

COMPANHIA DE SANEAMENTO BASICO DO ESTADO DE SAO PAULO-SABESP
Form 20-F
May 12, 2016

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

FORM 20 F

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

OR

o ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2015

OR

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

For the transition period from _____ to _____

OR

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

Date of event requiring this shell company report _____

Commission file number 001 31317

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

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

Federative Republic of Brazil
(Jurisdiction of incorporation or organization)

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

Rui de Britto Álvares Affonso
raffonso@sabesp.com.br
(+55 11 3388 8247)
Rua Costa Carvalho, 300 05429 900 São Paulo, SP, Brazil

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

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, or a non accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b 2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non accelerated filer

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

TABLE OF CONTENTS

		Page
<u>PART I</u>		<u>6</u>
<u>ITEM 1.</u>	<u>IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS</u>	<u>6</u>
<u>ITEM 2.</u>	<u>OFFER STATISTICS AND EXPECTED TIMETABLE</u>	<u>6</u>
<u>ITEM 3.</u>	<u>KEY INFORMATION</u>	<u>6</u>
<u>ITEM 4.</u>	<u>INFORMATION ON THE COMPANY</u>	<u>24</u>
<u>ITEM 5.</u>	<u>OPERATING AND FINANCIAL REVIEW AND PROSPECTS</u>	<u>80</u>
<u>ITEM 6.</u>	<u>DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES</u>	<u>106</u>
<u>ITEM 7.</u>	<u>MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS</u>	<u>115</u>
<u>ITEM 8.</u>	<u>FINANCIAL INFORMATION</u>	<u>124</u>
<u>ITEM 9.</u>	<u>THE OFFER AND LISTING</u>	<u>127</u>
<u>ITEM 10.</u>	<u>ADDITIONAL INFORMATION</u>	<u>132</u>
<u>ITEM 11.</u>	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	<u>146</u>
<u>ITEM 12.</u>	<u>DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES</u>	<u>148</u>
<u>PART II</u>		<u>151</u>
<u>ITEM 13.</u>	<u>DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES</u>	<u>151</u>
<u>ITEM 14.</u>	<u>MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS</u>	<u>151</u>
<u>ITEM 15.</u>	<u>CONTROLS AND PROCEDURES</u>	<u>151</u>
<u>ITEM 16.</u>		<u>153</u>
<u>PART III</u>		<u>158</u>
<u>ITEM 17.</u>	<u>FINANCIAL STATEMENTS</u>	<u>158</u>
<u>ITEM 18.</u>	<u>FINANCIAL STATEMENTS</u>	<u>158</u>
<u>ITEM 19.</u>	<u>EXHIBITS</u>	<u>158</u>
<u>PART IV</u>		<u>159</u>
<u>SIGNATURES</u>		<u>159</u>

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 financial statements as of December 31, 2015 and 2014 and for the three years ended December 31, 2015 have been audited, as stated in the report appearing herein, 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, 2015, were adversely impacted by the most serious drought in our serviced region in 85 years. Both the water conservation measures we implemented to mitigate the effects of the drought on our water supply and a significantly heightened public awareness of the need to conserve water during the current water crisis negatively impacted our revenues. Improved rainfall throughout the rainy season that began in October 2015, the collaborative efforts between us and the population we service and emergency construction conducted by us throughout 2014 and 2015 in order to reduce the impacts of the water crisis resulted in an increase in the volume of water in the reservoirs in our largest market, the São Paulo metropolitan region, at the end of 2015 compared to the end of 2014. As of December 31, 2015, the reservoirs in the São Paulo metropolitan region, where our largest market is located, contained 703 billion liters of bulk water storage for treatment, compared to 301 billion liters available for treatment as of December 31, 2014. Under normal circumstances, we withdraw 6.2 billion liters per day (equivalent to the total water production of 71.4 m³/s in February 2014 for the São Paulo metropolitan region) from the reservoirs. This volume decreased to 4.7 billion liters per day during the drought (equivalent to the total water production of 54.8 m³/s in December 2015 for the São Paulo metropolitan region). Average monthly water production in 2015 was of 52.0 m³/s, compared to 62.2 m³/s in 2014 and 69.1 m³/s in 2013. 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 resulted in a significant decrease in the volume of water billed and revenues from services we provide, which had a material adverse effect on our company and could continue to do so if the drought escalates in severity” and “Item 4.B. Business Overview—The Current 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, 2015 was R\$3.9048 to US\$1.00, which was the commercial rate for the purchase of U.S. dollars in effect on December 31, 2015, 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.

