

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

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

**FORM 20 F**

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

**OR**

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

**OR**

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

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

**OR**

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

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

**Commission file number 001 31317**

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

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

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

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

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

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

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

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

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

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

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

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

Yes  No

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

Yes  No

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

Yes  No

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

Yes  No

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

Large Accelerated Filer   
Non accelerated Filer

Accelerated Filer   
Emerging Growth Company

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

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

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

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

Item 17  Item 18

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

Yes  No

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

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## PRESENTATION OF FINANCIAL AND OTHER INFORMATION

### General

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

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

### Water Crisis

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

### Other Information

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

In addition, references to:

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

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

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

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

### ***Market Information***

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

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

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

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



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

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

## CAUTIONARY STATEMENTS ABOUT FORWARD LOOKING STATEMENTS

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

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

municipal governments share competency regarding these services;

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

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

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

## Part I

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

Not applicable.

### ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

### ITEM 3. KEY INFORMATION

#### A. Selected Financial Data

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

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

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

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

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

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

(1) ADS-American Depositary Share.

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**Selected Statement of Financial Position Data**

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

**Selected Statements of Cash Flows Data:**

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

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

**Operating Data****Indicator**

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

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

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

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

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

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

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

## **B. Capitalization and Indebtedness**

Not applicable.

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





Not applicable.

## **D. Risk Factors**

### **Risks Relating to Brazil**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

## **Risks Relating to Our Business**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

*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: