>December<br/>31, 2016</b> | <b>Additions</b> | <b>Contract<br/>renewal</b> | <b>Reversal of<br/>estimated<br/>losses</b> | <b>Transfers</b> | <b>Write-offs<br/>and<br/>disposals</b> | <b>Amortization</b> | <b>December<br/>31, 2017</b> |
|------------------------------------|------------------------------|------------------|-----------------------------|---|------------------|---|---------------------|------------------------------|
| Intangible right<br>arising from:  |                              |                  |                             |   |                  |   |                     |                              |
| Agreements – equity<br>value       | 7,482,955                    | 374,775          | (531,818)                   | 2,078                                       | 1,663            | (2,795)                                 | (185,244)           | 7,141,614                    |
| Agreements –<br>economic value     | 1,381,652                    | 142,429          | -                           | 8   | 2,604            | (1,163)                                 | (91,593)            | 1,433,937                    |
| Program contracts                  | 6,576,021                    | 772,278          | 531,818                     | 4,834                                       | (1,784)          | (6,606)                                 | (281,495)           | 7,595,066                    |
| Program contracts –<br>commitments | 823,216                      | 121,313          | -                           | -   | -                | -                                       | (34,154)            | 910,375                      |
| Services contracts –<br>São Paulo  | 14,552,707                   | 1,976,079        | -                           | 6,460                                       | (18,346)         | (13,848)                                | (586,037)           | 15,917,015                   |
| Software license                   | 430,237                      | 103,424          | -                           | -   | 6,489            | -                                       | (72,025)            | 468,125                      |
| <b>Total</b>                       | <b>31,246,788</b>            | <b>3,490,298</b> | <b>-</b>                    | <b>13,380</b>                               | <b>(9,374)</b>   | <b>(24,412)</b>                         | <b>(1,250,548)</b>  | <b>33,466,132</b>            |

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Notes to the Financial Statements****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of reais, unless otherwise indicated**

|                                    | <b>December<br/>31, 2015</b> | <b>Additions</b> | <b>Contract<br/>renewal</b> | <b>Estimated<br/>losses</b> | <b>Transfers</b> | <b>Write-offs<br/>and<br/>disposals</b> | <b>Amortization</b> | <b>December<br/>31, 2016</b> |
|------------------------------------|------------------------------|------------------|-----------------------------|-----------------------------|------------------|---|---------------------|------------------------------|
| Intangible right<br>arising from:  |                              |                  |                             |                             |                  |   |                     |                              |
| Agreements – equity<br>value       | 7,287,630                    | 391,545          | (9,587)                     | (1,335)                     | 1,014            | (6,233)                                 | (180,079)           | 7,482,955                    |
| Agreements –<br>economic value     | 1,353,020                    | 106,307          | -                           | (8)                         | 6                | (110)                                   | (77,563)            | 1,381,652                    |
| Program contracts                  | 6,288,575                    | 553,126          | 9,587                       | (4,360)                     | 2,023            | (5,571)                                 | (267,359)           | 6,576,021                    |
| Program contracts –<br>commitments | 850,530                      | 5,762            | -                           | -                           | -                | -                                       | (33,076)            | 823,216                      |
| Services contracts –<br>São Paulo  | 12,367,017                   | 2,697,724        | -                           | (4,495)                     | 9,696            | (2,894)                                 | (514,341)           | 14,552,707                   |
| Software license                   | 366,854                      | 101,367          | -                           | -                           | (167)            | -                                       | (37,817)            | 430,237                      |
| <b>Total</b>                       | <b>28,513,626</b>            | <b>3,855,831</b> | <b>-</b>                    | <b>(10,198)</b>             | <b>12,572</b>    | <b>(14,808)</b>                         | <b>(1,110,235)</b>  | <b>31,246,788</b>            |

In 2018, the Company renewed a program contract with the municipalities of Angatuba, Arandu, Assis, Cachoeira Paulista, Carapicuíba, Gália, Guararema, Itirapuã, Monções, Monte Mor, Piraju, Poá, Praia Grande, Queluz, Salesópolis, São Vicente and Terra Roxa. The Company also started operations in the municipality of Saltinho.

In December 2018, the Company signed a contract with the municipalities of Guarulhos and Aguaí, to begin operating in January and June of 2019, respectively.

All of these contracts are valid for 30 years, except for the contract signed with Guarulhos, which is valid for 40 years.

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

**Notes to the Financial Statements**

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**(c) Intangible arising from concession agreements**

The Company operates public service concession agreements for water supply and sewage services mostly based on agreements that set out rights and obligations relative to the exploration of assets related to the public service (See Note 3.8 (a)). A general obligation also exists to return the concession infrastructure to the concession grantor in good working condition at the end of the concession.

As of December 31, 2018, the Company operated in 369 municipalities in the State of São Paulo (368 as of December 31, 2017). Most of these contracts have a 30-year concession period.

The services provided by the Company are billed at a price regulated and controlled by São Paulo State Sanitation and Energy Regulatory Agency (ARSESP).

Intangible rights arising from concession agreements include:

**(i) Concession agreements – equity value**

These refer to municipalities assumed until 2006, except for the municipalities assumed by economic value through assets valuation report prepared by independent experts. The amortization of assets is calculated according to the straight-line method, which considers the assets useful life.

(ii) Concession agreements – economic value

From 1999 through 2006, the negotiations for new concessions were conducted on the basis of the economic and financial result of the transaction, determined in a valuation report issued by independent appraisers.

The amount determined in the related contract, after the transaction is closed with the municipal authorities, realized through the subscription of the Company's shares or in cash, is recorded as "concession agreements" and amortized over the period of the related concession (usually 30 years). As of December 31, 2018 and 2017 there were no amounts pending related to these payments to the municipalities.

Intangible assets are amortized on a straight-line basis over the period of the concession agreements or for the useful lives of the underlying assets, whichever is shorter.

(iii) Program contracts

These refer to the renewal of contracts previously referred to as concession agreements whose purpose is to provide sanitation services. The amortization of the assets acquired until the dates of signatures of the program contracts is calculated according to the straight-line method, which considers the assets' useful lives. Assets acquired or built after the signature dates of program contracts are amortized during the contracted period (30 years) or during the useful lives of underlying assets, whichever is shorter.

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(iv) Program contracts - Commitments

After the enactment of the regulatory framework in 2007, renewals of concessions started to be made through of program contracts. In some of these program contracts, the Company undertook the commitment to financially participate in social and environmental actions. The assets built and financial commitments assumed within the program contracts are recorded as intangible assets and are amortized by the straight-line method in accordance with the duration of the program contract (mostly, 30 years).

As of December 31, 2018 and 2017, the amounts not yet disbursed were recorded under “program contract commitments”, in current liabilities, totaling R\$ 225,291 and R\$ 128,802, respectively, and in noncurrent liabilities, totaling R\$ 142,314 and R\$ 110,698, respectively. In 2018, the annual rate of 8.06% (WACC) was applied to calculate the present value adjustment of these contracts.

(v) Services agreement with the Municipality of São Paulo

On June 23, 2010, the Company entered into an agreement with the State of São Paulo and the Municipality of São Paulo to regulate the provision of water and sewage services in the municipalitu of São Paulo for a 30-year period, which is extendable for an another 30-year period.

Also on June 23, 2010, an agreement was signed between the state and municipal government, and SABESP and the Sanitation and Energy Regulatory Agency of the State of São Paulo (“ARSESP”) are the consenting and intervening

parties, whose main aspects are the following:

1. The State and the Municipality of São Paulo grant to SABESP the right to explore the sanitation services in the capital of the State of São Paulo, which consists of the obligation to provide such service and charge the respective tariff for this service;
2. The State and the Municipality sets forth ARSESP as the agency responsible for regulating the tariff, controlling and monitoring the services.
3. The evaluation model of the contract was the discounted cash flow, which considered the financial and economic sustainability of SABESP's operations in the metropolitan region of São Paulo;
4. All operating costs, taxes, investments and the opportunity cost of investors and the creditors of SABESP's were considered in the cash flow analysis;
5. The agreement provides for investments established in the agreement comply with the minimum of 13% of the gross revenue from the municipality of São Paulo, net of the taxes on revenues. Investment plans referring to SABESP's execution shall be compatible with the activities and programs foreseen in the state, municipal sanitation plans, and where applicable, the metropolitan plan. The investment plan is not definite and will be revised by Managing Committee every four years, especially as to investments to be made in the following period;

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**Notes to the Financial Statements**

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6. The payment related to the Municipal Fund of Environmental Sanitation and Infrastructure to be applied in the sanitation service within the municipality must be recovered through the tariffs charges. Such payment represents 7.5% of the total revenue from the municipality of São Paulo, net of the taxes on revenue and delinquency in the period, recognized in profit or loss, as operating cost;

7. The opportunity cost of the investors and the creditors was established by the Weighted Average Cost of Capital (WACC) methodology. The WACC was the interest rate used to discount the cash flow of the operation; and

8. The agreement considers the recovery of net assets in operation, preferably evaluated through equity valuation or carrying amount monetarily restated, as defined by ARSESP. In addition, the agreement provides for the remuneration of investments to be made by SABESP, so that there is no residual value at the end of the agreement.

Referring to the recovery through tariff, mentioned in item 6 above, of transfer to the Municipal Fund of Environmental Sanitation and Infrastructure, ARSESP issued in April 2013, the Resolution no. 413, postponing the application of Resolution no. 407 until the conclusion of the tariff revision process, the transfer to the bill of services of amounts referring to the municipal charges which were stipulated in Resolution no. 407. The postponement to apply Resolution no. 407 was due to a request by the São Paulo State Government to analyze, among other things, methods to reduce the impact on consumers.

As of April 18, 2014, ARSESP Resolution no. 484 was published with the final results of SABESP's Tariff Revision, however, both the São Paulo Municipal Government, through Official Letter no. 1,309/14-SGM/GAB and the São Paulo State Government through a petition filed by the São Paulo State Office, through the Official Letter ATG/Official Letter no. 092/14-CC, requested a postponement of the effects of ARSESP Resolution no. 413,



published in the São Paulo State Official Gazette on March 20, 2013, until the conclusion of the revision of the Agreement entered into between the São Paulo Municipal Government, the São Paulo State Government and SABESP.

By means of Resolution no. 488 of May 7, 2014, ARSESP maintained the suspension of the effectiveness of ARSESP Resolution no. 407, published on March 22, 2013, until the results obtained in the revision of the Agreement entered into by the São Paulo Municipal Government, the São Paulo State Government and SABESP postponing authorization for the transfer to the bill of the services related to the legally established municipal fees that, by force of the Program Agreements and Water Supply and Sewage Services Agreements, should be included in the Tariff Revision.

The agreement represents 51.52% of the total revenue of the Company as of December 31, 2018, and ensures the judicial and assets security.

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**Notes to the Financial Statements**

**Years ended December 31, 2018, 2017 and 2016**

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The municipality of São Paulo and the Company did not conclude an agreement to equalize financial pending issues existing until the signature date of the Agreement related to the rendering of water supply and sewage services to the real properties of the municipality, and for that reason, the Company filed a suit to collect these accounts, which are accrued for losses.

**(d) Capitalization of interest and other finance charges**

In 2018, the Company capitalized interest and inflation adjustment, including related foreign currency exchange effects in concession intangible assets, totaling R\$488,502, including the São Lourenço Production System and Leases (R\$649,048 in 2017 and R\$700,743 in 2016) during the construction period.

**(e) Construction margin**

The Company acts as a principal responsible to construct and install the infrastructure related to the concession, using own efforts or hiring outsourcing services, receiving the risks and benefits.

Accordingly, the Company recognizes revenue from construction service corresponding to the cost of construction increased by gross margin. Generally, the constructions related to the concessions are performed by third parties, in such case, the margin of the Company is lower, normally, to cover eventual administration costs, and the responsibility of the primary risk. In 2018 and 2017 the margin was 2.3%.

Construction margin for 2018, 2017 and 2016 were R\$63,013, R\$70,335 and R\$81,513, respectively.

**(f) Expropriations**

As a result of the construction of priority projects related to water and sewage systems, the Company was required to expropriate third-parties' properties, and the owners of these properties will be compensated either amicably or through courts.

The costs of these expropriations are recorded as concession intangible assets after the transaction is concluded. In 2018, the total amount related to expropriations was R\$106,429 (R\$19,576 in 2017 and R\$40,452 in 2016).

**(g) Public-Private Partnership - PPP**

SABESP carries out operations related to the PPPs mentioned below. These operations and their respective obligations and guarantees are supported by agreements executed according to Law 11,079/04.

Alto Tietê Production System

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The Company and the special purpose entity CAB-Sistema Produtor Alto Tietê S/A, formed by Galvão Engenharia S.A. and Companhia Águas do Brasil – Cab Ambiental, signed in June 2008 the contract of public-private- partnership of Alto Tietê production system.

The contract last 15 years which purpose is to expand the capacity of treated water of Taiapuêba from 10 thousand to 15 thousand of liters per second, whose operation began in October 2011.

As of December 31, 2018 and 2017, the amounts recognized as intangible asset related to PPP were R\$359,759 and R\$371,862, respectively. In 2018, a discount rate of 8.20% p.a. was used to calculate the adjustment to present value of the agreement.

On a monthly basis, SABESP assigns funds from tariffs to the SPE CAB Sistema Produtor Alto Tietê S/A, in the amount of R\$10,361, corresponding to the monthly remuneration. This amount is annually adjusted by the IPC – FIPE and is recorded in a restricted account, pursuant to the contractual operating proceeding.

The guarantee is effective since the beginning of the operation and will be valid until the conclusion, termination, intervention, annulment or caducity of the Administrative Concession, or other extinction events provided for in the Concession Agreement or in the law applicable to administrative concessions, including in the event of bankruptcy or extinction of the SPE.

São Lourenço Production System

SABESP and the special purpose entity Sistema Produtor São Lourenço S/A, composed of Construções e Comércio Camargo Corrêa S/A and Construtora Andrade Gutierrez S/A, in August 2013 signed the public-private partnership agreements of the São Lourenço Production System.

In May 2018, the control of SPE Sistema Produtor São Lourenço S/A was transferred to CGGC Construtora do Brasil Ltda, previously composed of Construções e Comércio Camargo Corrêa S/A and Construtora Andrade Gutierrez S/A.

The objective of the contract is: a) the construction of a water producing system, mainly consisting of a water pipeline connecting Ibiúna to Barueri, a water collection station in Ibiúna, a water treatment station in Vargem Grande Paulista and water reservoirs; and b) the provision of services for a 25-year term, aiming at rendering services to operate the dehydration system, drying and final disposal of sludge, maintenance and works of the São Lourenço Production System. Works started in April 2014.

The São Lourenço Production System (SPSL) PPP began the service provision phase on July 10, 2018, as per the contractual clause that allows the beginning of operations provided that system has full operating capacity, without, however implying in the Acceptance of the Works. In this way, the Service Phase was initiated, with the consequent payment of the payments due, in parallel with the completion of the Phase of Works.

The estimated amount by inflation adjustment through December 31, 2018 is approximately R\$7.92 billion.

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

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After the beginning of the operations, every month SABESP will transfer to the SPE Sistema Produtor São Lourenço S/A funds from tariffs arising from the services provided, in the amount of R\$32.0 million, equivalent to the estimated monthly remuneration plus interest and charges. The amount above will be annually reevaluated by the IPC - FIPE and should be monthly recorded in a restricted account, in accordance with the operating procedures of the agreements.

This obligation with the SPE will become effective as of the beginning of the system's appropriate operation, duly accepted by SABESP, valid until the occurrence of any of the following events, whichever occurs first: (i) the original payment date of the last installment of interest / amortization of the principal taken out by the SPE to execute the works; (ii) the end, termination, intervention, annulment, caducity of the Administrative Concession, or other extinction events provided for in the Concession Agreement or in the law applicable to administrative concessions, including bankruptcy or extinction of the SPE.

As of December 31, 2018 and 2017, the carrying amount recorded in the Company's intangible assets, related to this PPP, amounted to R\$3,208,464 and R\$2,818,805, respectively. Intangible assets are accounted for based on the physical evolution of the construction which, as of December 31, 2018, was approximately 96.8% complete, with a counter-entry in the Private Public Partnership (PPP) liabilities account. In 2018, a discount rate of 7.80% p.a. was used to calculate the adjustment to present value of the agreement.

The obligations assumed by the Company as of December 31, 2018 and 2017 are shown in the table below, and the increase in intangible assets and liabilities was mainly due to the progress of PPP São Lourenço works in 2018.

|              | December 31, 2018   |                        |                   | December 31, 2017   |                        |                   |
|--------------|---------------------|------------------------|-------------------|---------------------|------------------------|-------------------|
|              | Current liabilities | Noncurrent liabilities | Total liabilities | Current liabilities | Noncurrent liabilities | Total liabilities |
| Alto Tietê   | 39,283              | 252,093                | 291,376           | 35,083              | 282,501                | 317,584           |
| São Lourenço | 98,544              | 3,023,204              | 3,121,748         | 24,924              | 2,728,908              | 2,753,832         |
| Total        | 137,827             | 3,275,297              | 3,413,124         | 60,007              | 3,011,409              | 3,071,416         |

**(h) Works in progress**

With the adoption of IFRS 15 - Revenue from contract with customer, as of January 1, 2018, assets related to the concession under construction, recorded under the scope of IFRIC 12 – Service Concession Arrangements, previously recognized as part of intangible assets as works in progress were reclassified to contract asset, according to note 14, in the amount of R\$ 10,387 million. The amount of R\$10,387 million is recorded under intangible assets as works in progress as of December 31, 2017 (R\$10,387 million as of December 31, 2017), and, in 2017, the major projects are located in the municipalities of São Paulo, Franca and Itanhaém, totaling R\$6,497 million (including R\$2,819 million from São Lourenço PPP), R\$253 million and R\$208 million, respectively.