1

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;
- “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 326 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;
- “sewage coverage ratio” are to the ratio between the number of residences connected to the sewage collection network, divided by the number of urban residences in a certain area;
- “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 coverage ratio” are to the ratio between the number of residences connected to the water supply network, divided by the number of urban residences in a certain area; and
- “water crisis” are to the drought we have experienced from late 2013 throughout most of 2015. This drought is the most serious drought that our service region has experienced in 85 years and primarily affects 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 a research prepared by SEADE: “Projections for the State of São Paulo – Population and Residences until 2025” (*Projeções para o Estado de São Paulo – População e Domicílios até 2025*).

Our contracts and the Municipalities We Serve

Throughout this document, we refer to the 364 municipalities we serve and to our 367 water contracts. This difference results from the fact that we have two partial water contracts with the municipality of Mogi das Cruzes. These contracts are partial because pursuant to them we serve only two neighborhoods of this municipality and, as a result, do not include Mogi das Cruzes in the total of municipalities we serve. Most of our contracts with the municipalities we serve are concession agreements which have a term of 30 years. On August 2, 2015, we signed a water contract with the municipality of Santa Isabel, which only became effective in January 2016. Therefore, we do not include the water contract with Santa Isabel amongst the 364 municipalities we serviced in 2015.

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, which may continue to be adversely affected by the current water crisis in São Paulo metropolitan region;
- the impact on our business of the water consumption reduction incentive program and other measures we took in 2014 and 2015 and any other measures we may need to take until the water levels of our reservoirs are normalized and sufficient to continuously serve the customers in the São Paulo metropolitan region;
- the impact on our business of lower water consumption practices adopted by our customers during the water crisis, which may remain in place even after the water levels of our reservoirs normalize;
- decisions by the São Paulo State Department of Water and Energy (*Departamento de Águas e Energia Elétrica do Estado de São Paulo*), or “DAEE”, and the National Water Agency (*Agência Nacional de Águas*), or “ANA”, limiting 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, and the 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 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;

4

- 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 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, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013 have been derived from our audited financial statements, prepared in accordance with IFRS, and included in this annual report. The selected financial data as of December 31, 2013, 2012 and 2011 and for the years ended December 31, 2012 and 2011 have been derived from our audited financial statements, prepared 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, 2011 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”.

The following tables present our selected financial data as of and for each of the periods indicated:

IFRS Summary Financial Data

	For the year ended December 31,				
2015 ⁽³⁾	2015	2014	2013 ⁽⁴⁾	2012 ⁽⁴⁾	2011 ⁽⁴⁾
US\$	R\$	R\$	R\$	R\$	R\$
<i>(in millions, except per share and per ADS⁽¹⁾ data)</i>					

Statement of operations data:

