

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

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

FORM 20 F/A

(Amendment No. 1)

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

OR

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

OR

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

For the transition period from _____ to _____

OR

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

Date of event requiring this shell company report _____

Commission file number 001 31317

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

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

Federative Republic of Brazil
(Jurisdiction of incorporation or organization)

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

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Rua Costa Carvalho, 300 05429 900 São Paulo, SP, Brazil

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

Title of each class	Name of each exchange on which registered
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.	

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

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

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

683,509,869 Shares of Common Stock

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

Yes No

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

Yes No

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

Yes No

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

Yes No

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

Large Accelerated Filer
Non accelerated Filer

Accelerated Filer
Emerging Growth Company

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

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

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

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

Item 17 Item 18

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

Yes No

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

EXPLANATORY NOTE

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

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

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

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

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

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PRESENTATION OF FINANCIAL AND OTHER INFORMATION

General

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

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

Water Crisis

Our results and operational performance for the fiscal year ended December 31, 2017 were partially affected by the lowest stream flow measurements in over 80 years due to the serious drought in 2014 and 2015. With the return of the rainfall to its historical average for the rainy season that began in October 2015 and ended in March 2016, the level of water in the reservoirs that provide water to the population of the São Paulo metropolitan region returned to normal and the measures taken during the water crisis to continue to service consumers were gradually discontinued. However, heightened public awareness of the need to conserve water during the crisis resulted in our customers adopting lower water consumption practices during the water crisis and these practices have been partially integrated into our consumers’ daily habits. Another probable factor for why consumptions levels have not yet returned to their pre-water crisis levels despite the return of the rainfall to its historical average is the contraction of the Brazilian economy, which may have resulted in lower consumption of water by industry and other businesses. As a result, despite our reservoirs having a higher volume of water available for treatment, the total volume of water billed to our clients did not return to the volume of water billed in 2013, before the water crisis. As of December 31, 2017, the reservoirs in the São Paulo metropolitan region, where our largest market is located, contained 916.8 million m³ of water storage for treatment, compared to 951.1 million m³ available for treatment as of December 31, 2016. The measurements for these years do not include the so called “technical reserve” of 287.5 million m³. See “Item 4.B. Business Overview—The Recent Water Crisis”. Average monthly water production in 2017 for the São Paulo metropolitan region was 60.6 m³/s, compared to 58.5 m³/s in 2016, 52.0 m³/s in 2015, 62.2 m³/s in 2014 and 69.1 m³/s in 2013, the year before the water crisis started. For more information, see “Item 3.D. Risk Factors—Risks Relating to Our Business—“The measures we took to mitigate the effects of the drought that occurred in 2014 and 2015 resulted in a significant decrease in the volume of water billed and revenues from services we provide and, despite the discontinuation in May 2016 of the measures that were used to face the drought, new consumption habits were incorporated and the volume of water billed continues to be impacted by those measures.” and “Item 4.B. Business Overview—The Recent Water Crisis”.

Convenience Translations

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

Rounding

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

Other Information

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

In addition, references to:

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

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

Market Information

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

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

Our Contracts and the Municipalities We Serve

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

CAUTIONARY STATEMENTS ABOUT FORWARD LOOKING STATEMENTS

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

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

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

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

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

Part I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

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

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

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

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

Selected Income Statement

Data:

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

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

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

(2) ADS-American Depositary Share.

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

Selected Statement of Financial Position Data

As of December 31,

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

Selected Statements of Cash Flows**Data:**

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

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

(2) ADS-American Depositary Share.

Operating Data

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

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

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

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

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

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

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

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

Exchange Rates

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

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

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

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

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

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

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

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

Source: Central Bank

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

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

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

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

Source: Central Bank

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

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Risks Relating to Brazil

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Risks Relating to Our Control by the State of São Paulo

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Risks Relating to Our Business

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

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

The worst depletion of water storage occurred in the Cantareira System, the largest system of the São Paulo metropolitan region. As a result of the drought and low water volume in the Cantareira System, DAEE and the National Water Agency (*Agência Nacional de Águas*, or ANA), continuously regulated the volume of water we were permitted to extract from this system between March 2014 and May 2017. The DAEE and ANA determined this amount based on levels of rainfall, water inflow, level of water in our reservoirs and the solicitations we made to extract water based on this information, and informed us of the amount we were permitted to extract through periodical notices. In February 2016, as a result of the return of average rainfall levels to the region, we received authorization to extract 23 cubic meters per second, or m³/s, from the Cantareira System, an increase compared to the 13.5 m³/s we were authorized to extract for the majority of 2015, still significantly below the water volume we were allowed to extract in the period prior to February 2014, when we were allowed to extract up to a total of 33 m³/s. From September to November 2016 we received authorization to extract 25 m³/s, and from December 2016 to May 2017, we received authorization to extract 31 m³/s. In May 2017, the water grant that regulates the volume of water that may be extracted from the Cantareira System was renewed, based on the volume of water available in the reservoirs. In order to balance supply and demand despite the restricted water availability, we adopted a series of measures from 2014 to April 2016, including: (i) using treated water from other production systems to serve

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

With the return of the rainfall to its historical average for the rainy season that began in October 2015 and ended in March 2016, the volume of water available to the population of the São Paulo metropolitan region returned to a normal level and the measures taken during the water crisis to continue to service consumers were gradually discontinued. However, heightened public awareness of the need to conserve water during the crisis resulted in our customers adopting lower water consumption practices during the water crisis and these practices were partially integrated in our consumers' daily habits. As a result of this new behavior, despite us having a higher volume of water available for treatment, the volume of water billed to our clients did not return to the volume of water billed before the water crisis, in 2013. The average monthly water production in 2017 for the São Paulo metropolitan region was 60.6 cubic meters per second, or m³/s, compared to 58.5 m³/s in 2016, 52.0 m³/s in 2015, 62.2 m³/s in 2014 and 69.1 m³/s in 2013, the year before the water crisis started. The largest recovery of consumption occurred in the residential category. The industrial category showed slower growth due to the Brazilian economy and the investments made by this sector during the water crisis, such as the reuse of water, the use of rainwater and alternative sources of supply.

At the end of March 2018, the total volume of water stored in the reservoirs that supply the metropolitan region of São Paulo was 1,162.8 billion m³ compared to 1,223.9 billion m³ at the end of March 2017 and 1,178.8 billion m³ at the end of March 2016. In addition, the Cantareira system's maximum storage capacity, including the technical reserve of 287.5 million m³, is 1,269.5 billion m³. Excluding the technical reserve, which is 287.5 million m³, the Cantareira's maximum storage capacity is 982.0 million m³. The volume of water in the Cantareira system recovered throughout the October 2015 – March 2016 rainy season and was 641.9 million m³ as of March 2016, which represents 50.6% of its maximum storage capacity, including the technical reserve of 287.5 million m³. The volume of water in the Cantareira system was 932 million m³ as of March 31, 2017, which represents 73.4% of its maximum storage capacity, including the technical reserve of 287.5 million m³. The volume of water in the Cantareira system was 532.3 million m³ (not including the technical reserve of 287.5 million m³) as of March 31, 2018, as the rain levels and water inflows into the reservoirs that supply the metropolitan region of São Paulo during the October 2017-March 2018 rainy season were below the historical average. In December 2017, 7.8 million inhabitants were serviced by this system, compared to 7.6 million and 5.4 million in December 2016 and December 2015, respectively. For more information about the water crisis, see "Item 4.B. Business Overview—The Recent Water Crisis".