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Notes to the Financial Statements****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of reais, unless otherwise indicated****(i) Amortization of intangible assets**

The amortization average rate totaled 4.2% as of December 31, 2018 and 3.9% as of December 31, 2017 and 2016.

**(j) Software license of use**

The software license of use is capitalized based on the costs incurred to acquire software and make them ready for use. As of April 10, 2017, the Company implemented the Integrated Business Management System (Enterprise Resource Planning – SAP ERP), which includes the administrative/financial module. The implementation of the commercial module is in progress.

**16 Property, plant and equipment****(a) Statement of financial position details**

|                          | <b>December 31, 2018</b> |                     |            | <b>December 31, 2017</b> |                     |            |
|--------------------------|--------------------------|---------------------|------------|--------------------------|---------------------|------------|
|                          | <b>Cost</b>              | <b>depreciation</b> | <b>Net</b> | <b>Cost</b>              | <b>depreciation</b> | <b>Net</b> |
| Land                     | 92,979                   | -                   | 92,979     | 92,507                   | -                   | 92,507     |
| Buildings                | 79,086                   | (38,961)            | 40,125     | 79,013                   | (36,653)            | 42,360     |
| Equipment                | 372,872                  | (256,786)           | 116,086    | 330,753                  | (226,950)           | 103,803    |
| Transportation equipment | 11,333                   | (7,860)             | 3,473      | 10,862                   | (7,182)             | 3,680      |



|                        |         |           |         |         |           |         |
|------------------------|---------|-----------|---------|---------|-----------|---------|
| Furniture and fixtures | 27,250  | (13,672)  | 13,578  | 24,430  | (12,614)  | 11,816  |
| Other                  | 1,659   | (288)     | 1,371   | 1,122   | (238)     | 884     |
| Total                  | 585,179 | (317,567) | 267,612 | 538,687 | (283,637) | 255,050 |

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## Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2018, 2017 and 2016

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## (b) Changes

|                          | December 31,<br>2017 | Additions | Transfers | Write-offs<br>and disposals | Depreciation | December<br>31, 2018 |
|--------------------------|----------------------|-----------|-----------|-----------------------------|--------------|----------------------|
| Land                     | 92,507               | -         | 472       | -                           | -            | 92,979               |
| Buildings                | 42,360               | 73        | -         | -                           | (2,308)      | 40,125               |
| Equipment                | 103,803              | 46,473    | 986       | (81)                        | (35,095)     | 116,086              |
| Transportation equipment | 3,680                | 589       | -         | -                           | (796)        | 3,473                |
| Furniture and fixtures   | 11,816               | 2,972     | -         | (27)                        | (1,183)      | 13,578               |
| Other                    | 884                  | 538       | -         | -                           | (51)         | 1,371                |
| Total                    | 255,050              | 50,645    | 1,458     | (108)                       | (39,433)     | 267,612              |

|                             | December 31,<br>2016 | Additions | Transfers   | Write-offs<br>and disposals | Depreciation | December<br>31, 2017 |
|-----------------------------|----------------------|-----------|-------------|-----------------------------|--------------|----------------------|
| Land                        | 92,494               | -         | 13          | -                           | -            | 92,507               |
| Buildings                   | 43,262               | 86        | 1,358       | -                           | (2,346)      | 42,360               |
| Equipment                   | 149,140              | 17,627    | (15,945)    | (178)                       | (46,841)     | 103,803              |
| Transportation<br>equipment | 4,531                | -         | (33)        | (27)                        | (791)        | 3,680                |
| Furniture and fixtures      | 11,986               | 1,207     | (75)        | (54)                        | (1,248)      | 11,816               |
| Other                       | <u>970</u>           | <u>-</u>  | <u>(15)</u> | <u>(20)</u>                 | <u>(51)</u>  | <u>884</u>           |
| Total                       | 302,383              | 18,920    | (14,697)    | (279)                       | (51,277)     | 255,050              |

|                          | <b>December 31,<br/>2015</b> | <b>Additions</b> | <b>Transfers</b> | <b>Write-offs<br/>and disposals</b> | <b>Depreciation</b> | <b>December<br/>31, 2016</b> |
|--------------------------|------------------------------|------------------|------------------|-------------------------------------|---------------------|------------------------------|
| Land                     | 102,708                      | -                | (10,214)         | -                                   | -                   | 92,494                       |
| Buildings                | 45,891                       | -                | (911)            | (45)                                | (1,673)             | 43,262                       |
| Equipment                | 162,218                      | 26,061           | (6,380)          | (181)                               | (32,578)            | 149,140                      |
| Transportation equipment | 5,692                        | 214              | (556)            | -                                   | (819)               | 4,531                        |
| Furniture and fixtures   | 8,418                        | 511              | 4,258            | (10)                                | (1,191)             | 11,986                       |
| Other                    | 149                          | 845              | -                | -                                   | (24)                | 970                          |
| <b>Total</b>             | <b>325,076</b>               | <b>27,631</b>    | <b>(13,803)</b>  | <b>(236)</b>                        | <b>(36,285)</b>     | <b>302,383</b>               |

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**(c) Depreciation**

The Company annually review the depreciation rates of: buildings – 3.0%; equipment- 16.5%; transportation equipment - 10% and furniture and fixture – 6.8%. Land is not depreciated.

The depreciation average rate was 12.3%, 13.6% and 10.9%, as of December 31, 2018, 2017 and 2016, respectively.

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Notes to the Financial Statements****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of reais, unless otherwise indicated****17 Borrowings and financing**

| <b>Borrowings and financing outstanding balance</b> | <b>December 31, 2018</b> |                   |                  | <b>December 31, 2017</b> |                   |                  |
|---|--------------------------|-------------------|------------------|--------------------------|-------------------|------------------|
|   | <b>Current</b>           | <b>Noncurrent</b> | <b>Total</b>     | <b>Current</b>           | <b>Noncurrent</b> | <b>Total</b>     |
| <b>Financial institution</b>                        |                          |                   |                  |                          |                   |                  |
| <b>Local currency</b>                               |                          |                   |                  |                          |                   |                  |
| 10th issue debentures                               | 42,493                   | 40,194            | 82,687           | 41,702                   | 80,953            | 122,655          |
| 12th issue debentures                               | 45,450                   | 249,249           | 294,699          | 45,450                   | 294,702           | 340,152          |
| 14th issue debentures                               | 41,270                   | 103,005           | 144,275          | 40,503                   | 141,351           | 181,854          |
| 15th issue debentures                               | 359,394                  | -                 | 359,394          | 346,414                  | 345,788           | 692,202          |
| 17th issue debentures                               | 279,100                  | 532,691           | 811,791          | 144,391                  | 781,922           | 926,313          |
| 18th issue debentures                               | 33,469                   | 165,267           | 198,736          | 33,020                   | 194,872           | 227,892          |
| 20th issue debentures                               | 248,334                  | -                 | 248,334          | 250,000                  | 246,890           | 496,890          |
| 21th issue debentures                               | -                        | 499,604           | 499,604          | -                        | 499,628           | 499,628          |
| 22th issue debentures                               | -                        | 756,040           | 756,040          | -                        | -                 | -                |
| Brazilian Federal Savings Bank                      | 75,223                   | 1,266,592         | 1,341,815        | 78,487                   | 1,154,599         | 1,233,086        |
| Brazilian Development Bank - BNDES BAIXADA SANTISTA | 16,899                   | -                 | 16,899           | 16,782                   | 16,782            | 33,564           |
| Brazilian Development Bank - BNDES PAC              | 11,227                   | 39,169            | 50,396           | 11,143                   | 50,028            | 61,171           |
| Brazilian Development Bank - BNDES PAC II 9751      | 4,364                    | 18,811            | 23,175           | 4,334                    | 22,991            | 27,325           |
| Brazilian Development Bank - BNDES PAC II 9752      | 3,186                    | 23,100            | 26,286           | 2,367                    | 19,526            | 21,893           |
| Brazilian Development Bank - BNDES ONDA LIMPA       | 23,632                   | 123,875           | 147,507          | 23,469                   | 146,461           | 169,930          |
| Brazilian Development Bank - BNDES TIETÊ III        | 30,589                   | 252,197           | 282,786          | 30,378                   | 280,825           | 311,203          |
| Brazilian Development Bank - BNDES 2015             | 31,615                   | 490,729           | 522,344          | 10,050                   | 397,922           | 407,972          |
| Leases  | 19,077                   | 549,589           | 568,666          | 17,573                   | 544,044           | 561,617          |
| Other   | 1,380                    | 8,163             | 9,543            | 1,466                    | 9,477             | 10,943           |
| Interest and charges                                | 98,410                   | -                 | 98,410           | 101,855                  | -                 | 101,855          |
| <b>Total in local currency</b>                      | <b>1,365,112</b>         | <b>5,118,275</b>  | <b>6,483,387</b> | <b>1,199,384</b>         | <b>5,228,761</b>  | <b>6,428,145</b> |

| <b>Borrowings and financing outstanding balance</b>   | <b>December 31, 2018</b>     |                   |                   | <b>December 31, 2017</b> |                   |                   |              |
|---|------------------------------|-------------------|-------------------|--------------------------|-------------------|-------------------|--------------|
|   | <b>Financial institution</b> | <b>Current</b>    | <b>Noncurrent</b> | <b>Total</b>             | <b>Current</b>    | <b>Noncurrent</b> | <b>Total</b> |
| <b>Foreign currency</b>   |                              |                   |                   |                          |                   |                   |              |
| Inter-American Development Bank - BID 1212 – US\$71,947 thousand (US\$92,503 thousand in December 2017)                 | 39,826                       | 238,954           | 278,780           | 34,000                   | 238,000           | 272,000           |              |
| Inter-American Development Bank - BID 2202 – US\$544,457 thousand (US\$438,071 thousand in December 2017)               | 124,098                      | 1,969,565         | 2,093,663         | 81,757                   | 1,375,358         | 1,457,115         |              |
| International Bank of Reconstruction and Development -BIRD – US\$91,286 thousand (US\$79,946 thousand in December 2017) | 11,779                       | 341,646           | 353,425           | -                        | 301,665           | 301,665           |              |
| Deutsche Bank – US\$75,000 (US\$150,000 thousand in December 2017)  | 288,479                      | -                 | 288,479           | 248,100                  | 242,343           | 490,443           |              |
| Eurobonds – US\$350,000 thousand (US\$350,000 thousand in December 2017)  | -                            | 1,354,532         | 1,354,532         | -                        | 1,155,331         | 1,155,331         |              |
| JICA 15 – ¥12,676,730 thousand (¥13,829,160 thousand in December 2017)  | 40,646                       | 406,462           | 447,108           | 33,881                   | 372,696           | 406,577           |              |
| JICA 18 – ¥11,397,760 thousand (¥12,433,920 thousand in December 2017)  | 36,545                       | 365,230           | 401,775           | 30,463                   | 334,849           | 365,312           |              |
| JICA 17 – ¥1,826,957 thousand (¥1,534,959 thousand in December 2017)  | 11,835                       | 51,786            | 63,621            | 2,507                    | 41,835            | 44,342            |              |
| JICA 19 – ¥31.561.726 thousand (¥29,777,232 thousand in December 2017)  | 64,028                       | 1,047,081         | 1,111,109         | -                        | 873,383           | 873,383           |              |
| BID 1983AB – US\$58,462 thousand (US\$82,404 thousand in December 2017)   | 68,554                       | 155,653           | 224,207           | 79,201                   | 189,990           | 269,191           |              |
| Interest and charges  | 52,710                       | -                 | 52,710            | 37,462                   | -                 | 37,462            |              |
| <b>Total in foreign currency</b>  | <b>738,500</b>               | <b>5,930,909</b>  | <b>6,669,409</b>  | <b>547,371</b>           | <b>5,125,450</b>  | <b>5,672,821</b>  |              |
| <b>Total borrowings and financing</b>   | <b>2,103,612</b>             | <b>11,049,184</b> | <b>13,152,796</b> | <b>1,746,755</b>         | <b>10,354,211</b> | <b>12,100,966</b> |              |

Exchange rate as of December 31, 2018: US\$3.8748; ¥0.03527 (as of December 31, 2017: US\$3.3080; ¥0.02940).

As of December 31, 2018, the Company did not have balances of borrowings and financing, raised during the year, to mature within 12 months.

## Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2018, 2017 and 2016

Amounts in thousands of reais, unless otherwise indicated

| Local currency                                      | Guarantees | Maturity  | Annual interest rates   | Inflation adjustment  |
|---|------------|-----------|---|-----------------------|
| 10th issue debentures                               | Own funds  | 2020      | TJLP +1.92% (Series 1 and 3) and 9.53% (Series 2)                   | IPCA (Series 2)       |
| 12th issue debentures                               | Own funds  | 2025      | TR + 9.5%   |                       |
| 14th issue debentures                               | Own funds  | 2022      | TJLP +1.92% (Series 1 and 3) and 9.19% (Series 2)                   | IPCA (Series 2)       |
| 15th issue debentures                               | Own funds  | 2019      | CDI + 0.99% (Series 1) and 6.2% (Series 2)                          | IPCA (Series 2)       |
| 17th issue debentures                               | Own funds  | 2023      | CDI +0.75 (Series 1) and 4.5% (Series 2) and 4.75% (Series 3)       | IPCA (Series 2 and 3) |
| 18th issue debentures                               | Own funds  | 2024      | TJLP 1.92 % (Series 1 and 3) and 8.25% (Series 2)                   | IPCA (Series 2)       |
| 20th issue debentures                               | Own funds  | 2019      | CDI + 3.80%   |                       |
| 21th issue debentures                               | Own funds  | 2022      | CDI + 0.60% e CDI+ 0.90%  |                       |
| 22th issue debentures                               | Own funds  | 2025      | CDI +0.58 (Series 1) and CDI + 0.90% (Series 2) and 6.0% (Series 3) | IPCA (Series 3)       |
| Brazilian Federal Savings Bank                      | Own funds  | 2019/2039 | 5% to 9.5%  | TR                    |
| Brazilian Development Bank - BNDES BAIXADA SANTISTA | Own funds  | 2019      | TJLP+2.5%   |                       |
| Brazilian Development Bank - BNDES PAC              | Own funds  | 2023      | TJLP+2.15%  |                       |
| Brazilian Development Bank - BNDES PAC II 9751      | Own funds  | 2027      | TJLP+1.72%  |                       |
| Brazilian Development Bank - BNDES PAC II 9752      | Own funds  | 2027      | TJLP+1.72%  |                       |
| Brazilian Development Bank - BNDES ONDA LIMPA       | Own funds  | 2025      | TJLP+1.92%  |                       |
| Brazilian Development Bank - BNDES TIETÊ III        | Own funds  | 2028      | TJLP+1.66%  |                       |

|  |           |      |  |     |
|--|-----------|------|--|-----|
| Brazilian Development Bank -<br>BNDES 2015 | Own funds | 2035 | TJLP+2.5%  |     |
| Leases                                     |           | 2035 | 7.73% to 10.12%                                      | IPC |
| Other                                      | Own funds | 2025 | 12% (Presidente Prudente) and TJLP<br>+ 1.5% (FINEP) | TR  |

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****Notes to the Financial Statements****Years ended December 31, 2018, 2017 and 2016****Amounts in thousands of reais, unless otherwise indicated**

| <b>Foreign currency</b>   | <b>Guarantees</b> | <b>Maturity</b> | <b>Annual interest rates</b> | <b>Exchange rate changes</b> |
|---|-------------------|-----------------|------------------------------|------------------------------|
| Inter-American Development Bank - BID 1212<br>- US\$71,947 thousand                 | Government        | 2025            | 3.31% (*)                    | US\$                         |
| Inter-American Development Bank - BID 2202<br>- US\$544,457 thousand                | Government        | 2035            | 3.42% (*)                    | US\$                         |
| International Bank for Reconstruction and<br>Development - BIRD US\$91,286 thousand | Government        | 2034            | 2.85% (*)                    | US\$                         |
| Deutsche Bank US\$75,000 thousand   | -                 | 2019            | 4.50% (*)                    | US\$                         |
| Eurobonds – US\$350,000 thousand  | -                 | 2020            | 6.25%                        | US\$                         |
| JICA 15 – ¥12,676,730 thousand  | Government        | 2029            | 1.8% and 2.5%                | Yen                          |
| JICA 18 – ¥11,397,760 thousand  | Government        | 2029            | 1.8% and 2.5%                | Yen                          |
| JICA 17– ¥1,826,957 thousand  | Government        | 2035            | 1.2% and 0.01%               | Yen                          |
| JICA 19– ¥31,561,726 thousand   | Government        | 2037            | 1.7% and 0.01%               | Yen                          |
| BID 1983AB – US\$58,462 thousand  | -                 | 2023            | 2.08% to 2.38% (*)           | US\$                         |

(\*)Rates comprising LIBOR + contractually defined spread.



## Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2018, 2017 and 2016

Amounts in thousands of reais, unless otherwise indicated

(i) Payment schedule – accounting balances as of December 31, 2018

|                                  | 2019      | 2020      | 2021      | 2022      | 2023    | 2024    | 2025 to<br>2039 | TOTAL      |
|----------------------------------|-----------|-----------|-----------|-----------|---------|---------|-----------------|------------|
| <b>LOCAL CURRENCY</b>            |           |           |           |           |         |         |                 |            |
| Debentures                       | 1,049,510 | 589,190   | 479,995   | 559,184   | 362,555 | 204,832 | 150,294         | 3,395,560  |
| Brazilian Federal                |           |           |           |           |         |         |                 |            |
| Savings Bank                     | 75,223    | 78,072    | 82,169    | 86,589    | 79,037  | 77,369  | 863,356         | 1,341,815  |
| BNDES                            | 121,512   | 103,260   | 102,809   | 102,809   | 97,069  | 91,581  | 450,353         | 1,069,393  |
| Leasing                          | 19,077    | 36,903    | 38,700    | 40,654    | 43,416  | 45,153  | 344,763         | 568,666    |
| Other                            | 1,380     | 1,380     | 1,380     | 1,380     | 1,380   | 1,380   | 1,263           | 9,543      |
| Interest and charges             | 98,410    | -         | -         | -         | -       | -       | -               | 98,410     |
| <b>TOTAL IN LOCAL CURRENCY</b>   | 1,365,112 | 808,805   | 705,053   | 790,616   | 583,457 | 420,315 | 1,810,029       | 6,483,387  |
| <b>FOREIGN CURRENCY</b>          |           |           |           |           |         |         |                 |            |
| BID                              | 163,923   | 163,923   | 163,923   | 163,923   | 163,923 | 163,923 | 1,388,905       | 2,372,443  |
| BIRD                             | 11,779    | 23,557    | 23,557    | 23,557    | 23,557  | 23,557  | 223,861         | 353,425    |
| Deutsche Bank                    | 288,479   | -         | -         | -         | -       | -       | -               | 288,479    |
| Eurobonds                        | -         | 1,354,532 | -         | -         | -       | -       | -               | 1,354,532  |
| JICA                             | 153,055   | 140,431   | 140,431   | 140,431   | 140,431 | 140,431 | 1,168,403       | 2,023,613  |
| BID 1983AB                       | 68,554    | 67,786    | 29,806    | 29,806    | 28,255  | -       | -               | 224,207    |
| Interest and charges             | 52,710    | -         | -         | -         | -       | -       | -               | 52,710     |
| <b>TOTAL IN FOREIGN CURRENCY</b> | 738,500   | 1,750,229 | 357,717   | 357,717   | 356,166 | 327,911 | 2,781,169       | 6,669,409  |
| <b>Overall Total</b>             | 2,103,612 | 2,559,034 | 1,062,770 | 1,148,333 | 939,623 | 748,226 | 4,591,198       | 13,152,796 |

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## Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2018, 2017 and 2016

Amounts in thousands of reais, unless otherwise indicated

(ii) Changes

|                                      | December<br>31, 2017 | Funding          | Borrowings<br>costs | Monetary<br>variation<br>and<br>exchange<br>rate<br>changes | Inflation<br>adjustment /<br>update<br>interest -<br>Capitalized | Interest<br>and fees<br>paid | Amortization       | Accrued<br>interest | Interest and<br>fees –<br>(* ) | Borro<br>cos<br>expe |
|--------------------------------------|----------------------|------------------|---------------------|---|--|------------------------------|--------------------|---------------------|--------------------------------|----------------------|
| <b>LOCAL CURRENCY</b>                |                      |                  |                     |   |  |                              |                    |                     |                                |                      |
| Debentures                           | 3,576,842            | 750,000          | (3,021)             | 62,676  |  | -(259,175)                   | (905,080)          | 226,810             |                                | 34,409               |
| Brazilian<br>Federal<br>Savings Bank | 1,236,674            | 194,244          | -                   | -   |  | -(102,772)                   | (85,515)           | 75,668              |                                | 27,385               |
| BNDES                                | 1,042,036            | 131,000          | -                   | 3,438   | 4,001  | (90,397)                     | (102,314)          | 28,909              |                                | 55,725               |
| Leasing                              | 561,616              | -                | -                   | -   | 6,366  | (38,196)                     | (17,427)           | 40,290              |                                | 16,017               |
| Other                                | 10,977               | -                | -                   | 69  | -  | (772)                        | (1,470)            | 763                 |                                | 4                    |
| <b>TOTAL IN LOCAL CURRENCY</b>       | <b>6,428,145</b>     | <b>1,075,244</b> | <b>(3,021)</b>      | <b>66,183</b>   | <b>10,367</b>  | <b>(491,312)</b>             | <b>(1,111,806)</b> | <b>372,440</b>      |                                | <b>133,540</b>       |
| <b>FOREIGN CURRENCY</b>              |                      |                  |                     |   |  |                              |                    |                     |                                |                      |
| BID                                  | 1,743,257            | 484,690          | (2,365)             | 237,433   | 53,208   | (55,391)                     | (130,520)          | 26,910              |                                | 41,878               |
| BIRD                                 | 303,278              | -                | -                   | 48,279  | 3,462  | (7,607)                      | -                  | 6,945               |                                | 2,044                |
| Deutsche<br>Bank                     | 496,726              | -                | -                   | 62,918  | -  | (35,207)                     | (268,508)          | 28,862              |                                | 4,454                |
| Eurobonds                            | 1,158,642            | -                | -                   | 198,380   | -  | (97,952)                     | -                  | 85,072              |                                | 13,448               |
| JICA                                 | 1,700,448            | 80,196           | (191)               | 329,638   | 6,787  | (33,519)                     | (82,608)           | 33,992              |                                | 1,209                |
| BID 1983AB                           | 270,470              | -                | -                   | 39,241  | -  | (11,060)                     | (85,306)           | 9,681               |                                | 1,488                |
| <b>TOTAL IN FOREIGN CURRENCY</b>     | <b>5,672,821</b>     | <b>564,886</b>   | <b>(2,556)</b>      | <b>915,889</b>  | <b>63,457</b>  | <b>(240,736)</b>             | <b>(566,942)</b>   | <b>191,462</b>      |                                | <b>64,521</b>        |

*CURRENCY*

*Overall Total* 12,100,966,130 (5,577) 982,072 73,824(732,048) (1,678,748) 563,902 198,061

(\*) amount related to accrued interest which as part of the contract asset.

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## Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2018, 2017 and 2016

Amounts in thousands of reais, unless otherwise indicated

|                                  | December<br>31, 2016 | Funding          | Borrowings<br>costs | Lease         | Monetary<br>variation<br>and<br>exchange<br>rate<br>changes | Inflation<br>adjustment /<br>update<br>interest -<br>Capitalized | Interest<br>and fees<br>paid | Amortization       | Accrued<br>interest | Interest and<br>fees –<br>Capitalized<br>(*) |
|----------------------------------|----------------------|------------------|---------------------|---------------|---|--|------------------------------|--------------------|---------------------|--|
| <b>LOCAL CURRENCY</b>            |                      |                  |                     |               |   |  |                              |                    |                     |  |
| Debentures                       | 3,641,912            | 500,000          | (1,157)             | -             | 51,768  |  | -(301,493)                   | (597,794)          | 176,780             | 103,215                                      |
| Brazilian<br>Federal             |                      |                  |                     |               |   |  |                              |                    |                     |  |
| Savings Bank                     | 1,150,691            | 144,654          | -                   | -             | 5,495   | 1,415  | (95,854)                     | (65,836)           | 78,283              | 17,820                                       |
| BNDES                            | 946,984              | 171,153          | -                   | -             | 5,405   | 2,512  | (78,466)                     | (87,993)           | 33,938              | 48,294                                       |
| Leasing                          | 552,516              | -                | -                   | -24,693       | -   | -  | -                            | (15,593)           | -                   | -  |
| Other                            | 11,677               | -                | -                   | -             | 116   | -  | (876)                        | (750)              | 779                 | 31   |
| <b>TOTAL IN LOCAL CURRENCY</b>   | <b>6,303,780</b>     | <b>815,807</b>   | <b>(1,157)</b>      | <b>24,693</b> | <b>62,784</b>   | <b>3,927</b>   | <b>(476,689)</b>             | <b>(767,966)</b>   | <b>289,780</b>      | <b>169,360</b>                               |
| <b>FOREIGN CURRENCY</b>          |                      |                  |                     |               |   |  |                              |                    |                     |  |
| BID                              | 1,811,664            | 96,889           | (2,497)             | -             | (15,193)  | 40,228   | (38,654)                     | (189,280)          | 22,547              | 16,803                                       |
| BIRD                             | 261,337              | 35,710           | -                   | -             | 2,874   | 2,837  | (4,049)                      | -                  | 3,662               | 88   |
| Deutsche<br>Bank                 | 485,090              | -                | (720)               | -             | 7,335   | -  | (31,774)                     | -                  | 21,286              | 11,923                                       |
| Eurobonds                        | 1,141,469            | -                | -                   | -             | 17,115  | -  | (85,338)                     | -                  | 55,046              | 29,529                                       |
| JICA                             | 1,617,215            | 63,909           | (287)               | -             | 82,563  | 2,525  | (28,652)                     | (65,702)           | 27,602              | 1,115  |
| BID 1983AB                       | 343,588              | -                | (82)                | -             | 1,609   | -  | (10,931)                     | (75,610)           | 6,858               | 3,715  |
| <b>TOTAL IN FOREIGN CURRENCY</b> | <b>5,660,363</b>     | <b>196,508</b>   | <b>(3,586)</b>      | <b>-</b>      | <b>96,303</b>   | <b>45,590</b>  | <b>(199,398)</b>             | <b>(330,592)</b>   | <b>137,001</b>      | <b>63,975</b>                                |
| <b>Overall Total</b>             | <b>11,964,143</b>    | <b>1,012,315</b> | <b>(4,743)</b>      | <b>24,693</b> | <b>159,087</b>  | <b>49,517</b>  | <b>(676,087)</b>             | <b>(1,098,558)</b> | <b>426,781</b>      | <b>233,341</b>                               |

(\*) amount related to accrued interest which as part of the contract asset.

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## Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2018, 2017 and 2016

Amounts in thousands of reais, unless otherwise indicated

|                                      | December<br>31, 2015 | Funding        | Borrowings<br>costs | Lease               | Monetary<br>variation<br>and<br>exchange<br>rate<br>changes | Inflation<br>adjustment /<br>update<br>interest -<br>Capitalized | Interest<br>and fees<br>paid | Amortization     | Accrued<br>interest | Interest and<br>fees –<br>Capitalized<br>(*) |
|--------------------------------------|----------------------|----------------|---------------------|---------------------|---|--|------------------------------|------------------|---------------------|--|
| <b>LOCAL CURRENCY</b>                |                      |                |                     |                     |   |  |                              |                  |                     |  |
| Debentures                           | 4,203,127            | -              | (1,241)             | -                   | 105,385   | -  | (375,027)                    | (663,468)        | 214,245             | 154,813                                      |
| Brazilian<br>Federal<br>Savings Bank | 1,067,464            | 113,310        | -                   | -                   | 15,619  | 6,405  | (89,896)                     | (52,315)         | 63,813              | 26,290                                       |
| BNDES                                | 696,329              | 313,072        | (2,242)             | -                   | -   | -  | (55,806)                     | (76,469)         | 38,172              | 33,760                                       |
| Leasing                              | 534,894              | -              | -                   | 32,111              | -   | -  | -                            | (14,489)         | -                   | -  |
| Other                                | 1,962                | 10,014         | -                   | -                   | 31  | -  | (905)                        | (655)            | 1,149               | 8,000  |
| <b>TOTAL IN LOCAL CURRENCY</b>       | <b>6,503,776</b>     | <b>436,396</b> | <b>(3,483)</b>      | <b>32,111</b>       | <b>121,035</b>  | <b>6,405</b>   | <b>(521,634)</b>             | <b>(807,396)</b> | <b>317,379</b>      | <b>214,953</b>                               |
| <b>FOREIGN CURRENCY</b>              |                      |                |                     |                     |   |  |                              |                  |                     |  |
| BID                                  | 2,194,353            | 113,543        | (3,819)             | -                   | (396,817)   | 37,412   | (42,429)                     | (133,063)        | 21,792              | 20,100                                       |
| BIRD                                 | 238,940              | 59,983         | -                   | -                   | (40,213)  | 1,971  | (1,876)                      | -                | 1,916               | 59,983                                       |
| Deutsche<br>Bank                     | -                    | 469,020        | (9,167)             | -                   | 19,845  | -  | -                            | -                | 2,042               | 2,800  |
| Eurobonds                            | 1,922,256            | -              | -                   | -                   | (334,915)   | -  | (128,283)                    | (437,752)        | 69,002              | 50,230                                       |
| JICA                                 | 1,756,969            | 188,755        | (468)               | -                   | (259,455)   | 5,771  | (33,799)                     | (73,854)         | 30,791              | 2,360  |
| BID 1983AB                           | 505,306              | -              | (236)               | -                   | (78,910)  | -  | (11,923)                     | (83,247)         | 6,548               | 4,770  |
| <b>TOTAL IN FOREIGN CURRENCY</b>     | <b>6,617,824</b>     | <b>831,301</b> | <b>(13,690)</b>     | <b>-(1,090,465)</b> | <b>45,154</b>   | <b>(218,310)</b>   | <b>(727,916)</b>             | <b>132,091</b>   | <b>80,871</b>       | <b>80,871</b>                                |

*CURRENCY*

*Overall Total* 13,121,600 1,267,697 (17,173) 32,111 (969,430) 51,559 (739,944) (1,535,312) 449,470 295,82

(\*) amount related to accrued interest which as part of the contract asset.

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****(a) Debentures**

Balance as of December 31, 2018 is stated net of borrowings costs in the amount of R\$5,590 (R\$6,223 as of December 31, 2017), which will be amortized during the same maturity period of each contract.

**(i) Main events****Amortizations**

|                                   | <b>Amount</b> | <b>Maturity</b>   | <b>Interest rates</b> |
|-----------------------------------|---------------|-------------------|-----------------------|
| 17 <sup>th</sup> issue - series 1 | R\$ 144,391   | January 15, 2018  | CDI                   |
| 17 <sup>th</sup> issue - series 2 | R\$ 348,434   | February 15, 2018 | IPCA                  |
| 20 <sup>th</sup> issue            | R\$ 250,000   | December 20, 2018 | CDI                   |
| 10 <sup>th</sup> issue            | R\$ 42,438    | 2018 (*)          | TJLP/IPCA             |
| 12 <sup>th</sup> issue            | R\$ 45,450    | 2018 (*)          | TR                    |
| 14 <sup>th</sup> issue            | R\$ 40,726    | 2018 (*)          | TJLP/IPCA             |
| 18 <sup>th</sup> issue            | R\$ 33,641    | 2018 (*)          | TJLP/IPCA             |

(\*) Amounts paid during the year.

**Funding**

As of February 19, 2018, the Company held the 22nd issue of unsecured debentures, not convertible into shares, totaling R\$ 750 million, in up to three series, for public distribution, with restricted placement efforts, pursuant to CVM Instruction 476/09, distributed as follows:

|          | <b>Amount</b> | <b>Maturity</b> | <b>Remuneration</b> |
|----------|---------------|-----------------|---------------------|
| Series 1 | R\$ 100,000   | 3 years         | CDI + 0.58% p.a.    |
| Series 2 | R\$ 400,000   | 5 years         | CDI + 0.90% p.a.    |
| Series 3 | R\$ 250,000   | 7 years         | IPCA + 6.00% p.a.   |

The proceeds from the debenture issue a allocated to refinance financial commitments and recompose the Company's cash.

**(ii) Covenants**

For the outstanding contracts, the Company has the following restrictive clauses "covenants":

**Applicable to the 10<sup>th</sup> issue, 14<sup>th</sup> issue and 18<sup>th</sup> issue:**

Financial covenants applicable to the 10<sup>th</sup>, 14<sup>th</sup> and 18<sup>th</sup> issues and the financing agreements entered into with the BNDES, except for agreement no. 08.2.0169.1 (PAC):

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The financing agreements entered into with the BNDES specify two ranges in which the Company needs to maintain its Adjusted EBITDA / Adjusted Financial Expenses, Adjusted Net Debt / Adjusted EBITDA, and Other Onerous Debt / Adjusted EBITDA ratios.

These agreements also specify a guarantee mechanism in which the Company needs to ensure that a portion of the monthly receivables amount is daily recorded in a fiduciary account linked to the BNDES. In this process, every day, after the BNDES notifies the depositary bank that the Company is not in default, this portion of the monthly receivables amount is transferred to a Company current account.

The renegotiated/amended covenants are:

A. Maintenance of the following ratios, quarterly calculated and related to accrued amounts over the last 12 months, upon the disclosure of reviewed interim financial statements or audited annual financial statements entails the need to record R\$225.9 million per month in a fiduciary account linked to the BNDES:

- Adjusted EBITDA / Adjusted financial expenses equal to or higher than 3.50;
- Adjusted net debt / Adjusted EBITDA equal to or lower than 3.00;
- Other onerous debt (\*) / Adjusted EBITDA equal to or lower than 1.00.

(\*)“Other Onerous Debts” correspond to the sum of social security liabilities, health care plan, installment payment of tax debts and installment payment of debts with the Electricity supplier.

B. In case of failure to comply with one or more ratios specified in item A, in two or more quarters, consecutive or not, within twelve months, the Company will be failing to comply with the first range of ratios and the portion of the monthly receivables to be recorded in a fiduciary account linked to the BNDES will be automatically increased by 20%, if the ratios are maintained in the following range:

- Adjusted EBITDA / Adjusted financial expenses lower than 3.50 and equal to or higher than 2.80;
- Adjusted net debt / adjusted EBITDA equal to or lower than 3.80 and higher than 3.00;
- Other onerous debt / Adjusted EBITDA equal to or lower than 1.30 and higher than 1.00.

C. The failure to achieve one or more than one ratio stipulated in item B, and/or the Company does not comply with the automatic reinforcement of guarantee under the terms of item B, the Company will be failing to comply with the covenant terms and the BNDES may, at its sole discretion:

- require the creation of additional guarantees, not below 30 days, within term to be defined by it through notice;

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- suspend the release of funds; and/or
- declare the early maturity of the financing agreements.

As of December 31, 2018, the amount of R\$242.9 million was guaranteed for the agreements above (excluding the guarantee of agreement nº 08.2.0169.1).