Net operating revenues	2,999.3	11,711.6	11,213.2	11,315.6	10,737.6	9,927.4
Cost of sales and services	(2,115.6)	(8,260.8)	(7,635.6)	(6,816.3)	(6,449.9)	(6,018.7)
Gross profit	883.7	3,450.8	3,577.6	4,499.3	4,287.7	3,908.7
Selling expenses	(153.2)	(598.1)	(736.6)	(637.1)	(697.3)	(619.3)
Administrative expenses	11.5	45.0	(924.4)	(729.1)	(717.4)	(683.6)
Operating profit	779.6	3,044.0	1,910.7	3,138.8	2,843.3	2,512.0
Financial income (expenses), net	(629.1)	(2,456.5)	(635.9)	(483.2)	(295.7)	(633.0)
Net income	137.3	536.3	903.0	1,923.6	1,911.9	1,380.9
Earnings per share – basic and dilute ⁽¹⁾	0.20	0.78	1.32	2.81	2.80	2.02
Earnings per ADS – basic and dilute ⁽¹⁾	0.20	0.78	1.32	2.81	2.80	2.02
Dividends and interest on shareholders' equity per share ⁽²⁾	0.05	0.19	0.32	0.67	0.66	0.43
Dividends and interest on shareholders' equity per ADS ⁽²⁾	0.05	0.19	0.32	0.67	0.66	0.43
Weighted average number of common shares outstanding ⁽²⁾	683,509,869	683,509,869	683,509,869	683,509,869	683,509,869	683,509,869

6

(1) ADS - American Depositary Share.

(2) 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 revised to give effect to the stock split retrospective to all periods presented.

(3) 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, 2015 of R\$3.9048 to US\$1.00.

(4) Data for 2012 and 2011 have been restated in application of IAS 19 – Employee Benefits (as revised in 2011) and IFRS 11 – Joint Arrangements, as described in our audited financial statements for the year ended December 31, 2013. With respect to IAS 19 – Employee Benefits, the principal adjustment is the change in the accounting record method of actuarial gains and losses, such that accumulated differences between actuarial estimates and actual obligations are recognized in Other Comprehensive Income when they occur.

Balance Sheet Data

	As of December 31,					
	2015 ⁽²⁾ US\$	2015 R\$	2014 R\$	2013 R\$	2012 ⁽³⁾ R\$	2011 ⁽³⁾ R\$
	<i>(in millions, except per share and per ADS⁽¹⁾ data)</i>					
Property, plant and equipment	83.3	325.1	304.8	199.5	196.7	181.6
Intangible assets	7,302.2	28,513.6	25,979.5	23,846.2	21,967.5	20,125.7
Total assets	8,632.1	33,706.6	30,355.4	28,274.3	26,476.1	24,983.2
Current portion of long term loans and financing	390.9	1,526.3	1,207.1	640.9	1,342.6	1,629.2
Long term loans and financing	2,969.5	11,595.3	9,578.6	8,809.1	7,532.7	6,794.1
Interest on shareholders' equity payable	32.6	127.4	214.5	457.0	414.4	247.5
Total liabilities	5,119.3	19,990.0	17,051.0	15,343.5	15,219.4	14,438.3
Equity	3,512.8	13,716.6	13,304.4	12,930.8	11,256.8	10,544.9
Capital stock	2,561.0	10,000.0	10,000.0	6,203.7	6,203.7	6,203.7
Other financial information:						
Cash generated from operating activities	676.4	2,641.4	2,480.3	2,777.2	2,343.2	2,698.6
Cash used in investing activities	(629.9)	(2,459.5)	(2,757.7)	(2,281.5)	(1,996.7)	(1,883.2)
Cash provided by (used in) financing activities	(68.0)	(265.7)	218.5	(629.7)	(572.7)	(661.3)
Purchases of intangible assets and property, plant and equipment as presented in our statement of cash flow	(628.0)	(2,452.1)	(2,748.3)	(2,335.8)	(2,026.1)	(2,068.8)

(1) ADS - American Depositary Share.

(2) 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, 2015 of R\$3.9048 to US\$1.00.

(3) Data for 2012 and 2011 have been restated in application of IAS 19 – Employee Benefits (as revised in 2011) and IFRS 11 – Joint Arrangements, as described in our audited financial statements for the year ended December 31, 2013. With respect to IAS 19 – Employee Benefits, the principal adjustment is the change in the accounting record method of actuarial gains and losses, such that accumulated differences between actuarial estimates and actual obligations are recognized in Other Comprehensive Income when they occur.