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

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

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

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

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

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

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

system is divided into five tranches: (i) if the volume of water available is higher than 60% of the reservoirs' capacity, we can draw up to 33m³/s; (ii) if the volume of water is between 40% and 60% of the reservoirs' capacity, we can draw up to 31m³/s; (iii) if the volume of water is between 30% and 40% of the reservoirs' capacity, we can draw up to 27m³/s; (iv) if the volume of water is between 20% and 30% of the reservoirs' capacity, we can draw up to 23m³/s; and (v) if the volume of water available is lower than 20% of the reservoirs' capacity, we can draw up to 15.5m³/s.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Risks Relating to Our Common Shares and ADSs

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

Overview

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

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

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

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

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

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

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

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

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

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

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

Our Strengths

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

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

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

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

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

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

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

Our Strategy

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

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

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

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

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

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

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

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

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

Development of the Company—Overview”.

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

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

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

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

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

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

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

State of São Paulo

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

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

History

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

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

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

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

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

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

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

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

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

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

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

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

Corporate Organization

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

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

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

Capital Expenditure Program

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

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

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

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

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

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

Main Projects of Our Capital Expenditure Program

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

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

The main programs are:

Metropolitan Water Program

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

Since 2000, the Metropolitan Water Program has increased the production capacity in 8.1 m³/s, 5 m³/s of which can be attributed to the Public Private Partnership, or “PPP”, conducted in the Alto do Tietê concluded in 2011, and 2.1 m³/s of which can be attributed to increased production in Guarapiranga System, concluded in 2015.

Aiming to improve the provision of water to the São Paulo Metropolitan Region, in April 2018, we increased treated water production capacity by approximately 6.4 m³/s by concluding construction and initiating pre-operation of the São Lourenço System. In addition, in March 2018, we began transferring water from the Jaguari reservoir (part of the Paraíba do Sul Basin) to the Atibainha reservoir (part of the PCJ River Basin). This interconnection adds 5.13 m³/s of water availability.

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

Interconnection of Jaguari and Atibainha Reservoirs

In March 2018, we completed the interconnection of the Jaguari and Atibainha reservoirs, which is a strategic and priority works project to guarantee secure access to water for the metropolitan region of São Paulo. With contracted investments of R\$555 million, this construction allows for the transfer of an average 5.13 m³/s of water from the Jaguari reservoir of the Paraíba do Sul Basin to the Atibainha reservoir of the Cantareira System, the largest system that provides water to the metropolitan region of São Paulo. In the future, the transfer of water shall also work in the opposite direction, from the Atibainha reservoir to the Jaguari reservoir, optimizing the reservation capacity of both reservoirs, and benefitting the population of the Paraíba Valley. The construction work on the interconnection began in February 2016 and was completed during March 2018. In March 2018, we also began transferring water from the Jaguari reservoir (part of the Paraíba do Sul Basin) to the Atibainha reservoir (part of the PCJ River Basin).

São Lourenço Project

The metropolitan region lacks water sources, which requires us to obtain water from increasingly distant sources. In order to address this situation, we developed, under a PPP contract, a new supply system called São Lourenço, which expands our production capacity by 6.4 m³/s and should be able to benefit a population of almost 2.0 million people.

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

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

Reversal of the Itapanhaú River

We plan to begin construction of a pumping system for the Itapanhaú River during the first half of 2018. This system is expected to have the capacity to pump an average of 2 m³/s (maximum of 2.5 m³/s) of water to Biritiba-Mirim, part of the Alto Tietê system. The project aims to improve water security in the São Paulo metropolitan region and is expected to directly benefit approximately 4.5 million residents that receive water from the Alto Tietê system as well as indirectly benefit 21 million people in the greater São Paulo region via the integrated system. We expect to invest a total of R\$91.7 million in this project.

Corporate Program for Reduction of Water Loss

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

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

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

Water Source Program

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

Coastal Water Program

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

Federal.