*Financial covenants applicable to financing agreement no. 08.2.0169.1 entered into with the BNDES:*

- Adjusted EBITDA / adjusted net operating revenue: equal to or higher than 38%;
- Adjusted EBITDA /adjusted financial expenses: equal to or higher than 2.35;
- Adjusted net debt / adjusted EBITDA: equal to or lower than 3.20.

The BNDES will annually verify if the ratios have been complied with by analyzing the annual audited financial statements, which must be presented to the BNDES or published by April 30 of the subsequent year referring to the financial statements. If the Company complies, cumulatively, with the ratios above, the BNDES will reduce the interest stipulated in the agreement from 2.15% p.a. to 1.82% p.a., from June 16 of the year when the analysis is carried out to June 15 of the subsequent year.

The agreements also have a cross default clause, e.g., the early maturity of any of the Company's debts, the amount of which may anyhow compromise the settlement of its obligations provided for in the Indenture deed shall imply the early maturity of such agreement.

**Applicable to the 12<sup>th</sup> issue:**

Calculated every quarter upon the disclosure of interim or annual financial statements:

- Adjusted current ratio (current assets divided by current liabilities, excluding from current liabilities the current portion of noncurrent debts incurred by the Company that are recorded in current liabilities) higher than 1.0;
  
- EBITDA to paid financial expenses ratio equal to or higher than 1.5;
  
- Disposal of operating assets, extinguishment of license, loss of concession or loss of Issuer's capacity to execute and operate the basic sanitation public utilities in areas of the State of São Paulo territory, which considered individually or jointly during the contract's effectiveness, result in a reduction of net sales revenue and/or services revenue of the Issuer exceeding twenty-five percent (25%). The limit established above will be calculated quarterly, taking into account the Issuer's operating income for the twelve (12) months preceding the end of each quarter and applying the financial information disclosed by the Issuer; and

Noncompliance with these obligations only will be characterized when verified in its interim financial statements, during at least, two consecutive quarters, or also two nonconsecutive quarters within a twelve-month period.



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In case of noncompliance with the covenants, the trustee should call an extraordinary debenture holders' meeting within 48 hours from the acknowledgement of the noncompliance to resolve on the declaration of early maturity of the debentures.

This issue has an early maturity clause, in case there is a downgrade, by more than two levels, of the “brAA-” risk rating in national scale originally attributed to this issue’s Debentures by the Rating Agency, always taking into consideration the Standard & Poor’s rating table. As of December 31, 2018, SABESP’s rate was “brAAA”.

The agreement also has a cross default clause, i.e. the early maturity of any of the Company’s debts, equal to or exceeding R\$50 million, adjusted by IPCA variation as of the issue date, due to contractual default, the amount of which may anyhow compromise the settlement of the Company’s monetary obligations arising from the Issue, shall imply the early maturity of this agreement.

**Applicable to the 15<sup>th</sup> issue, 17<sup>th</sup> issue and 20<sup>th</sup> issues:**

Calculated every quarter upon the disclosure of interim or annual financial statements:

- Adjusted total Debt/EBITDA: lower than or equal to 3.65;

- EBITDA/ paid financial expenses: equal to or higher than 1.5;

- Disposal of operating assets, extinguishment of license, loss of concession or loss of Issuer's capacity to execute and operate the basic sanitation public utilities in areas of the State of São Paulo territory, which considered individually or jointly during the contract's effectiveness, result in a reduction of net sales revenue and/or services revenue of the Issuer exceeding twenty-five percent (25%). The limit established above will be calculated quarterly, taking into account the Issuer's operating income for the twelve (12) months preceding the end of each quarter and applying the financial information disclosed by the Issuer; and

Non-compliance with the covenant clauses, during, at least, two consecutive quarters, or also two nonconsecutive quarters within a twelve-month period shall result in the early maturity of the agreement.

The agreements have a cross acceleration clause, i.e., the early maturity of any of the Company's debts, equal to or exceeding R\$90 million (for the 20th issue, amount equal to or exceeding R\$120 million), adjusted by IPCA variation as of the issue date, due to contractual default, the amount of which may compromise the settlement of the Company's monetary obligations arising from the Issue, will result in the early maturity of these agreements.

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**Applicable to 21<sup>st</sup> and 22<sup>st</sup> issues:**

Calculated every quarter upon the disclosure of interim or annual financial statements:

- Net debt/ EBITDA: lower than or equal to 3.65;

- EBITDA/ paid financial expenses: equal to or higher than 1.5;

- Disposal of operating assets, extinguishment of license, loss of concession or loss of Issuer's capacity to execute and operate the basic sanitation public utilities in areas of the State of São Paulo territory, which considered individually or jointly during the deed's effectiveness, result in a reduction of net sales revenue and/or services revenue of the Issuer exceeding twenty-five percent (25%). The limit established above will be calculated quarterly, taking into account the Issuer's operating income for the twelve (12) months preceding the end of each quarter and applying the financial information disclosed by the Issuer.

Non-compliance with the covenant clauses, during, at least, two consecutive quarters, or also two nonconsecutive quarters within a twelve-month period shall result in the early maturity of the agreement.

The agreement have a cross acceleration clause, i.e., the early maturity of any of the Company's debts, equal to or exceeding R\$145 million, adjusted by IPCA variation as of the issue date, result in an event of default that result in the early maturity of these agreements.

**(b) Brazilian Federal Savings Bank - CEF**

**(i) Main events**

Funding totaled R\$194,244 in 2018, mainly related to the agreements in progress of the Growth Acceleration Program (PAC).

In 2018, amortizations totaled R\$85,515.

The guarantee for financing agreements entered into with the Brazilian Federal Savings Bank is the recognition of a portion of tariffs in an account for this purpose with the Brazilian Federal Savings Bank, which should maintain a flow equal to or at least three times the amount of the monthly charges, during the grace period, based on interest, the management fee and the credit risk rate and, during the amortization phase, based on the principal, interest, the management fee and the credit risk rate. Additionally, the Company maintains a reserve account, linked to financing agreements, in the Brazilian Federal Savings Bank, which is maintained during the entire term the agreements, where an amount is accrued equivalent to a monthly charge, composed of, during the grace period, interest, the management fee and the credit risk rate and, during the amortization phase, of the principal, interest, the management fee and the credit risk rate.

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### **(ii) Sanitation to All Program of the Brazilian Federal Savings Bank (CEF)**

On December 28, 2018, SABESP entered into seven financing agreements (twenty-one sub-credits) with the Brazilian Federal Savings Bank, totaling R\$ 652.2 million. The agreements were selected by the Ministry of Cities – City Progress / Sanitation to All Programs. The funds came from the Guarantee Fund for Length of Service - FGTS and will allocated to sanitation services.

### **Covenants**

The agreements have a cross default clause, i.e., the early maturity of any of the Company's debts, due to contractual default, the occurrence of which may anyhow compromise the settlement of its monetary obligations deriving from these contracts shall imply the early maturity.

The agreement has the following covenants:

Calculated every quarter upon the disclosure of interim financial information based on information included in the financial statements for the last twelve (12) months:

Restrict the funding of new debt so that:

- Adjusted EBITDA/ adjusted financial expenses equal to or higher than 2.80;
- Adjusted net debt/adjusted EBITDA: equal to or higher than 3.80;
- Other onerous debt(\*) / adjusted EBITDA lower than or equal to 1.30

(\*) "Other Onerous Debts" correspond to the sum of social security liabilities, health care plan, installment payment of tax debts and installment payment of debts with the electricity supplier.

**(c) BNDES**

Balance as of December 31, 2018 is stated net of borrowings costs in the amount of R\$2,584 (R\$2,793 on December 31, 2017), which will be amortized during the same maturity period of each contract.

**(i) Main events**

In 2018, funding from current contracts totaled R\$131,000, mainly referring to the BNDES 2015 agreement, in the amount of R\$124,000 and BNDES PAC II 9752, in the amount of R\$ 7,000.

In 2018, amortizations totaled R\$102,314.

Loans are collateralized by part of revenues from the provision of water and sewage services, up to the total amount of the outstanding balance.

**(ii) Covenants**

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The agreements entered into with the BNDES have standardized financial covenants, as described in item (a), (ii), covenants applicable to the 10<sup>th</sup> issue, 14<sup>th</sup> issue and 18<sup>th</sup> issue, of this Note.

**(d) Leasing**

The Company has lease agreements signed as Assets Lease. During the construction period, works are capitalized to intangible assets in progress and the lease amount is recorded at the same proportion. Works are estimated to be concluded in 2019.

After startup, the lease payment period starts (240 monthly installments), whose amount is periodically restated by contracted price index.

**(e) Eurobonds**

Balance as of December 31, 2018 is net of borrowing costs in the amount of R\$1,648 (R\$2,470 as of December 31, 2017), which will be amortized during the same maturity period of the contract.

**(i) Covenants**

The contract has the following restrictive clauses “covenants”:

Calculated every quarter upon the disclosure of interim or annual financial statements:

Restrict the funding of new debts so that:

- Adjusted total debt to EBITDA does not exceed 3.65;
- The Company's debt service coverage ratio, determined at the end of each quarter, shall not be lower than 2.35.

Non-compliance with covenants will accelerate the maturity of the agreement.

The agreement has a cross default clause, i.e., the early maturity of any indebtedness in view of the Company's loans or any of its Subsidiaries (\*) with a total principal amount of US\$ 25,000,000.00 or more (or its corresponding amount in other currencies) shall imply this agreement's early maturity.

(\*) As per agreement, subsidiary is: "the company, partnership or another entity from which over 50% of its voting shares are directly or indirectly owned or controlled by any Person or one or other Person's Subsidiaries, or their combination".

**(f) Deutsche Bank US\$150 million**



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Balance as of December 31, 2018 is net of borrowing costs in the amount of R\$2,131 (R\$5,757 as of December 31, 2017), which will be amortized during the maturity period of the contract.

In 2018, amortizations totaled R\$ 268,508.

**(i) Covenants**

The agreement has the following restrictive clauses “covenants”:

Calculated every quarter upon the disclosure of interim or annual financial statements:

- Total debt/adjusted EBITDA: lower than 3.65;
- Company's debt service coverage ratio, determined at the end of each quarter, shall not be lower than 2.35.

Non-compliance with covenants for two quarters, consecutive or not, will accelerate the maturity of the agreement.

The agreement has a “cross acceleration” clause, i.e., in the early maturity of any debt of the Company or any of its subsidiaries, with a total principal or aggregate amount equal to or higher than R\$120 million (or its equivalent in another currency), contracted pursuant to the Brazilian law, or with a total principal or aggregate amount equal to or higher than US\$50 million (or its equivalent in another currency), in the case of debts governed by the laws of any other jurisdiction other than Brazil, will result in the early maturity of the agreement.

(\* Pursuant to the agreement, a subsidiary means any partnership, corporation, company, association or commercial entity in which SABESP or one or more of its subsidiaries directly or indirectly hold more than 50% of the outstanding common shares with voting rights of its respective capital stock.

**(g) Inter-American Development Bank (BID)**

Balance as of December 31, 2018 is net of borrowing costs amounting to R\$15,999 (R\$14,517 as of December 31, 2017), which will be amortized during the same maturity period of the agreement.

**(i) Main events**

In 2018, funding referring to BID 2202 agreement totaled R\$ 484,690 and amortizations totaled R\$ 130,520.

**(ii) Guarantees**

Loans obtained from multilateral agencies and from Government Agencies, such as the BID, BIRD and JICA, are guaranteed by the Federal Government, with a counter-guarantee of the São Paulo State government.

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**(iii) Covenants**

For the outstanding contracts, the Company has the following restrictive clauses “covenants”:

Calculated every quarter upon the disclosure of interim or annual financial statements:

- Loan agreement 1,212 - Tariffs must: (a) produce revenues sufficient to cover the system's operating expenses, including administrative, operating, maintenance, and depreciation expenses; (b) provide a return on property, plant, and equipment no less than 7%; and (c) during project execution, the balances of current loans must not exceed 8.5% of total equity.

These agreements have an early maturity clause, i.e., in the early maturity will occur in the event the Company's fail failure to comply with any obligation therewith or any agreements signed with the Bank related to Project finance.

**(h) Japan International Cooperation Agency - JICA**

**(i) Relevant funding**

Balance as of December 31, 2018 is stated net of borrowing costs amounting to R\$3,113 (R\$3,100 as of December 31, 2017), which will be amortized during the same maturity period of the contract.

**(ii) Main events**

In 2018, the Company raised R\$80,196, referring to BZ-P19 (JICA 19) e BZ-P17 (JICA 17) agreements.

In 2018, amortizations totaled R\$82,608 referring to JICA BZ-15, JICA BZ-17 and JICA BZ-18 agreements.

For the guarantees assigned, see item g (ii) of this note.

**(i) AB Loan (IADB 1983AB)**

The balance stated as of December 31, 2018 is net of borrowing costs amounting to R\$2,322 (R\$3,400 as of December 31, 2017), which will be amortized during the same maturity period of the contract.

**(i) Main events**

In 2018, amortization totaled R\$85,306.

**(ii) Covenants**

The Company has the following restrictive clauses “covenants”:

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Calculated every quarter upon the disclosure of interim or annual financial statements:

- The Company's ratio of debt service coverage, determined on a consolidated basis, must be higher than or equal to 2.35; and

- Total adjusted debt over adjusted EBITDA, determined on a consolidated basis, must be lower than 3.65.

The agreement has an early maturity clause, i.e., in the event of default, the BID may order the early maturity of the loan or part of it.

The agreement also has a "cross default" clause, i.e., in the event of default of any other Company debt with the BID or with third parties (in this case, higher than US\$25 million), the BID may order the early maturity of the loan.

**(j) International Bank for Reconstruction and Development - IBRD**

Balance as of December 31, 2018 is stated net of borrowing costs amounting to R\$290 (R\$310 as of December 31, 2017), which will be amortized during the same maturity period of the contract.

For the guarantees assigned, see item g (ii) of this Note.

**(k) Covenants**

As of December 31, 2018 and 2017, the Company had met the requirements set forth by its borrowings and financing agreements.

**(l) Exchange rate changes**

In 2018, the US dollar appreciated 17.1%, from R\$ 3.3080 on December 31, 2017 to R\$ 3.8748 on December 31, 2018, increasing debt in US dollars by R\$ 675,145, and the yen appreciated 20.0%, from R\$ 0.02940 on December 31, 2017 to R\$ 0.035270 on December 31, 2018, increasing debt in yen by R\$ 337,309.

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**(m) Borrowings and financing – Credit Limits**

| <b>Agent</b>                                  | <b>December 31, 2018</b><br>(in millions of reais (*)) |
|---|--|
| Brazilian Federal Savings Bank                | 1,908  |
| Brazilian Development Bank – BNDES            | 1,455  |
| Japan International Cooperation Agency – JICA | 208  |
| Other   | 38   |
| <b>TOTAL</b>                                  | <b>3,609</b>   |

(\* ) Brazilian Central Bank’s exchange rate as of December 30, 2018 ( ¥1.00 = R\$0.03527).

SABESP in order to comply with its Capex plan relies on a fund-raising plan.

Financing resources contracted have specific purposes, which have been released for the execution of their respective investments, according to the progress of the works.

**18 Taxes recoverable/payable**

**(a) Current assets**

|  | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|--|--------------------------|--------------------------|
| <b>Recoverable taxes</b>                               |                          |                          |
| Income tax and social contribution                     | 361,758                  | 270,614                  |
| Withholding income tax (IRRF) on financial investments | 6,423                    | 2,606                    |
| Other federal taxes                                    | 12,522                   | 3,365                    |
| Total  | 380,703                  | 276,585                  |

The increase in recoverable taxes is mainly due to the increase in the “income tax and social contribution” item, referring to the estimates paid are higher that the amounts due in the year.