Operating Data

	As of and for the year ended December 31,				
	2015	2014	2013	2012	2011
Number of water connections (in thousands)	8,420	8,210	7,888	7,679	7,481
Number of sewage connections (in thousands)	6,861	6,660	6,340	6,128	5,921
Percentage of population with water connections (in percentages)	99	99	99	99	99
Percentage of population with sewer connections (in percentages)	86	85	84	83	82
Percentage of treated sewer ⁽¹⁾ (in percentages)	78	77	78	77	76
Volume of water billed during period (in millions of cubic meters)	1,914	2,069	2,149	2,094	2,045
Water Billed Loss Index during period (average) (in percentages) ⁽²⁾	16.4	21.3	24.4	25.7	25.6
Water Metered Loss Index during period (average) (in percentages) ⁽³⁾	28.5	29.8	31.2	32.1	32.0
Water loss per connection per day (average) ⁽⁴⁾	258	319	372	392	395
Number of employees	14,223	14,753	15,015	15,019	14,896

7

(1) Treated sewage as a percentage of collected sewage.

(2) 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*).

(3) 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*).

(4) 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*).

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. Primarily as a result of the global financial crisis, the *real* depreciated 32.0% against the U.S. dollar during 2008 and closed 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. On December 31, 2015, 2014, and 2013, the *real*/U.S. dollar exchange rate was R\$3.9048, R\$2.6562 and R\$2.3426 per US\$1.00, respectively.

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*. 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—Exchange rate instability 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 (*BM&FBOVESPA S.A. Bolsa de Valores, Mercadorias e Futuros*), or the “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⁾	High	Low
2011	1.8758	1.6746	1.9016	1.5345
2012	2.0435	1.9550	2.1121	1.7024
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

Month ended	Period end	R\$ per US\$1.00		
		Average	High	Low
October 31, 2015	3.8589	3.8801	4.0010	3.7386
November 30, 2015	3.8506	3.7765	3.8506	3.7010
December 31, 2015	3.9048	3.8711	3.9831	3.7476
January 31, 2016	4.0428	4.0524	4.1558	3.9863
February 28, 2016	3.9578	3.9734	4.0492	3.8653
March 31, 2016	3.5589	3.7039	3.9913	3.5589
April 30, 2016	3.4508	3.5658	3.6921	3.4508

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⁾	High	Low
2011	0.0243	0.0211	0.0249	0.0186
2012	0.0237	0.0245	0.0263	0.0211
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

Month ended	Period end	R\$ per ¥1.00		
		Average	High	Low
October 31, 2015	0.0320	0.0323	0.0335	0.0311
November 30, 2015	0.0313	0.0308	0.0315	0.0301
December 31, 2015	0.0324	0.0318	0.0329	0.0304
January 31, 2016	0.0333	0.0343	0.0355	0.0333

February 28, 2016	0.0348	0.0347	0.0359	0.0331
March 31, 2016	0.0317	0.0328	0.0351	0.0317
April 30, 2016	0.0323	0.0326	0.0342	0.0317

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 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. On September 9, 2015, Brazil was downgraded below investment grade by Standard & Poor's Financial Services LLC, and received a further downgrade by the same rating agency on February 17, 2016. In addition, on December 16, 2015, Brazil was downgraded below investment grade by Fitch Ratings Inc. and in February 24, 2016 by Moody's Investors Service, Inc.. 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.

Current political conditions in Brazil may affect the confidence of investors and the public in general as well as the development of the economy. Uncertainty with regard to matters such as the presidential administration's future policies and appointments to influential governmental positions and ongoing investigations into allegations of corruption in state-controlled enterprises may also affect the confidence of investors and the general public. It may also have an adverse impact on the Brazilian economy, our business, financial condition, results of operations and the market price of our common shares and ADSs.