During the first phase of this program, we have focused mainly on increasing water production in order to satisfy demand and improve water quality in the Baixada Santista metropolitan region. In order to reach this goal, we built two water treatment plants, which started operations in 2013: Mambu/Branco, with water treatment capacity of 1.6 m³/s, and Jurubatuba, with water treatment capacity of 2 m³/s. We have also begun constructing two additional water treatment plants in the municipality of Peruíbe.

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

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

Tietê Project

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

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

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

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

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

The five principal sewage treatment facilities in the São Paulo metropolitan region have an aggregate installed capacity of 20.5 cubic meters of sewage per second and currently treat an aggregate of 18 cubic meters of sewage per second (13.5 m³/s greater than the volume treated at the start of the Tietê Project).

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

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

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

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

Clean Stream Program

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

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

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

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

Clean Wave Program

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

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

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

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

Other Policies and Programs

Nossa Guarapiranga

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

plants that obstruct water extraction; and (iii) we removed and disposed of solid residue that had accumulated at the bottom of the dam in the river basin. Two vessels were built specifically for this purpose. We work as a collaborative team with the municipal government of São Paulo in the Nossa Guarapiranga project, with the municipal government of São Paulo transporting all of the residue collected through these fronts to a sanitary landfill. In 2017, we removed 17,700 m³ of solid residue from this basin.

Pró Conexão

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

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

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

B. Business Overview

Our Operations

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

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

Description of Our Activities

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

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

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

We set forth below a description of our activities.

Wholesale Operations

Wholesale Water Services

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

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

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

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

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

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

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

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

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

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

Wholesale Sewage Services

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

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

Water Operations

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

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

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

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

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

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

Seasonality

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

Water Resources

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

In order to supply water to the São Paulo metropolitan region, we rely on 20 reservoirs of non treated water and 226 reservoirs of treated water, which are located in the areas under the influence of the eight water producing systems comprising the interconnected water system of the São Paulo metropolitan region. The total capacity of the water sources available for treatment in this area is 75.9 m³/s, not including an additional 5.5 m³/s resulting from the emergency construction work conducted by us in 2014 and 2015. Total current installed capacity is 75.8 m³/s and can be distributed to the São Paulo metropolitan region. Average verified production for the interconnected water system of the São Paulo metropolitan region was 60.6 m³/s during 2017. The Cantareira, Guarapiranga and Alto Tietê systems produce 82.7% of the water we distributed in the São Paulo metropolitan region in 2017.

In March 2018, we began operations on one important project for the interconnected water system of the São Paulo metropolitan region with the beginning of the transfer of water from the Jaguari reservoir to the Atibainha reservoir. The interconnection between the Jaguari and Atibainha reservoirs will have an average flow of 5.13m³/s and represents an important increase in water security for the Cantareira System and for the water supply in the São Paulo metropolitan area. For more information see “—Capital Expenditure Program—Main Projects of Our Capital Expenditure Program—Interconnection of Jaguarí and Atibainha Reservoirs”.

The construction of the São Lourenço Production System, another important project for the interconnected water system of the São Paulo metropolitan region, began in April 2014 and was completed in April 2018. Upon completion in April 2018, pre-operation began. The São Lourenço Production System represents an increase of 6.4m³/s in water availability and production capacity of the region’s integrated system and is the ninth interconnected production system for the Metropolitan Region. For more information see “—Capital Expenditure Program—Main Projects of Our Capital Expenditure Program—São Lourenço Project”.

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

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

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

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

Water production system:

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

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

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

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

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

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

Water Treatment

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

Water Distribution

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

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

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

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

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

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

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

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

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

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

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

Water Loss

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

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

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

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

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

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

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

These indicators are calculated by applying the following formulas:

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

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

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

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Where:

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

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

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

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

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

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

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

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

Our strategy to reduce water loss has two approaches:

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

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

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

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

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

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

Water Quality

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

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

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

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

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

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

Fluoridation

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

Sewage Operations

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

Sewage System

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

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

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

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

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

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

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

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

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

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

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

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