**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****(b) Current liabilities**

|  | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|--|--------------------------|--------------------------|
| <b>Taxes and contributions payable</b> |                          |                          |
| Cofins and Pasep                       | 82,381                   | 74,034                   |
| INSS (Social Security contribution)    | 38,871                   | 35,365                   |
| IRRF (withholding income tax)          | 66,825                   | 58,204                   |
| Other                                  | 12,486                   | 16,362                   |
| Total                                  | 200,563                  | 183,965                  |

**19 Deferred taxes and contributions****(a) Statement of financial position details**

|  | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|--|--------------------------|--------------------------|
| <b>Deferred income tax assets</b>                      |                          |                          |
| Provisions   | 337,833                  | 482,863                  |
| Pension obligations - G1                               | 157,044                  | 165,503                  |
| Donations of underlying asset on concession agreements | 54,131                   | 55,112                   |
| Credit losses  | 197,920                  | 199,063                  |
| Other  | 186,887                  | 151,562                  |
| Total deferred tax assets                              | 933,815                  | 1,054,103                |
| <b>Deferred income tax liabilities</b>                 |                          |                          |
| Temporary difference on concession of intangible asset | (433,842)                | (460,177)                |
| Capitalization of borrowing costs                      | (420,978)                | (415,379)                |

|   |             |             |
|---|-------------|-------------|
| Profit on supply to governmental entities | (206,978)   | (76,705)    |
| Actuarial gain/loss – G1 Plan             | (36,430)    | (36,538)    |
| Construction margin                       | (86,164)    | (88,947)    |
| Borrowing costs                           | (10,665)    | (13,111)    |
| Total deferred tax liabilities            | (1,195,057) | (1,090,857) |
| Deferred tax assets (liabilities), net    | (261,242)   | (36,754)    |

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****(b) Realization**

|  | December 31, 2018 | December 31, 2017 |
|--|-------------------|-------------------|
| <b>Deferred income tax assets</b>      |                   |                   |
| to be realized within 12 months        | 158,294           | 221,999           |
| to be realized after one year          | 775,521           | 832,104           |
| Total deferred tax assets              | 933,815           | 1,054,103         |
| <b>Deferred income tax liabilities</b> |                   |                   |
| to be realized within 12 months        | (32,546)          | (51,520)          |
| to be realized after one year          | (1,162,511)       | (1,039,337)       |
| Total deferred tax liabilities         | (1,195,057)       | (1,090,857)       |
| Deferred tax asset (liabilities)       | (261,242)         | (36,754)          |

**(c) Changes**

|  | December 31, 2017 | Net change | December 31, 2018 |
|--|-------------------|------------|-------------------|
| <b>Deferred income tax assets</b>                      |                   |            |                   |
| Provisions   | 482,863           | (145,030)  | 337,833           |
| Pension obligations - G1                               | 165,503           | (8,459)    | 157,044           |
| Donations of underlying asset on concession agreements | 55,112            | (981)      | 54,131            |
| Credit losses  | 199,063           | (1,143)    | 197,920           |
| Other  | 151,562           | 35,325     | 186,887           |
| Total  | 1,054,103         | (120,288)  | 933,815           |
| <b>Deferred income tax liabilities</b>                 |                   |            |                   |
| Temporary difference on concession of intangible asset | (460,177)         | 26,335     | (433,842)         |
| Capitalization of borrowing costs                      | (415,379)         | (5,599)    | (420,978)         |
| Profit on supply to governmental entities              | (76,705)          | (130,273)  | (206,978)         |
| Actuarial (gain)/loss – G1                             | (36,538)          | 108        | (36,430)          |
| Construction margin                                    | (88,947)          | 2,783      | (86,164)          |
| Borrowing costs  | (13,111)          | 2,446      | (10,665)          |

|  |             |           |             |
|--|-------------|-----------|-------------|
| Total                                  | (1,090,857) | (104,200) | (1,195,057) |
| Deferred tax assets (liabilities), net | (36,754)    | (224,488) | (261,242)   |

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|  | <b>December 31, 2016</b> | <b>Net change</b> | <b>December 31, 2017</b> |
|--|--------------------------|-------------------|--------------------------|
| <b>Deferred income tax assets</b>                      |                          |                   |                          |
| Provisions   | 524,129                  | (41,266)          | 482,863                  |
| Actuarial gain/loss – G1                               | 85,044                   | (85,044)          | -                        |
| Pension obligations - G1                               | 167,922                  | (2,419)           | 165,503                  |
| Donations of underlying asset on concession agreements | 57,317                   | (2,205)           | 55,112                   |
| Credit losses  | 266,757                  | (67,694)          | 199,063                  |
| Other  | 151,247                  | 315               | 151,562                  |
| <b>Total</b>   | <b>1,252,416</b>         | <b>(198,313)</b>  | <b>1,054,103</b>         |
| <b>Deferred income tax liabilities</b>                 |                          |                   |                          |
| Temporary difference on concession of intangible asset | (492,341)                | 32,164            | (460,177)                |
| Capitalization of borrowing costs                      | (374,512)                | (40,867)          | (415,379)                |
| Profit on supply to governmental entities              | (92,365)                 | 15,660            | (76,705)                 |
| Actuarial gain/loss – G1                               | -                        | (36,538)          | (36,538)                 |
| Construction margin                                    | (91,790)                 | 2,843             | (88,947)                 |
| Borrowing costs  | (15,063)                 | 1,952             | (13,111)                 |
| <b>Total</b>   | <b>(1,066,071)</b>       | <b>(24,786)</b>   | <b>(1,090,857)</b>       |
| Deferred tax assets (liabilities), net                 | 186,345                  | (223,099)         | (36,754)                 |

|  | <b>December 31, 2018</b> | <b>December 31, 2017</b> | <b>December 31, 2016</b> |
|--|--------------------------|--------------------------|--------------------------|
| <b>Opening balance</b>   | <b>(36,754)</b>          | <b>186,345</b>           | <b>128,242</b>           |
| Net change in the year:  |                          |                          |                          |
| - corresponding entry to the income statement                          | (224,596)                | (101,517)                | (60,667)                 |
| - corresponding entry to valuation adjustments to equity (Note 21 (b)) | 108                      | (121,582)                | 118,770                  |
| <b>Total net change</b>  | <b>(224,488)</b>         | <b>(223,099)</b>         | <b>58,103</b>            |
| <b>Closing balance</b>   | <b>(261,242)</b>         | <b>(36,754)</b>          | <b>186,345</b>           |

**(d) Reconciliation of the effective tax rate**

The amounts recorded as income tax and social contribution expenses in the financial statements are reconciled to the statutory rates, as shown below:

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

|   | <b>December 31, 2018</b> | <b>December 31, 2017</b> | <b>December 31, 2016</b> |
|---|--------------------------|--------------------------|--------------------------|
| Profit before income taxes                  | 3,912,319                | 3,503,614                | 4,129,054                |
| Statutory rate                              | 34%                      | 34%                      | 34%                      |
| Estimated expense at statutory rate         | (1,330,186)              | (1,191,229)              | (1,403,878)              |
| Tax benefit of interest on equity           | 264,816                  | 245,444                  | 245,637                  |
| Permanent differences                       |                          |                          |                          |
| Provision – Law 4,819/58 - Go (i)           | (46,544)                 | (57,104)                 | (63,039)                 |
| Donations                                   | (13,068)                 | (12,413)                 | (10,987)                 |
| Other differences                           | 47,731                   | 30,998                   | 50,311                   |
| Income tax and social contribution          | (1,077,251)              | (984,304)                | (1,181,956)              |
| Current income tax and social contribution  | (852,655)                | (882,787)                | (1,121,289)              |
| Deferred income tax and social contribution | (224,596)                | (101,517)                | (60,667)                 |
| Effective rate                              | 28%                      | 28%                      | 29%                      |

(i) Permanent difference related to the provision for actuarial liability (Note 21 (b) (iii)).

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****20 Provisions****(a) Lawsuits and proceedings that resulted in provisions****(I) Statement of financial position details**

The Company is party to a number of claims and legal proceedings arising in the normal course of business, including civil, tax, labor and environmental matters. Management recognizes provisions in the financial statements consistently with the recognition and measurement criteria established in Note 3.15. The ultimate timing and amounts of the payments depends on the outcome of the court cases. The provisions, net of escrow deposits are as follows:

|                           | <b>Provisions</b> | <b>Escrow deposits</b> | <b>December 31, 2018</b> | <b>Provisions</b> | <b>Escrow deposits</b> | <b>December 31, 2017</b> |
|---------------------------|-------------------|------------------------|--------------------------|-------------------|------------------------|--------------------------|
| Customer claims (i)       | 290,649           | (43,841)               | 246,808                  | 438,619           | (56,301)               | 382,318                  |
| Supplier claims (ii)      | 67,985            | (24,380)               | 43,605                   | 332,037           | (259,608)              | 72,429                   |
| Other civil claims (iii)  | 98,302            | (13,519)               | 84,783                   | 114,544           | (16,227)               | 98,317                   |
| Tax claims (iv)           | 63,335            | (8,091)                | 55,244                   | 77,100            | (5,507)                | 71,593                   |
| Labor claims (v)          | 302,935           | (10,932)               | 292,003                  | 299,842           | (6,741)                | 293,101                  |
| Environmental claims (vi) | 170,419           | -                      | 170,419                  | 160,446           | -                      | 160,446                  |
| <b>Total</b>              | <b>993,625</b>    | <b>(100,763)</b>       | <b>892,862</b>           | <b>1,422,588</b>  | <b>(344,384)</b>       | <b>1,078,204</b>         |
| Current                   | 458,387           | -                      | 458,387                  | 607,959           | -                      | 607,959                  |
| Noncurrent                | 535,238           | (100,763)              | 434,475                  | 814,629           | (344,384)              | 470,245                  |



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## Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## (II) Changes

|                           | December 31,<br>2017 | Additional<br>provisions | Interest and<br>inflation<br>adjustment | Use of the<br>accrual | Amounts not<br>used<br>(reversal) | December 31,<br>2018 |
|---------------------------|----------------------|--------------------------|---|-----------------------|-----------------------------------|----------------------|
| Customer claims (i)       | 438,619              | 29,732                   | 40,749                                  | (141,421)             | (77,030)                          | 290,649              |
| Supplier claims (ii)      | 332,037              | 36,100                   | 21,161                                  | (308,253)             | (13,060)                          | 67,985               |
| Other civil claims (iii)  | 114,544              | 22,578                   | 12,939                                  | (16,146)              | (35,613)                          | 98,302               |
| Tax claims (iv)           | 77,100               | 10,763                   | 4,157                                   | (2,490)               | (26,195)                          | 63,335               |
| Labor claims (v)          | 299,842              | 83,499                   | 32,290                                  | (44,900)              | (67,796)                          | 302,935              |
| Environmental claims (vi) | 160,446              | 33,392                   | 18,294                                  | (115)                 | (41,598)                          | 170,419              |
| Subtotal                  | 1,422,588            | 216,064                  | 129,590                                 | (513,325)             | (261,292)                         | 993,625              |
| Escrow deposits           | (344,384)            | (53,205)                 | (5,533)                                 | 269,248               | 33,111                            | (100,763)            |
| Total                     | 1,078,204            | 162,859                  | 124,057                                 | (244,077)             | (228,181)                         | 892,862              |

|                           | December 31,<br>2016 | Additional<br>provisions | Interest and<br>inflation<br>adjustment | Use of the<br>accrual | Amounts not<br>used<br>(reversal) | December 31,<br>2017 |
|---------------------------|----------------------|--------------------------|---|-----------------------|-----------------------------------|----------------------|
| Customer claims (i)       | 572,210              | 26,642                   | 44,805                                  | (138,466)             | (66,572)                          | 438,619              |
| Supplier claims (ii)      | 332,667              | 23,017                   | 36,888                                  | (39,433)              | (21,102)                          | 332,037              |
| Other civil claims (iii)  | 131,286              | 13,517                   | 12,057                                  | (19,975)              | (22,341)                          | 114,544              |
| Tax claims (iv)           | 69,898               | 6,877                    | 7,392                                   | (259)                 | (6,808)                           | 77,100               |
| Labor claims (v)          | 285,413              | 55,106                   | 38,861                                  | (43,498)              | (36,040)                          | 299,842              |
| Environmental claims (vi) | 150,084              | 32,377                   | 16,156                                  | (24,585)              | (13,586)                          | 160,446              |
| Subtotal                  | 1,541,558            | 157,536                  | 156,159                                 | (266,216)             | (166,449)                         | 1,422,588            |
| Escrow deposits           | (368,483)            | (29,089)                 | (7,823)                                 | 15,354                | 45,657                            | (344,384)            |
| Total                     | 1,173,075            | 128,447                  | 148,336                                 | (250,862)             | (120,792)                         | 1,078,204            |

|                           | <b>December 31,<br/>2015</b> | <b>Additional<br/>provisions</b> | <b>Interest and<br/>inflation<br/>adjustment</b> | <b>Use of the<br/>accrual</b> | <b>Amounts not<br/>used<br/>(reversal)</b> | <b>December 31,<br/>2016</b> |
|---------------------------|------------------------------|----------------------------------|--|-------------------------------|--|------------------------------|
| Customer claims (i)       | 561,061                      | 109,540                          | 95,459   | (87,334)                      | (106,516)                                  | 572,210                      |
| Supplier claims (ii)      | 296,660                      | 12,885                           | 43,679   | (20,018)                      | (539)                                      | 332,667                      |
| Other civil claims (iii)  | 124,833                      | 20,638                           | 19,940   | (8,080)                       | (26,045)                                   | 131,286                      |
| Tax claims (iv)           | 62,812                       | 20,716                           | 14,265   | (4,621)                       | (23,274)                                   | 69,898                       |
| Labor claims (v)          | 283,991                      | 51,408                           | 29,419   | (37,072)                      | (42,333)                                   | 285,413                      |
| Environmental claims (vi) | 83,520                       | 68,485                           | 23,508   | -                             | (25,429)                                   | 150,084                      |
| Subtotal                  | 1,412,877                    | 283,672                          | 226,270  | (157,125)                     | (224,136)                                  | 1,541,558                    |
| Escrow deposits           | (330,663)                    | (38,269)                         | (27,153)   | 9,601                         | 18,001                                     | (368,483)                    |
| Total                     | 1,082,214                    | 245,403                          | 199,117  | (147,524)                     | (206,135)                                  | 1,173,075                    |

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****(b) Lawsuits deemed as contingent liabilities**

The Company is party to lawsuits and administrative proceedings relating to environmental, tax, civil and labor claims, which are assessed as contingent liabilities in the financial statements, since it either does not expect outflows to be required or the amount of the obligation cannot be reliably measured. Contingent liabilities are represented as follows:

|                           | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|---------------------------|--------------------------|--------------------------|
| Customer claims (i)       | 207,600                  | 219,900                  |
| Supplier claims (ii)      | 1,459,100                | 1,430,600                |
| Other civil claims (iii)  | 719,300                  | 733,100                  |
| Tax claims (iv)           | 1,439,100                | 1,291,000                |
| Labor claims (v)          | 624,200                  | 677,400                  |
| Environmental claims (vi) | 4,343,800                | 3,879,000                |
| Total                     | 8,793,100                | 8,231,000                |

**(c) Explanation on the nature of main classes of lawsuits****(i) Customer claims**

Approximately 890 lawsuits (1,070 as of December 31, 2017) were filed by commercial customers, who claim that their tariffs should correspond to other consumer categories, and 490 lawsuits (680 as of December 31, 2017) in which customers claim a reduction in the sewage tariff due to losses in the system, consequently requesting the refund of amounts charged by the Company and 40 lawsuits (50 as of December 31, 2017) in which customers plead the reduction in tariff under the category as “Social Welfare Entity”. The Company was granted both favorable and unfavorable final decisions at several court levels. The R\$ 135,510 decrease in accrued lawsuits was mainly due to payments in the period, and revisions of expectations arising from court decisions in the period.

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

**(ii) Supplier claims**

These lawsuits include lawsuits filed by some suppliers alleging underpayment of monetary restatements, withholding of amounts related to the understated inflation rates deriving from Real economic plan, and the economic and financial imbalance of the agreements, and are in progress at different courts. The R\$ 28,824 decrease in accrued lawsuits was mainly due to payments in the period.

**(iii) Other civil claims**

These mainly refer to indemnities for property damage, pain and suffering, and loss of profits allegedly caused to third parties, such as vehicle accidents, claims, challenges on the methodology to collect tariffs, among others, filed at different court levels.

**(iv) Tax claims**

Tax claims refer mainly to issues related to tax collections and fines in general challenged due to disagreements regarding notification or differences in the interpretation of legislation by the Company's Management. The R\$ 16,349 decrease in accrued lawsuits was mainly due to revisions of expectations arising from court decisions in the period. The R\$ 148,100 increase in lawsuits deemed as contingent liabilities is mainly related to the update of lawsuits in progress.

(a) In 2006, the Brazilian Federal Revenue Service, by means of a tax execution, verified the Company's compliance with the tax obligations related to income tax and social contribution for calendar year 2001, and issued a tax

assessment adjusted through December 31, 2018 in the amount of R\$ 53,430 (R\$ 52,192 as of December 31, 2017). The Company appealed this recognition and was granted a partial relief in the first administrative instance. In December 2015, it filed a Voluntary Appeal against the part of the decision that was unfavorable to it. In March 2018, a decision for production of more evidence was published. Management considers that this administrative proceeding is deemed as a possible disbursement.

(b) The municipality of São Paulo, through law, revoked the services tax exemption which until then the company withheld and thereafter issued tax deficiency notices related to the sewage service and ancillary activities, in the updated amount of R\$ 605,008 (R\$ 547,510 as of December 31, 2017), which currently are subject-matter of Tax Foreclosures, deemed by the Management as contingent liabilities. SABESP filed a writ of mandamus against this revocation, which was rejected. Writs of prevention and actions for annulment were also filed, aiming the suspension of enforceability of credits and the annulment of tax deficiency notices, as it understands that notwithstanding the exemption revocation, the sewage activities and ancillary activities are not included in the list of activities subject to taxation by municipality. The appellate decision was favorable to the Company. The Municipality's special and extraordinary appeal is still pending. The Company's Management deemed the proceeding as contingent liability.

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(c) The Federal Revenue Service rejected some offset requests made by the Company for the extinction of IRPJ/CSLL payable, using favorable amounts, arising from undue payments of IRPJ/CSLL, which were paid based on monthly estimates. The amount involved was adjusted through December 31, 2018 and is R\$ 36,070 (R\$ 42,173 as of December 31, 2017). Management considers that this administrative proceeding is deemed as a possible disbursement.

(d) The Company's request for an authorization to offset taxes was rejected, overdue in the periods of July, August and September 2002 against the amount of IRPJ paid in excess in 1997 and 1998, due to inflation adjustment over the financial statements (Law 8,200/91), which was anticipated in 1996 due to an injunction, after excluded due discontinuance of proceeding and application of Provisional Measure 38/02. The Administrative Council of Tax Appeals rejected the credit from 1997. The amount involved was adjusted through December 31, 2018 and is estimated at R\$ 52,427 (R\$ 51,374 as of December 31, 2017). Management considers that this administrative proceeding is deemed as a possible disbursement.

(e) Some municipalities have filed several lawsuits against SABESP related to taxes and fines in general, which were accrued and deemed as contingent liabilities. As of December 31, 2018, the restated amounts of such lawsuits were R\$ 17,682 (R\$ 40,123 as of December 31, 2017) and R\$ 677,786 (R\$ 582,168 as of December 31, 2017), respectively.