10

Currently, Brazilian markets are experiencing heightened volatility due to the uncertainties derived from the ongoing *Lava Jato* investigation, being conducted by the Office of the Brazilian Federal Prosecutor, and its impact on the Brazilian economy and political environment. Certain of these companies are also facing investigations by the Brazilian Securities Commission (*Comissão de Valores Mobiliários*), or CVM, and the U.S. Securities and Exchange Commission, or the SEC. Members of the Brazilian federal government and of the legislative branch, as well as senior officers of large state-owned companies have faced allegations of political corruption, since they have allegedly accepted bribes by means of kickbacks on contracts granted by the government to several infrastructure, oil and gas and construction companies. The profits of these kickbacks allegedly financed the political campaigns of political parties of the current federal government coalition that were unaccounted for or not publicly disclosed, as well as served to personal enrichment of the recipients of the bribery scheme.

The potential outcome of these investigations is uncertain, but they have already an adverse impact on the image and reputation of the implicated companies, and on the general market perception of the Brazilian economy. We cannot predict whether such allegations will lead to further political and economic instability or whether new allegations against government officials will arise in the future. In addition, we cannot predict the outcome of any such allegations nor their effect on the Brazilian economy.

The development of such unethical conduct cases could adversely affect our business, financial condition and results of operations.

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 14.15%, 11.65% and 9.90% at the end of 2015, 2014 and 2013, 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", the Brazilian annual inflation rates were 10,67%, 6,41% and 5,91%, during 2015, 2014 and 2013, 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. In 2008, primarily as a result of the global financial crisis, the *real* depreciated 32.0% against the U.S. dollar and closed 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. On December 31, 2015, 2014 and 2013, the *real*/U.S. dollar exchange rate was R\$3.9048, R\$2.6562 and R\$2.343 per US\$1.00, respectively. There can be no assurance that the *real* will not depreciate further against the U.S. dollar. As of April 30, 2016, the commercial selling rate as reported by the Central Bank was R\$3.4508 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 a total foreign currency denominated debt of R\$6,617.8 million as of December 31, 2015 and we anticipate that we may incur additional amounts of foreign currency denominated debt in the future. In 2015, our results of operations were negatively affected by the 47.0% depreciation of the *real* against the U.S. dollar, and a depreciation of the *real* against the yen by 46.0% which led to a R\$1,992.0 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) of our 2015 financial statements.

For further information on exchange rate instability impacts, see “Item 5.B. Liquidity and Capital Resources—Capital Sources—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.

The global financial crisis has caused 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 have and may continue to, 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, 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 April 30, 2016, 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, including holders of ADSs. See “Item 5.A. Operating and Financial Review and Prospects—Certain Transactions with Controlling Shareholder”.

12

Following the elections for State governor in 2014, the re-elected governor appointed Mr. Jerson Kelman as our Chief Executive Officer in January 2015, 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*), was elected our Chairman for the current board of directors' term of two years, ending in April 2016. Mr. Benedito Pinto Ferreira Braga Junior's term was renewed in our annual general shareholder's meeting held on April 29, 2016 for another two years, ending in April 2018. Future 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.

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, 2015, the State owed us R\$66.3 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\$855.1 million as of December 31, 2015. 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, 2015, we had a provision for an actuarial liability in the amount of R\$2,166.9 million with respect to future supplemental pension payments for which the State does not accept responsibility. On March 18, 2015, we, the State and DAEE, with the intervention of the Department of Sanitation and Water Resources, executed a term of agreement, in the amount of R\$1,012.3 million, of which R\$696.3 million refers to the principal amount and R\$316.0 million refers to the monetary adjustment of the principal through February 2015. For a detailed discussion of this agreement, see "Item 7.B. Related Party Transactions—Agreements with the State of São Paulo" and Note 10 of our 2015 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 of São Paulo" and Note 10 of our 2015 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".

EMAE, a State-controlled company that has a concession to produce energy in the Guarapiranga and Billings reservoirs is seeking damages from us for the water we draw from these reservoirs.