**(v) Labor claims**

The Company is a party to labor lawsuits, involving issues such as overtime, shift schedule, health hazard premium and hazardous duty premium, prior notice, change of function, salary equalization, service outsourcing and other. Part of the amount involved is in provisional or final execution at various court levels. The R\$ 53,200 decrease in lawsuits deemed as contingent liabilities is mainly due to the revision of expectations arising from court decisions in the year.



**(vi) Environmental claims**

These refer to several administrative proceedings and lawsuits filed by government entities, including Companhia de Tecnologia de Saneamento Ambiental – Cetesb and the Public Prosecution Office of the State of São Paulo, that aim affirmative and negative covenants and penalty is estimated due to failure to comply in addition to the imposition of indemnity due to environmental damages allegedly caused by the Company. The amounts accrued represent the best estimate of the Company at this moment, however, may differ from the amount to be disbursed as indemnity to alleged damages, in view of the current stage of referred proceedings. The R\$ 464,800 increase in lawsuits deemed as contingent liabilities is mainly due to the new lawsuits filed and updates on lawsuits in progress.

Among the main lawsuits the Company is involved, there are public civil actions the subject-matters of which are: a) sentence SABESP to restrain itself from discharging or releasing sewage without due treatment; b) invest in the water and sewage treatment system of the municipality, under the penalty of paying a fine; c) payment of indemnity due to environmental damages, amongst others.

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### **(d) Other concession-related legal proceedings**

The Company is a party to concessions-related proceedings, where it challenges compensatory issues for the resumption of water supply and sewage collection services by some municipalities or the right to continue operating said services.

The amount of intangible assets related to the municipalities mentioned in the lawsuits mentioned below totaled R\$ 114,335 as of December 31, 2018 (R\$ 114,335 as of December 31, 2017), of which R\$ 109,990 (items “c” to “h”) reclassified to indemnities receivable in current and noncurrent assets, and estimated losses in the full amount of the claim were recorded, in previous periods. All municipalities mentioned below are not operated by the Company. When a municipality is awarded a final and unappealable favorable sentence, allowing it to repossess sanitation service assets and operations, the Brazilian legislation provides for the indemnity of the Company’s investments.

(a) Cajobi filed an action to recover possession against SABESP, which was granted relief to maintain the municipality in the possession of water and sewage assets; the likelihood of the Company resuming operations is remote. As of February 18, 2018, the appeal filed in the Appellate Court was denied. SABESP filed a special appeal. Meanwhile, SABESP has filed a motion against the municipality of Cajobi aiming at the enumeration and appraisal of the concession assets, which is in the forensic accounting stage and will support the subsequent filing of an action for damages;

(b) Macatuba filed an action to recover possession against SABESP, which was granted relief; the likelihood of the Company resuming operations is remote. The lawsuit is currently awaiting judgment of the special appeal filed by SABESP. Meanwhile, SABESP has filed an appeal requesting the payment by the municipality of indemnity related to non-amortized reversible assets. The action is in the forensic accounting stage. In this same action, the municipality of Macatuba counterclaimed because it believes that SABESP earned, through the collection of tariffs, more than the amount invested in the water and sewage system, requesting that the Company be sentenced to pay an indemnity to be calculated by forensic experts, which is deemed as a contingent liability;

(c) The Company filed a repossession action against the municipality of Álvares Florence, which was deemed groundless in an unappealable judgment. SABESP also filed an action for damages, requiring the payment related to non-amortized reversible assets. The Court sentenced the municipality to comply with the terms of the agreement. The municipality then filed motion and the appeal is pending judgment;

(d) Embaúba filed a repossession action against SABESP, which was granted relief to maintain the municipality in the possession of water and sewage assets and was issued a final and unappealable decision. The indemnity action was judged groundless in first instance and upheld by the Court of Justice. The appeal filed by SABESP in the Superior Court of Justice was not known;

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(e) Araçoiaba da Serra filed a repossession action against SABESP, which was granted relief to maintain the municipality in the possession of water and sewage assets and was issued a final and unappealable decision. SABESP filed an indemnity action, which is in progress, in the forensic expert stage;

(f) Itapira filed a repossession action against SABESP, which was granted relief to maintain the municipality in the possession of water and sewage assets, which was issued final and unappealable decision. SABESP filed an indemnity action, which was held valid to determine the reimbursement of R\$ 16,554, which must be adjusted for inflation as from the filing of the lawsuit (February 2008). This decision may be challenged.

(g) Tuiuti, through an action, obtained the right to continue operating water and sewage services. However, in a counter-claim, the municipality was sentenced to pay an indemnity, as a final decision that became an execution object by SABESP. As of December 7, 2016, an official communication was issued requesting the payment of the award;

(h) Mauá is a defendant in a lawsuit filed by SABESP in 1996, in order to receive indemnification for its investments during the period of the concession agreement. The court found for the plaintiff and the decision was executed. The lawsuit is currently pending payment through registered warranties.

**(e) Environmental lawsuits with settlements entered into in 2018**

In 2018, the Company entered into several legal and administrative agreements totaling R\$ 48,353. Of this amount, R\$ 46,538 is related to the construction and R\$ 1,835 to environmental indemnifications, recorded under “other liabilities”. The accumulated balance as of December 31, 2018, corresponding to environmental indemnifications, totaled R\$ 44,828 (R\$ 43,014 as of December 31, 2017).



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**(f) Guarantee insurance for escrow deposit**

The Company contracts guarantee insurance for escrow deposit, which was renewed as of May 25, 2017, in the amount of R\$ 500 million. Such insurance will be used to settle legal claims instead of have immediate cash disbursement by the Company, such insurance is used until the conclusion of these proceedings limited to up to five years.

In 2018, the Company used R\$ 160,377 of the total contracted amount (R\$ 101,192 in 2017). The amount of R\$ 471,556 is currently outstanding from the current contract.

**21 Employees benefits**

**(a) Health benefit plan**

The health benefit plan is managed by Sabesprev and consists of optional, free choice, health plans sponsored by contributions of SABESP and the active participants, as follows:

. Company: 7.2% (December 31, 2017 – 7.7%) on average, of gross payroll;

. Participating employees: 3.21% of base salary and premiums, equivalent to 2.5% of payroll, on average.

**(b) Pension plan benefits**

|  | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|--|--------------------------|--------------------------|
| <b>Funded plan – G1 (i)</b>  |                          |                          |
| Present value of defined benefit obligations                               | 2,532,338                | 2,319,841                |
| Fair value of the plan's assets  | (2,168,436)              | (1,931,380)              |
| Net liabilities recognized for defined benefit obligations                 | 363,902                  | 388,461                  |
| <b>Unfunded plan – G0 (iii)</b>  |                          |                          |
| Present value of defined benefit obligations                               | 2,606,107                | 2,543,877                |
| Net liabilities recognized for defined benefit obligations                 | 2,606,107                | 2,543,877                |
| Liability as per statement of financial position – pension obligations (*) | <b>2,970,009</b>         | <b>2,932,338</b>         |

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

Despite the decrease in interest rate in the year, the decrease of actuarial deficit was mainly due to the higher profitability of the plan's assets.

Pursuant to IAS19, the Company recognizes gains/(losses), due to changes in assumptions under equity, as valuation adjustments to equity, as shown below:

|   | <b>G1 Plan</b> | <b>G0 Plan</b> | <b>Total</b> |
|---|----------------|----------------|--------------|
| As of December 31, 2018                               |                |                |              |
| Actuarial gains/(losses) on obligations               | (114,188)      | (10,783)       | (124,971)    |
| Gains/(losses) on financial assets                    | 113,869        | -              | 113,869      |
| Total gains/(losses)                                  | (319)          | (10,783)       | (11,102)     |
| Deferred income tax and social contribution - G1 Plan | 108            | -              | 108          |
| Valuation adjustments to equity                       | (211)          | (10,783)       | (10,994)     |

|   | <b>G1 Plan</b> | <b>G0 Plan</b> | <b>Total</b> |
|---|----------------|----------------|--------------|
| As of December 31, 2017                               |                |                |              |
| Actuarial gains/(losses) on obligations               | 305,511        | 51,535         | 357,046      |
| Gains/(losses) on financial assets                    | 52,083         | -              | 52,083       |
| Total gains/(losses)                                  | 357,594        | 51,535         | 409,129      |
| Deferred income tax and social contribution - G1 Plan | (121,582)      | -              | (121,582)    |
| Valuation adjustments to equity                       | 236,012        | 51,535         | 287,547      |

|   | <b>G1 Plan</b> | <b>G0 Plan</b> | <b>Total</b> |
|---|----------------|----------------|--------------|
| As of December 31, 2016                               |                |                |              |
| Actuarial gains/(losses) on obligations               | (541,783)      | (241,711)      | (783,494)    |
| Gains/(losses) on financial assets                    | 192,458        | -              | 192,458      |
| Total gains/(losses)                                  | (349,325)      | (241,711)      | (591,036)    |
| Deferred income tax and social contribution - G1 Plan | 118,770        | -              | 118,770      |
| Valuation adjustments to equity                       | (230,555)      | (241,711)      | (472,266)    |



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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****(i) G1 Plan**

The Company sponsors a defined benefit pension plan for its employees ("G1 Plan"), which is managed by Sabesprev, receives similar contributions established in a plan of subsidy of actuarial study of Sabesprev, as follows:

- 0.99% of the portion of the salary of participation up to 20 salaries; and
- 8.39% of the surplus, if any, of the portion of the salary of participation over 20 salaries.

As of December 31, 2018, SABESP had a net actuarial liability of R\$363,902 (R\$388,461 as of December 31, 2017) representing the difference between the present value of the Company's defined benefit obligations to the participating employees, retired employees, and pensioners; the fair value of the plan's assets.

|   | <b>2018</b> | <b>2017</b> |
|---|-------------|-------------|
| Defined benefit obligation, beginning of the year               | 2,319,841   | 2,465,721   |
| Current service cost  | 13,905      | 17,582      |
| Interest cost   | 213,201     | 260,409     |
| Actuarial (gains)/losses recorded as other comprehensive income | 114,188     | (305,511)   |
| Benefits paid   | (128,797)   | (118,360)   |
| Defined benefit obligation, end of the year                     | 2,532,338   | 2,319,841   |

Below, the change of fair value of the plan during the year:

|  | <b>2018</b> | <b>2017</b> |
|--|-------------|-------------|
| Fair value of the plan's assets, beginning of the year | 1,931,380   | 1,712,551   |

|   |           |           |
|---|-----------|-----------|
| Expected return on the plan assets                              | 179,449   | 183,689   |
| Expected Company's contributions                                | 36,199    | 48,742    |
| Expected participants' contributions                            | 36,336    | 52,675    |
| Benefits paid   | (128,797) | (118,360) |
| Actuarial gains/(losses) recorded as other comprehensive income | 113,869   | 52,083    |
| Fair value of the plan's assets, end of the year                | 2,168,436 | 1,931,380 |
| (Deficit)/Surplus   | (363,902) | (388,461) |

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

The amounts recognized in the year are as follows:

|                                      | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|--------------------------------------|-------------|-------------|-------------|
| Current service expenses             | (22,431)    | (35,093)    | 13,562      |
| Interest cost rate                   | 213,201     | 260,409     | 285,227     |
| Expected return on the plan's assets | (179,449)   | (183,689)   | (201,778)   |
| Total expenses                       | 11,321      | 41,627      | 97,011      |

In 2018, the expenses related to defined pension plan amounting to R\$7,530, R\$1,133 and R\$704 (R\$35,156, R\$1,864 and R\$619 in 2017 and R\$60,263, R\$7,982 and R\$24,557 in 2016), were recorded in operating costs, selling and administrative expenses, respectively. The amount of R\$1,955 was capitalized in assets (R\$3,988 in 2017 and R\$4,209 in 2016).

|  | <b>2019</b> |
|--|-------------|
| Estimated expenses                       |             |
| Service cost                             | 8,610       |
| Interest cost rates                      | 224,429     |
| Participants' contribution               | (31,712)    |
| Net profitability on financial assets    | (192,965)   |
| Expense to be recognized by the employer | 8,362       |

Actuarial assumptions:

|                                     | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|-------------------------------------|-------------|-------------|-------------|
| Discount rate – actual rate (NTN-B) | 4.91% p.a.  | 5.35% p.a.  | 5.74% p.a.  |
| Inflation rate                      | 4.01% p.a.  | 3.96% p.a.  | 4.87% p.a.  |
| Expected rate of return on assets   | 9.12% p.a.  | 9.52% p.a.  | 10.89% p.a. |

|                        |            |            |            |
|------------------------|------------|------------|------------|
| Future salary increase | 6.09% p.a. | 6.04% p.a. | 6.97% p.a. |
| Mortality table        | AT-2000    | AT-2000    | AT-2000    |

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

The number of active participants as of December 31, 2018 was 4,056 (4,317 as of December 31, 2017), and of inactive participants was 7,149 (6,978 as of December 31, 2017).

The benefit to be paid of G1 pension plan, expected for 2019 is R\$177,516.

The contributions of the Company and participants of Plan G1 in 2018 were R\$ 36,199 (R\$ 48,742 in 2017) and R\$ 36,336 (R\$ 52,047 in 2017), respectively. Of this amount, the Company and the participants' payments corresponding to the actuarial deficit of the G1 funded plan in 2018, totaled R\$ 26,672 and R\$ 16,832, respectively.

**Sensitivity analysis of the defined benefit pension plan as of December 31, 2017 regarding the changes in the main assumptions are:**

| <b>Plan – G1</b>   | <b>Change in assumption</b> | <b>Impact on present value of the defined benefit obligations</b> |
|--------------------|-----------------------------|---|
| Discount rate      | Increase of 1.0%            | Decrease of R\$263,661  |
|                    | Decrease of 1.0%            | Increase of R\$319,455  |
| Life expectation   | Increase of 1 year          | Increase of R\$48,558   |
|                    | Decrease of 1 year          | Decrease of R\$49,705   |
| Wage increase rate | Increase of 1.0%            | Increase of R\$31,418   |
|                    | Decrease of 1.0%            | Decrease of R\$27,019   |

**Plan's assets**

The plan's investment policies and strategies are aim at getting consistent returns and reduce the risks associated to the utilization of financial assets available on the Capital Markets through diversification, considering factors, such as the liquidity needs and the long-term nature of the plan liability, types and availability of financial instruments in the local

and international markets, general economic conditions and forecasts as well as requirements under the law. The plan's asset allocation management strategies are determined with the support of reports and analysis prepared by Sabesprev and independent financial advisors:

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

|                                       |     | <b>December 31, 2018</b> | <b>December 31, 2017</b> |
|---------------------------------------|-----|--------------------------|--------------------------|
| Fixed income                          |     |                          |                          |
| - NTNBs                               |     | 1,225,738                | 1,064,935                |
| - NTNCs                               |     | 163,966                  | 146,495                  |
| Government bonds in own portfolio     | (a) | 1,389,704                | 1,211,430                |
| Fixed income fund quotas              | (b) | 87,939                   | 260,352                  |
| Private credit investment fund quotas | (c) | -                        | 135,454                  |
| Debentures                            |     | -                        | 3,902                    |
| Total fixed income                    |     | 1,477,643                | 1,611,138                |
| Equities                              |     |                          |                          |
| Stocks investment fund quotas         | (d) | 249,740                  | 195,459                  |
| Shares                                |     | -                        | 3,903                    |
| Total equities                        |     | 249,740                  | 199,362                  |
| Structured investments                |     |                          |                          |
| Equity investment fund quotas         | (e) | 121,043                  | 86,193                   |
| Real estate investment fund quotas    | (f) | -                        | 27,170                   |
| Multimarket investment fund quotas    | (g) | 310,785                  | -                        |
| Total structured investments          |     | 431,828                  | 113,363                  |
| Other                                 | (h) | 9,225                    | 7,517                    |
| Fair value of the plan's assets       |     | 2,168,436                | 1,931,380                |

(a) Fixed income: it is composed of government bonds issued by the National Treasury, between 2024 and 2055. These instruments are indexed by NTN-b indexed by IPCA (Extended Consumer Price Index) and NTN-c indexed by IGPM (General Market Price Index).

(b) Fixed Income Fund Quotas: investment funds that seek return on fixed income assets and shall have at least, 80% of the portfolio in directly related assets, summed up via derivatives to the risk factor.



(c) Private Credit Investment Fund Quotas: funds that seek return by means of the acquisition of operations representing corporate debts or disseminated receivables portfolios (rights or bonds), originated and sold by several assignors who anticipate funds and have receivables from several business activities as guarantee.

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(d) Equities: equity fund composed of Brazilian companies' stocks listed at B3.

(e) Equity Investment Fund Quotas: it is composed of a closed-ended investment fund. The assets under its management are destined to the acquisition of stocks, debentures, warrants or other securities convertible or swappable into shares issued by companies trading in stock exchanges or not.

(f) Real Estate Investment Fund Quotas: Funds investing in real estate projects (commercial buildings, shopping centers, hospitals, etc.). The return on capital invested occurs by sharing the Fund's proceeds or sale of its quotas in the Fund.

(g) Multimarket Investment Fund Quotas: Investment funds that use several investment strategies available in the capital markets in order to obtain return higher than the CDI.

(h) Other: Investment fund quotas in global companies' stocks, mostly US companies, borrowings, real estate, etc., reducing operational and contingent liabilities.

Restrictions with respect to asset portfolio investments, in the case of federal government securities:

i) instruments securitized by the National Treasury will not be permitted;

ii) derivative instruments must be used for hedge.

Restrictions with respect to asset portfolio investments, in the case of variable-income securities for internal management, are as follows:

- i) day-trade operations will not be permitted;
- ii) sale of uncovered share is prohibited;
- iii) swap operations without guarantee are prohibited
- iv) leverage will not be permitted, i.e., operations with derivatives representing leverage of asset or selling short, such operations cannot result in losses higher than invested amounts.