Empresa Metropolitana de Águas e Energia S.A., or EMAE, a company also controlled by the State of São Paulo that has a concession to produce hydroelectric energy using water in the Guarapiranga and Billings reservoirs, is seeking compensation from us for the water we draw from these reservoirs. EMAE has commenced various court and arbitration proceedings, alleging that our water use reduces their ability to generate and sell electricity. As stated in an Announcement to the Market that we issued on April 10, 2014, we are negotiating with EMAE regarding a potential

settlement of this water use dispute, although no agreement has yet been finalized.

In addition, the State of São Paulo, which is controlling shareholder of both EMAE and our company, may take action to resolve the dispute in a way that has an adverse effect on our business. On April 11, 2016 we were named in legal proceedings commenced by minority shareholders of EMAE against the State of São Paulo. The plaintiffs in these proceedings 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 in these proceedings 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.

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. In addition, if we are required to pay compensation to EMAE, our cash position and overall liquidity may be adversely affected.

We may be required to pay substantial charges for the use of reservoirs that are not our property.

We use the Billings and Guarapiranga reservoirs in order to provide water services. We are entitled to withdraw water from these reservoirs under a grant from DAEE. We are not currently charged for the use of these reservoirs and are uncertain as to whether we will continue to be able to use the reservoirs without paying charges or what the likely fee scale would be if one were imposed.

We may also be required to pay additional maintenance and operational costs to utilize these reservoirs. If we were required to pay substantial charges or additional maintenance or operational costs for our use of these reservoirs, we could be materially and adversely affected.

Risks Relating to Our Business

The measures we took to mitigate the effects of the drought resulted in a significant decrease in the volume of water billed and revenues from services we provide, which had a material adverse effect on our company and could continue to do so if the drought escalates in severity.

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 Jundiaí 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 have experienced below average rainfall since 2012. In the October 2013 – March 2014 rainy season, rain levels and water inflow into the reservoirs reached the lowest levels in 84 years of recorded rainfall in the region, a scenario that continued in the October 2014 – March 2015 rainy season. During the October 2015 – March 2016 rainy season, the level of rainfall in the region returned to the normal levels expected for the period. Improved rainfall in the rainy season that began in October 2015, the collaborative efforts between us and the population we serve and emergency construction conducted by us throughout 2014 and 2015 in order to reduce the impact of the water crisis, resulted in a partial restoration of the water levels of the Cantareira system.

The depletion of water storage is worst 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 ANA, since March 2014, have continuously regulated the volume of water we are permitted to extract from this system. The DAEE and ANA determine this amount based on levels of rainfall, water inflow, level of water in our reservoirs and our requests to extract water based on this information, and inform us of the amount we are permitted to extract via monthly notices. As of 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. This figure remains significantly below the water level 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.

In order to balance supply and demand despite the restricted water availability, we have adopted and will continue adopting a series of measures, including: (i) using treated water from other production systems to serve consumers originally supplied by the Cantareira system; (ii) to offer discounts (bonus) to consumers that 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 has never before been used to serve the population. See “Item 4.B. Business Overview—The Current Water Crisis”.

Even with the return of normal rainfall levels throughout the October 2015 – March 2016 rainy season, the need to recover the volume of water stored in the reservoirs of the Cantareira system will persist throughout the next rainy season. The Cantareira system's maximum storage capacity, including the technical reserve, is 1,269.5 million m³. Excluding the technical reserve, which is 287,5 million m³, the Cantareira system'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.

14

We cannot guarantee that we shall be authorized to extract the same volume of water from this system that we extracted prior to the drought to serve the needs of the population we service. In December 2015, 5.3 million inhabitants were serviced by this system, compared to 8.9 million in February 2014. For more information about the water crisis, see “Item 4.B. Business Overview—The Current Water Crisis”.