As of December 31, 2018, Sabesprev did not have financial assets issued by the Company in its own portfolio; however, said assets could have been part of the investment fund portfolio invested by the Foundation. The real estate held in the portfolio is not used by the Company.

The assets' consolidated profitability came to 11.75% in 2018, exceeding its actuarial target of 9.12% in the same period (INPC + 5.5% p.a.). In 2017, profitability reached 12.02%, also exceeding the variation of the actuarial target for that year, of 7.68%.

Concerning Fixed Income, the strategies focused on federal government bonds prevailed. Said bonds appreciated due to the result of presidential election, which market agents believe may give rise to liberal reforms.

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Concerning Equities, investments appreciated for the same reason, which led to the appreciation of fixed income investments. The return of Ibovespa reached 15.03% in 2018 and 26.86% in 2017.

Structured Investments also appreciated due to the valuation of investees, which are currently more developed than in previous years, in addition to dividend payments in 2018.

### **(ii) Private pension plan benefits – Defined contribution**

As of December 31, 2018, Sabesprev Mais plan, based on defined contribution, had 9,586 active and assisted participants (9,328 as of December 31, 2017).

With respect to the Sabesprev Mais plan, the contributions from the sponsor represent 100% over the total basic contribution from the participants. In 2018, expenses related to the obligation of defined contribution, totaling R\$13,227, R\$1,820 and R\$3,599, were allocated to operating costs, selling expenses and administrative expenses. The amount of R\$2,115 was capitalized in assets. In August 2016, the Company concluded the migration process initiated in 2010 and paid R\$30,891, corresponding to a non-recurring contribution and incentive to participants who migrated, and R\$7,214, corresponding to the previous balance, related to the migration that began in 2010.

The Company has made contributions in the amount of R\$20,762 in 2018 (R\$19,220 as of December 31, 2017).

### **(iii) G0 Plan**

Pursuant to State Law 4,819/58, employees who started providing services prior to May 1974 and retired as an employee of the Company acquired a legal right to receive supplemental pension payments, which rights are referred as "G0 Plan ". The Company pays these supplemental benefits on behalf of the State Government and makes claims

for reimbursements from the State Government, which are recorded as accounts receivable from related parties, limited to the amounts considered virtually certain that will be reimbursed by the State Government. As of December 31, 2018, the Company recorded a defined benefit obligation for the G0 Plan of R\$ 2,606,107 (R\$ 2,543,877 as of December 31, 2017).

|   | <b>2018</b> | <b>2017</b> |
|---|-------------|-------------|
| Defined benefit obligation, beginning of the year               | 2,543,877   | 2,512,080   |
| Current interest expense and service costs                      | 232,248     | 262,873     |
| Actuarial (gains)/losses recorded as other comprehensive income | 10,783      | (51,535)    |
| Benefits paid   | (180,801)   | (179,541)   |
| Defined benefit obligation, end of the year                     | 2,606,107   | 2,543,877   |

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The amounts recognized in the income statement are as follows:

|   | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|---|-------------|-------------|-------------|
| Current interest expense and service costs    | 232,248     | 262,873     | 282,117     |
| Amount received from GESP (undisputed amount) | (96,282)    | (95,191)    | (96,709)    |
| Total expenses                                | 135,966     | 167,682     | 185,408     |

In 2018 and 2017, the expenses related to the defined benefit obligation under Plan G0 were recorded in administrative expenses.

|                          | <b>2019</b> |
|--------------------------|-------------|
| Estimated expenses       |             |
| Interest cost rate       | 227,367     |
| Expense to be recognized | 227,367     |

The main actuarial assumptions used:

|                                     | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|-------------------------------------|-------------|-------------|-------------|
| Discount rate – actual rate (NTN-B) | 4.84% p.a.  | 5.30% p.a.  | 5.71% p.a.  |

|                        |            |            |            |
|------------------------|------------|------------|------------|
| Inflation rate         | 4.01% p.a. | 3.96% p.a. | 4.87% p.a. |
| Future salary increase | 6.09% p.a. | 6.04% p.a. | 6.97% p.a. |
| Mortality table        | AT-2000    | AT-2000    | AT-2000    |

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The number of active participants of Plan - Go as of December 31, 2018 and 2017 was 10. The number of beneficiaries, retirees and survivors as of December 31, 2018 was 2,038 (2,294 as of December 31, 2017).

The benefit payable from the Go pension plan expected for 2019 is R\$188,328.

**The sensitivity analysis of defined benefit pension plan as of December 31, 2017 to the changes in the main assumptions is:**

| <b>Plan – G0</b> | <b>Changes in assumption</b> | <b>Impact on present value of the defined benefit obligations</b> |
|------------------|------------------------------|---|
| Discount rate    | Increase of 1.0%             | Decrease of R\$233,665  |
|                  | Decrease of 1.0%             | Increase of R\$275,063  |
| Life expectation | Increase of 1 year           | Increase of R\$81,430   |
|                  | Decrease of 1 year           | Decrease of R\$81,436   |
| Wage growth rate | Increase of 1.0%             | Increase of R\$280,410  |
|                  | Decrease of 1.0%             | Decrease of R\$241,841  |

**(c) Profit sharing**

The Company has a profit-sharing program in accordance with an agreement with labor union and SABESP. The period covered represents the Company fiscal year, from January to December 2018. The limit of the profit sharing is up to one-month salary for each employee, depending on performance goals reached. As of December 31, 2018, the Program’s balance payable was recorded under “salaries, payroll charges and social contributions” in the amount of



R\$ 110,464 (R\$ 94,352 as of December 31, 2017).

**22 Services payable**

The services account records the balances payable, mainly from services received from third parties, such as supply of electric power, reading of hydrometers and delivery of water and sewage bills, cleaning, surveillance and security services, collection, legal counsel services, audit, marketing and advertising and consulting services, among others. This account also includes the amounts payable to the Municipal Fund of Environmental Sanitation and Infrastructure based on a percentage of the revenues from São Paulo local government (Note 15 (c) (v) (6)). The balances as of December 31, 2018 and 2017 were R\$ 454,022 and R\$ 408,275, respectively.

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****23 Knowledge Retention Program**

In June 2018, SABESP implemented the Knowledge Retention Program (PRC), aiming to provide personnel planning conditions and mitigate the impact of the exit of employees who possess strategic knowledge acquired throughout their career.

The period to enroll in the Program was from July 2, 2018 to October 31, 2018; however, the final term was postponed to November 30, 2018. Employment terminations will be carried out based on a previously set schedule, during the validity of the Program, i.e. from January 2, 2019 to December 30, 2020.

For those enrolled in the Program, the compliance with the agreements of the Collective Work Agreement effective on the date of termination is thereby guaranteed. They will also receive a severance incentive proportional to the length of service at SABESP, corresponding to a percentage of the balance of the Guarantee Fund for Length of Service (FGTS), for termination purposes, on the date of termination, as per the table below:

| <b>Length of service at SABESP (years)</b> | <b>% of the Guarantee Fund for Length of Service (FGTS)</b> |
|--|---|
| More than 15                               | 40%   |
| 11 - 15                                    | 30%   |
| 6 - 10                                     | 15%   |
| 0 - 5                                      | 5%  |

In 2018, the Company recorded R\$ 196,472, corresponding to the provision of compensatory payments of employees enrolled in the Program, R\$ 74,324 of which recorded under current liabilities and R\$ 122,148 under noncurrent liabilities.

For employees eligible to the Consent Decree (TAC) entered into with the São Paulo State Prosecution Office in 2009 who joined the Program, the Company reversed R\$ 170,303 in 2018.

As of December 31, 2018 the total provisioned corresponding to TAC was R\$ 140,818, R\$ 136,293 of which was recorded under current liabilities and R\$ 4,525 under noncurrent liabilities.

**24 Equity**

**(a) Authorized capital**

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

On December 13, 2018, the Board of Directors approved a capital increase of R\$ 10,000,000 to R\$ 15,000,000 (authorized limit) with capitalization of part of the investment reserve in the amount of R\$ 5,000,000.

**(b) Subscribed and paid-in capital**

As of December 31, 2018 and 2017, subscribed and paid-in capital was represented by 683,509,869 registered, book-entry common shares with no par value, as follows:

|   | <b>December 31, 2018</b> |                | <b>December 31, 2017</b> |                |
|---|--------------------------|----------------|--------------------------|----------------|
|   | <b>Number of shares</b>  | <b>%</b>       | <b>Number of shares</b>  | <b>%</b>       |
| State Department of Finance   | 343,524,285              | 50,26%         | 343,524,285              | 50,26%         |
| Companhia Brasileira de Liquidação e Custódia (**)                  | 212,612,143              | 31,10%         | 201,026,895              | 29,41%         |
| The Bank of New York ADR Department (equivalent in shares) (*) (**) | 125,278,967              | 18,33%         | 136,790,413              | 20,01%         |
| Other   | 2,094,474                | 0,31%          | 2,168,276                | 0,32%          |
|   | <b>683,509,869</b>       | <b>100,00%</b> | <b>683,509,869</b>       | <b>100,00%</b> |

(\*) each ADR corresponds to 1 share.

(\*\*) custodians

**(c) Distribution of earnings**

Shareholders are entitled to a minimum mandatory dividend of 25% of the adjusted net income under Brazilian GAAP, calculated according to the Brazilian corporate law. The dividends do not bear interest and the amounts not claimed within three years from the date of the Shareholders' Meeting that approved them mature in favor of the Company.

|   | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|---|-------------|-------------|-------------|
| Profit for the year   | 2,835,068   | 2,519,310   | 2,947,098   |
| (-) Legal reserve - 5%  | 141,755     | 125,965     | 147,355     |
|   | 2,693,313   | 2,393,345   | 2,799,743   |
| Minimum mandatory dividend – 25% (R\$0.9851, R\$0.87539 and R\$1.0240 as of December 31, 2018, 2017 and 2016 per share and per ADS) | 673,328     | 598,336     | 699,936     |

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## Companhia de Saneamento Básico do Estado de São Paulo - SABESP

On April 27, 2018, the Shareholders' General Meeting approved the distribution of dividends as interest on capital amounting to R\$ 105,543, for the 2017 fiscal year. Therefore, the amount of R\$ 53,539 related to the surplus minimum mandatory dividends of 25%, set forth in the Bylaws, recorded in the 2017 equity under "Additional proposed dividends" was transferred to current liabilities. These amounts started being paid in June 2018.

The Company proposed dividends as interest on capital *ad referendum* of the Annual Shareholders' Meeting of 2019, in the amount of R\$ 673,328 (R\$ 598,336 in 2017) and additional proposed dividends in the amount of R\$ 118,859 (R\$ 105,543 in 2017), totaling R\$ 792,187 (R\$ 703,879 in 2017), corresponding to R\$ 1.1590 per common share (R\$ 1.0298 in 2017), to be resolved on the Shareholders' Meeting to be held on April 29, 2019. The amount exceeding the minimum mandatory dividend due in the year of R\$ 118,859 (R\$ 105,543 in 2017) was reclassified into equity to the "Additional proposed dividends" account, this amount includes the withholding income tax of R\$58,258 (R\$52,004 in 2017).

Pursuant to CVM Resolution 207/1996, the Company imputed interest on capital to the minimum dividend by its net value of withholding income tax. The amount of R\$ 58,258 (R\$ 52,004 in 2017) referring to the withholding income tax was recognized in current liabilities, in order to comply with tax liabilities related to the credit of interest on capital.

The interest on capital balance payable as of December 31, 2018, totaling R\$ 673,765 (R\$ 598,612 in 2017), refers to the amount of R\$ 673,328 (R\$ 598,336 in 2017) declared in 2018, net of withholding income tax and R\$ 437 declared in previous years (R\$ 276 in 2017).

### (d) Legal reserve

Earnings reserve - legal reserve is a requirement for all Brazilian corporations and represents an allocation of retained earnings of 5% of annual net income determined based on Brazilian law, up to 20% of capital. However, we are not required to make any allocations to our legal reserve in a year in which the legal reserve, when added to our other established capital and earnings reserves, exceeds 30% of our capital stock. The amounts allocated to such reserve may only be used to increase our capital stock or to offset losses and are not available for the payment of dividends.

(e) **Investments reserve**

Earnings reserve - investments reserve is specifically formed by the portion corresponding to own funds assigned to the expansion of the water supply and sewage treatment systems, based on capital budget approved by the Management.

As of December 31, 2018 and 2017, the balance of investment reserve totaled R\$3,840,422 and R\$6,939,296, respectively.

Pursuant to paragraph four of article 28 of the by-laws, the Board of Directors may propose to the Shareholders' Meeting that the remaining balance of profit for the year, after deducting the legal reserve and minimum mandatory dividends, be allocated to an investment reserve that will comply with the following criteria:

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

I- its balance, jointly with the balance of the other earnings reserves, except for reserves for contingencies and realizable profits, may not exceed the capital stock;

II- the reserve is intended to guarantee the investment plan and its balance may be used:

- a) to absorb losses, whenever necessary;
- b) to distribute dividends, at any moment;
- c) in share redemption, reimbursement or purchase transactions authorized by law;
- d) in incorporation to the capital stock.

**(f) Allocation of profit for the year**

|        |                               | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|--------|-------------------------------|-------------|-------------|-------------|
| Profit |                               |             |             |             |
| (+)    | Profit for the year           | 2,835,068   | 2,519,310   | 2,947,098   |
| (-)    | Legal reserve – 5%            | 141,755     | 125,965     | 147,355     |
| (-)    | Minimum mandatory dividends   | 673,328     | 598,336     | 699,936     |
| (-)    | Additional proposed dividends | 118,859     | 105,543     | 123,557     |
|        | Investment reserve recorded   | 1,901,126   | 1,689,466   | 1.976.250   |

Management will send for approval at the Shareholders' Meeting, a proposal to reallocate retained earnings the amount of R\$1,901,126 to the Investment Reserve account, in order to meet the investment needs foreseen in the Capital Budget.

**(g) Retained earnings**



Retained earnings (accumulated losses): the statutory balance of this account is zero as all retained earnings must be distributed or allocated to an earnings reserve.

**(h) Other comprehensive loss**

Gains and losses arising from changes in the actuarial assumptions are accounted for as equity valuation adjustments, net of income tax and social contribution effects. See Note 21 (b), the breakdown of amounts recorded in 2018 and 2017.

|   | <b>G1</b> | <b>G0</b> | <b>Total</b> |
|---|-----------|-----------|--------------|
| Balance as of December 31, 2017                     | 70,927    | (609,028) | (538,101)    |
| Actuarial gains/(losses) for the year (Note 21 (b)) | (211)     | (10,783)  | (10,994)     |
| Balance as of December 31, 2018                     | 70,716    | (619,811) | (549,095)    |

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****25 Earnings per share****Basic and diluted**

Basic earnings per share is calculated by dividing the equity attributable to the Company's owners by the weighted average number of outstanding common shares during the year. The Company does not have potentially dilutive common shares outstanding or debts convertible into common shares. Accordingly, basic and diluted earnings per share are equal.

|  | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|--|-------------|-------------|-------------|
| Earnings attributable to Company's owners              | 2,835,068   | 2,519,310   | 2,947,098   |
| Weighted average number of common shares issued        | 683,509,869 | 683,509,869 | 683,509,869 |
| Basic and diluted earnings per share (reais per share) | 4.15        | 3.69        | 4.31        |

**26 Operating segment information**

Management, comprised of the Board of Directors and Board of Executive Officers, has determined the operating segment used to make strategic decisions, as sanitation services.

|   | <b>2018</b>           |  |  |
|---|-----------------------|--|--|
|   | <b>Sanitation (i)</b> | <b>Reconciliation<br/>to the financial<br/>statements (ii)</b> | <b>Balance as per<br/>financial<br/>statements</b> |
| Gross operating revenue   | 14,253,609            | 2,802,670  | 17,056,279   |
| Gross sales deductions  | (971,185)             | -  | (971,185)  |
| Net operating revenue   | 13,282,424            | 2,802,670  | 16,085,094   |
| Costs, selling and administrative expenses  | (8,203,883)           | (2,739,657)  | (10,943,540)                                       |
| Income from operations before other operating expenses, net and equity accounting | 5,078,541             | 63,013   | 5,141,554  |
| Other operating income / (expenses), net  |                       |  | 28,591   |
| Equity accounting   |                       |  | 6,510  |
| Financial result, net   |                       |  | (1,264,336)  |
| Income from operations before taxes   |                       |  | 3,912,319  |
| Depreciation and amortization   | (1,392,541)           |  | (1,392,541)  |

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(i) See note 33 for further information about non-cash items, other than depreciation and amortization that impact segment results, and for additional information to long-lived asset information;

(ii) Construction revenue and related costs not reported to the CODM.

|   |                       | <b>2017</b>  |  |
|---|-----------------------|--|--|
|   | <b>Sanitation (i)</b> | <b>Reconciliation<br/>to the financial<br/>statements (ii)</b> | <b>Balance as per<br/>financial<br/>statements</b> |
| Gross operating revenue   | 12,223,746            | 3,150,877  | 15,374,623   |
| Gross sales deductions  | (766,390)             | -  | (766,390)  |
| Net operating revenue   | 11,457,356            | 3,150,877  | 14,608,233   |
| Costs, selling and administrative expenses  | (7,566,104)           | (3,080,542)  | (10,646,646)                                       |
| Income from operations before other operating expenses, net and equity accounting | 3,891,252             | 70,335   | 3,961,587  |
| Other operating income / (expenses), net  |                       |  | (5,679)  |
| Equity accounting   |                       |  | 5,760  |
| Financial result, net   |                       |  | (458,054)  |
| Income from operations before taxes   |                       |  | 3,503,614  |
| Depreciation and amortization   | (1,301,897)           | -  | (1,301,897)  |

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(i) See note 33 for further information about non-cash items, other than depreciation and amortization that impact segment results, and for additional information to long-lived asset information;

(ii) Construction revenue and related costs not reported to the CODM.

|   |                       | <b>2016</b>  |  |
|---|-----------------------|--|--|
|   | <b>Sanitation (i)</b> | <b>Reconciliation<br/>to the financial<br/>statements (ii)</b> | <b>Balance as per<br/>financial<br/>statements</b> |
| Gross operating revenue   | 11,122,232            | 3,732,877  | 14,855,109   |
| Gross sales deductions  | (756,901)             | -  | (756,901)  |
| Net operating revenue   | 10,365,331            | 3,732,877  | 14,098,208   |
| Costs, selling and administrative expenses  | (7,026,699)           | (3,651,364)  | (10,678,063)                                       |
| Income from operations before other operating expenses, net and equity accounting | 3,338,632             | 81,513   | 3,420,145  |
| Other operating income / (expenses), net  |                       |  | 4,722  |
| Equity accounting   |                       |  | 4,740  |
| Financial result, net   |                       |  | 699,447  |
| Income from operations before taxes   |                       |  | 4,129,054  |
| Depreciation and amortization   | 1,146,626             | -  | 1,146,626  |



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(i) See note 33 for further information about non-cash items, other than depreciation and amortization that impact segment results, and for additional information to long-lived asset information;

(ii) Construction revenue and related costs not reported to the CODM.