The drought has prompted a continuous reduction in the volume of water billed and thus a reduction in revenue. In 2014, our water volume billed decreased 3.1% and our gross operational revenue fell by 6.7% compared to 2013. In 2015, our water volume billed decreased 8.0% and our gross operational revenue increased slightly by 0.5% compared to 2014. Therefore, there was and may continue to be a negative impact on our financial ratios linked to revenue, such as the debt to EBITDA ratio. We are required to maintain certain financial ratios at specified levels pursuant to restrictions and covenants of our existing debt agreements and failure to maintain these ratios may lead to a default under such agreements. Breach of any such covenant may result in a default under certain of our debt agreements and, due to customary cross-default provisions, could permit some of our creditors to accelerate our indebtedness unless we are able to renegotiate the terms of these agreements or receive waivers from the affected creditors. If such events were to occur, our financial condition would be adversely affected. See “Item 5.B. Liquidity and Capital Resources—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 DAEE – ANA in order to extract water from the Cantareira System. The water right was renewed in 2004 and would have expired in August 2014. However, due to current climate conditions, particularly the severe drought, the water right was extended until October 31, 2015 and later extended again until May 2017. The extraction of water throughout 2014 and 2015 was executed according to the specific rules established to combat the water crisis. The terms of this water right will define the volume of water that we will be authorized to extract from the Cantareira System to provide to the São Paulo metropolitan region. The drought that occurred in 2014 and for most of 2015 may influence the decision of ANA and DAEE regarding the volume of water that we will be authorized to extract pursuant to the renewal of the water right in 2017. The volume of water that we have been authorized to extract from the Cantareira System (which includes the PCJ River Basin and Juquerí River Basin) has been communicated to us via monthly notices according to the behavior of rainfall, water inflow, level of water in our reservoirs and our requests to extract water based on this information.
- 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. In 2016, there is no forecast of any shortages or rationing of energy and we estimate an increase of about 15% to 20% in energy expenses compared to 2015. In March 2015, we filed with ARSESP an extraordinary revision request based on the decline in the volume of water due to the water crisis and based on the unexpected increase in electricity tariffs. Our request was approved in May 2015. However, we may not be able to pass on any significant increases in energy tariffs to our customers in the future. 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 dams 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 Regulation”.

- The increasing degradation of watershed areas 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 “—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 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—Government Regulation—Water Usage”.
- Our water pipes are susceptible to the degradation caused by factors such as age, intense traffic, population density 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 Distribution" and "Item 4.B Business Overview-Descriptions 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) 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. Moreover, the Basic Sanitation Law 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 client registry. Currently, more than 90% of our water and sewage connections are billed to the user of our services, as foreseen under current regulations. We estimate that this change will affect ongoing legal disputes, particularly those regarding collection procedures, as well as business discussions in general. However, since this change is still being implemented, we are not currently able to predict its impact on our business.

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.

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

New joint entities have been, and may continue to be, set up to oversee basic sanitation services in metropolitan regions, including the São Paulo metropolitan region. We cannot predict how the shared management of these operations will be carried out in the São Paulo metropolitan region and other metropolitan regions we operate or what effect this may have on our business, financial condition or results of operations.

There are some pending cases before the Brazilian Supreme Court regarding whether the right to execute concession and program agreements in metropolitan regions belongs to the State or the municipal government. On February 28, 2013, the Brazilian Supreme Court decided a then pending case on this matter related to the state of Rio de Janeiro. A majority of the court held that the state of Rio de Janeiro must set up new entities to oversee the planning, regulation and auditing of basic sanitation services in the metropolitan region with the non-partisan participation of all the municipalities located in the metropolitan region.