Explanation on the reconciliation items for the financial statements.

The impacts on gross operating income and costs are as follows:

|   | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|---|-------------|-------------|-------------|
| Gross revenue from construction recognized under IFRIC 12 (a) | 2,802,670   | 3,150,877   | 3,732,877   |
| Construction costs recognized under IFRIC 12 (a)              | (2,739,657) | (3,080,542) | (3,651,364) |
| Construction margin   | 63,013      | 70,335      | 81,513      |

(a) Revenue from concession construction contracts is recognized in accordance with Note 3.3 (b).

The Company has insurance that covers fire and other damage to its assets and office buildings, and liabilities to third parties, among others. It also has civil liability insurance for the members of the Board of Directors and Board of Executive Officers (“D&O insurance”) and guarantee insurance for escrow deposit (as described in Note 20 (f)) and traditional guarantee insurance. The Company contracts insurance through bidding processes with the participation of the main Brazilian and international insurance companies that operate in Brazil.

As of December 31, 2018, the Company’s insurance coverage is as follows:

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|   | <b>Coverage</b> |
|---|-----------------|
| Specified risks – fire                        | 2,007,219       |
| Engineering risk                              | 911,961         |
| Guarantee insurance for escrow deposit        | 500,000         |
| Traditional guarantee insurance               | 100,000         |
| Civil liability– D&O (Directors and Officers) | 100,000         |
| Civil liability – works                       | 72,435          |
| Domestic and international transportation     | 11,470          |
| Civil liability – operations                  | 5,000           |
| Other   | 14              |
| Total   | 3,708,099       |

**28 Operating revenue****(a) Revenue from sanitation services:**

|                                  | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|----------------------------------|-------------|-------------|-------------|
| Metropolitan region of São Paulo | 10,295,509  | 8,636,926   | 7,749,694   |
| Regional Systems                 | 3,958,100   | 3,586,820   | 3,372,538   |
| Total                            | 14,253,609  | 12,223,746  | 11,122,232  |

**(b) Reconciliation between gross operating income and net operating income:**

|                                      | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|--------------------------------------|-------------|-------------|-------------|
| Revenue from sanitation services (i) | 14,253,609  | 12,223,746  | 11,122,232  |
| Construction revenue                 | 2,802,670   | 3,150,877   | 3,732,877   |

|   |            |            |            |
|---|------------|------------|------------|
| Sales tax   | (916,808)  | (757,619)  | (756,901)  |
| Regulation, Control and Oversight Fee (TRCF) (ii) | (54,377)   | (8,771)    | -          |
| Net revenue                                       | 16,085,094 | 14,608,233 | 14,098,208 |

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(i) Includes the amount of R\$63,901 corresponding to the TRCF charged from customers from the municipalities regulated by ARSESP.

(ii) Amount payable to ARSESP referring to regulation, control and oversight activities, pursuant to State Complementary Law 1,025/07.

**29 Operating costs and expenses**

|  | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|--|-------------|-------------|-------------|
| Operating costs                                  |             |             |             |
| Salaries, payroll charges and benefits           | (1,959,539) | (1,841,571) | (1,718,199) |
| Pension obligations                              | (25,066)    | (48,381)    | 131,469     |
| Construction costs (Note 26)                     | (2,739,657) | (3,080,542) | (3,651,364) |
| General supplies                                 | (238,034)   | (163,712)   | (173,224)   |
| Treatment supplies                               | (265,146)   | (287,592)   | (279,150)   |
| Outsourced services                              | (996,477)   | (857,063)   | (845,334)   |
| Electricity                                      | (956,840)   | (794,352)   | (932,435)   |
| General expenses                                 | (629,253)   | (531,985)   | (471,965)   |
| Depreciation and amortization                    | (1,276,444) | (1,173,765) | (1,072,918) |
|  | (9,086,456) | (8,778,963) | (9,013,120) |
| Selling expenses                                 |             |             |             |
| Salaries, payroll charges and benefits           | (289,378)   | (305,440)   | (271,690)   |
| Pension obligations                              | (3,602)     | (7,296)     | 17,941      |
| General supplies                                 | (6,391)     | (4,451)     | (3,585)     |
| Outsourced services                              | (273,470)   | (258,287)   | (278,565)   |
| Electricity                                      | (1,154)     | (762)       | (751)       |
| General expenses                                 | (102,213)   | (94,112)    | (93,180)    |
| Depreciation and amortization                    | (17,272)    | (15,664)    | (9,729)     |
|  | (693,480)   | (686,012)   | (639,559)   |
| Bad debt expense, net of recoveries (Note 9 (c)) | (166,727)   | (82,681)    | (90,488)    |
| Administrative expenses                          |             |             |             |
| Salaries, payroll charges and benefits           | (254,284)   | (229,752)   | (194,357)   |
| Pension obligations                              | (141,758)   | (171,830)   | (136,358)   |
| General supplies                                 | (4,881)     | (5,675)     | (2,585)     |

|  |              |              |              |
|--|--------------|--------------|--------------|
| Outsourced services                              | (204,728)    | (183,746)    | (154,926)    |
| Electricity                                      | (1,363)      | (965)        | (1,848)      |
| General expenses                                 | (232,288)    | (302,113)    | (289,862)    |
| Depreciation and amortization                    | (98,825)     | (112,468)    | (63,979)     |
| Tax expenses                                     | (58,750)     | (92,441)     | (90,981)     |
|  | (996,877)    | (1,098,990)  | (934,896)    |
| Operating costs and expenses                     |              |              |              |
| Salaries, payroll charges and benefits           | (2,503,201)  | (2,376,763)  | (2,184,246)  |
| Pension obligations                              | (170,426)    | (227,507)    | 13,052       |
| Construction costs (Note 26)                     | (2,739,657)  | (3,080,542)  | (3,651,364)  |
| General supplies                                 | (249,306)    | (173,838)    | (179,394)    |
| Treatment supplies                               | (265,146)    | (287,592)    | (279,150)    |
| Outsourced services                              | (1,474,675)  | (1,299,096)  | (1,278,825)  |
| Electricity                                      | (959,357)    | (796,079)    | (935,034)    |
| General expenses                                 | (963,754)    | (928,210)    | (855,007)    |
| Depreciation and amortization                    | (1,392,541)  | (1,301,897)  | (1,146,626)  |
| Tax expenses                                     | (58,750)     | (92,441)     | (90,981)     |
| Bad debt expense, net of recoveries (Note 9 (c)) | (166,727)    | (82,681)     | (90,488)     |
|  | (10,943,540) | (10,646,646) | (10,678,063) |

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP****30 Financial Income (Expenses)**

|  | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|--|-------------|-------------|-------------|
| Financial expenses   |             |             |             |
| Interest and charges on borrowings and financing – local currency (i)    | (332,149)   | (289,780)   | (317,379)   |
| Interest and charges on borrowings and financing – foreign currency (ii) | (171,686)   | (119,100)   | (113,268)   |
| Other financial expenses (iii)   | (187,563)   | (97,533)    | (86,372)    |
| Income tax over international remittance                                 | (19,779)    | (17,901)    | (18,823)    |
| Inflation adjustment on borrowings and financing (iv)                    | (66,183)    | (62,787)    | (121,036)   |
| Inflation adjustment on Sabesprev Mais deficit                           | -           | -           | (891)       |
| Other inflation adjustments (v)  | (45,193)    | (50,941)    | (48,634)    |
| Interest and inflation adjustments on provisions (vi)                    | 14,586      | (50,238)    | (133,488)   |
| Total financial expenses   | (807,967)   | (688,280)   | (839,891)   |
| Financial income   |             |             |             |
| Inflation adjustment gains (vii)   | 105,952     | 89,010      | 152,154     |
| Income on short-term investments (viii)                                  | 187,094     | 195,992     | 209,376     |
| Interest income (ix)   | 175,939     | 57,166      | 99,068      |
| Cofins and Pasep   | (22,693)    | (16,366)    | (23,535)    |
| Other  | 10          | 442         | 11,647      |
| Total financial income   | 446,302     | 326,244     | 448,710     |
| Financial income (expenses), net before exchange rate changes            | (361,665)   | (362,036)   | (391,181)   |
| Net exchange gains (losses)  |             |             |             |
| Exchange rate changes on borrowings and financing (x)                    | (915,897)   | (96,300)    | 1,090,466   |
| Exchange rate changes on assets  | 13,235      | 336         | 371         |
| Other exchange rate changes  | (9)         | (54)        | (209)       |
| Exchange rate changes, net   | (902,671)   | (96,018)    | 1,090,628   |
| Financial income (expenses), net   | (1,264,336) | (458,054)   | 699,447     |



**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

- (i) Increase of R\$ 42.4 million mainly due to the lower capitalization in the investment in 2018 compared to 2017.
- (ii) Increase of R\$ 52.6 million due to the appreciation of the dollar and the yen against the real in 2018 (17.1% and 20.0%, respectively), when compared to the real appreciation occurred in 2017 (1.5% and 5.3%, respectively).
- (iii) The variation is due to the increase in recognition of interest on Public-Private Partnership (PPP) contracts, due to the beginning of the the service provision of São Lourenço Production System (SPSL), on July 10, 2018.

**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

- (iv) The monetary variation derives mainly due to the higher variation of the IPCA in 2018, compared to the variation in 2017 (3.75% and 2.95%, respectively). The exposures to this rate are shown in Note 5.1 (d).
- (v) Expenses mainly related to inflation adjustments related to the commitments required by Public-Private Partnership, program contracts commitments and agreements.
- (vi) The decrease is mainly due to the reversion of provisions in 2018.
- (vii) The monetary variations gains increased mainly due to the higher restatement escrow deposits.
- (viii) The decrease is a result of the decrease in the CDI rate, of 6.89% p.a. in 2017 and 6.42% p.a. in 2018.
- (ix) The R\$ 118,773 increase in interest income is mainly due to the recognition of interest on installment agreements with customers, in 2018.
- (x) The change in expenses mainly reflects the appreciation of the U.S. dólar and the Yen against the Real in 2018 (17.1% and 20.0%, respectively), compared to appreciation presented in 2017 (1.5% and 5.3, respectively).

**31 Other operating income (expenses), net**

|  | <b>2018</b> | <b>2017</b> | <b>2016</b> |
|--|-------------|-------------|-------------|
| Other operating income, net            | 93,089      | 75,410      | 62,570      |
| Other operating expenses               | (64,498)    | (81,089)    | (57,848)    |
| Other operating income (expenses), net | 28,591      | (5,679)     | 4,722       |

Other operating income is comprised by sale of property, plant and equipment, sale of contracts awarded in public bids, right to sell electricity, indemnities and reimbursement of expenses, fines and collaterals, property leases, reuse water, PURA projects and services, net of Cofins and Pasep.

Other operating expenses consist mainly of derecognition of concessions assets due to obsolescence, discontinued construction works, unproductive wells, projects considered economically unfeasible, losses on property, plant and equipment and exceeding cost of electricity sold.



**32 Commitments**

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**Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

The Company has agreements to manage and maintain its activities, as well as agreements to build new projects aiming at achieving the objectives proposed in its target plan. Below, the main committed amounts as of December 31, 2018:

|                                       | <b>1 year</b>    | <b>1-3 years</b> | <b>3-5 years</b> | <b>More than 5<br/>years</b> | <b>Total</b>      |
|---------------------------------------|------------------|------------------|------------------|------------------------------|-------------------|
| Contractual obligations – Expenses    | 1,521,921        | 801,136          | 282,192          | 1,107,121                    | 3,712,370         |
| Contractual obligations – Investments | 2,675,326        | 2,213,620        | 1,009,148        | 5,737,495                    | 11,635,589        |
| <b>Total</b>                          | <b>4,197,247</b> | <b>3,014,756</b> | <b>1,291,340</b> | <b>6,844,616</b>             | <b>15,347,959</b> |

The main commitment refers to the São Lourenço PPP. See Note 15 (g).

**33 Supplemental cash flow information**

|  | <b>2018</b>      | <b>2017</b>      | <b>2016</b>      |
|--|------------------|------------------|------------------|
| Total additions of contract assets (Note 14)                               | 3,188,943        | -                | -                |
| Total additions to intangible assets (Note 15 (b))                         | 1,144,728        | 3,490,298        | 3,855,831        |
| Items not affecting cash (see breakdown below)                             | (2,201,112)      | (1,532,518)      | (1,747,664)      |
| <b>Total additions to intangible assets as per statement of cash flows</b> | <b>2,132,559</b> | <b>1,957,780</b> | <b>2,108,167</b> |

Investment and financing operations affecting intangible assets but not cash:

|  |           |           |           |
|--|-----------|-----------|-----------|
| Interest capitalized in the year (Note 15 (d))                   | 488,502   | 649,048   | 700,743   |
| Contractors payable  | 297,872   | 213,340   | 57,431    |
| Program contract commitments                                     | 149,974   | 95,126    | 4,262     |
| Public Private Partnership - São Lourenço PPP (Note 15 (g))      | 273,737   | 501,591   | 893,181   |
| Leases   | -         | 3,078     | 10,534    |
| Construction margin (Note 26)                                    | 63,013    | 70,335    | 81,513    |
| Agreement signed with the municipality of Guarulhos (Note 9 (a)) | 928,014   | -         | -         |
| Total  | 2,201,112 | 1,532,518 | 1,747,664 |

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## **Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

### **34 Events after the reporting period**

- **São Bernardo do Campo**

On March 12, 2019, the Executive Body (*Poder Executivo Municipal*) of São Bernardo do Campo submitted the Proposed Bill to the Municipal Chamber (*Câmara Municipal*) with the purpose of signing the Contract for the Provision of Public Services between the Municipality, the State of São Paulo, and Sabesp, in order to adjust the current contract to the current legislation.

The contract that enables the Company to provide services to the municipality of São Bernardo was celebrated in December 2003, i.e., prior to the Federal Law No. 11,445 of 2007. Considering that this Law establishes specific rules and conditions to contract basic sanitation services, there is a need to adjust the contract to comply with this legislation.

- **Santo André**

On March 20, 2019, was executed a Protocol of Intentions with the municipality of Santo André for the preparation of studies and evaluations aiming to resolve commercial relations and existing debts between the municipality and the Company.

- **2<sup>ND</sup> Ordinary Tariff Revision**

On May 24, 2018, in view of the result of the Second Ordinary Tariff Revision, the Company filed with ARSESP: (i) a request for reconsideration; and (ii) a request for clarification and revision. In the request for clarification and review, the Company requests revision of the value of the revenue of the city of São Paulo used to calculate the financial component referring to municipal funds.

In reply, on February 28, 2019 ARSESP decided not to accept the request for reconsideration (administrative appeal). Regarding the request for clarification and revision, the ARSESP decided for its partial approval, which will imply an index of 0.8408%, to be applied at the same time of the annual tariff adjustment (May 2019).

- **Payment of debentures**

The Company paid the installment corresponding to the 17<sup>th</sup> debenture issue, in the amount of R\$ 279,797, in January 2019, settled the 15<sup>th</sup> debenture issue, in the amount of R\$ 361,593, in February 2019, and prepaid the 20<sup>th</sup> debenture issue, in the amount of R\$ 250,000, in March 2019

- **23<sup>th</sup> Issuance of Debentures**

On April 8, 2019, was approved the 23<sup>th</sup> issuance of simple, unsecured and non-convertible debentures, in up to two series, for public distribution, with restricted placement efforts, pursuant to CVM Rule No. 476, dated as of January 16, 2009, as amended, in the total amount of up to R\$ 1,500,000,000.00 (one billion and five hundred million reais), being the Offer conditioned to the issuance of, at least, 750,000 (seven hundred and fifty thousand) Debentures, in the total amount of R\$750,000,000.00 (seven hundred and fifty million reais). The issuance and the number of Debentures to be placed in each serie, the remuneration of the Debentures and the total amount of the Offer will be defined according to the bookbuilding process, in the communicating vessels system.

- **Tariff readjustment**

On April 10, 2019, São Paulo State Energy and Sanitation Regulatory Agency (ARSESP - Agência Reguladora de Saneamento e Energia do Estado de São Paulo) published Resolution No. 859 authorizing the Company to apply a tariff readjustment of 4.7242% to its current tariffs, comprised of:

- IPCA variation in the period of 4.5754%;
- Efficiency factor (X Factor) of 0.6920%; and
- Compensatory adjustment of 0.8408%, as described in Technical Note NT.F-0010-2018.