On March 6, 2013, the court ruled that this holding would come into effect in the state of Rio de Janeiro after a remaining appeal of its holding is decided. The court’s holding represents a new paradigm in the management and provision of services. The Supreme Court has yet to clarify the effects and extension of its decision. The São Paulo metropolitan region (including the municipalities to which we provide water on a wholesale basis), to which a decision on such pending or new cases may apply, accounted for 67.3% of our gross operating revenue from services in 2015 (excluding revenues relating to the construction of concession infrastructure). In January 2015, the Federal Government issued the Metropolitan Bylaws (Law No. 13,089/2015) which establishes general guidelines for the planning, management and performance of public interest projects in metropolitan regions and in urban clusters instituted by the states; the general planning standards for integrated urban development and other international governance instruments; and the criteria to receive federal loans for initiatives related to international governance in the field of urban development.

We cannot predict how the shared management of these operations 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”.

17

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 48.2% of our gross operating revenues (excluding revenues relating to the construction of concession infrastructure) in the year ended December 31, 2015.

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*.

Because we were not previously required to transfer 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*, our existing tariff and adjustment formulas do not account for this requirement. Nonetheless, ARSESP is required to ensure that the tariffs will adequately compensate us for the services we provide, which includes the pass-through to tariffs.

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 Program Contracts and the Sewage and Water Supply Service Contracts, this charge must be considered in the tariff revision.

In April 2013, ARSESP issued Resolution No. 413/2013, which suspended Resolution No. 407/2013 until the tariff revision process is concluded, 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 establishes the conclusion of the 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. We cannot know when we will be able to pass the 7.5% charge on to consumers through the service bill.

As of December 31, 2015, we have transferred approximately R\$1.8 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.

We cannot assure you that this charge will eventually be passed through to customers or that the continued delay in passing this charge 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— Agreements with Municipalities and Metropolitan Regions – Rules Enacted by ARSESP”.

18

We currently lack formal agreements or concessions with 53 of the municipalities to which we provide service, and 36 of our existing concession agreements will expire between 2016 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, 2015, we held formal 30 year agreements with 278 municipalities (including the city of São Paulo) of the 364 municipalities we serve. We entered into 4 of these agreements during 2015. The 278 municipalities with which we had formal agreements at year-end accounted for 78.6% of our total revenues for the year ended December 31, 2015, and 68.4% of our intangible assets as of December 31, 2015. Of the 53 served municipalities for which we lacked formal agreements at year-end, we were in the process of actively renegotiating with all municipalities. Together, these 53 municipalities accounted for 12.9% of our total revenues for the year ended December 31, 2015 and 21.6% of our intangible assets as of that same date. Between 2016 and 2030, 36 of our existing concession agreements will expire. These 36 concession agreements accounted for 7.8% of our total revenues for the year ended December 31, 2015 and 7.4% 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 53 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, 2015, 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.

In 1997, the municipality of Santos enacted a law in order to repossess our water and sewage systems in Santos. We adopted the necessary judicial measures to contest this and we filed an ordinary suit against the municipality of Santos, after which the appellate court issued a decision in our favor. The proceedings were terminated and we have continued operations in the municipality. In September 2015, the State of São Paulo and the municipality of Santos entered into a service provision contract, with the intervention and consent of ARSESP. Under this agreement, ARSESP exercises the duties of regulating and supervising the provision of water and basic sanitation services in Santos, while SABESP continues to be responsible for the provision of water and basic sanitation to the municipality of Santos for the next 30 years.

In 1995, the municipality of Diadema terminated its concession agreement with us and did not pay the indemnification for our investments. In March 2014, we entered into an agreement with the municipality of Diadema to resolve water supply-related debt and indemnities. This agreement includes a contract to resume direct supply of water and sewage services to the municipality of Diadema for 30 years with the regulation and supervision of ARSESP. Guarantees are in place if the municipality of Diadema breaches the agreement entered into with us.

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, 2015, our total accounts receivable was R\$4,817.4 million. Of this amount, certain municipalities to which we provide water on a wholesale basis owed us R\$2,311.3 million, and certain municipal government entities owed us R\$710.4 million. Of the total amount owed by municipalities, R\$237.8 million was overdue by between 30 and 360 days and R\$2,047.7 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. 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 owed to us. If the municipalities and related entities do not pay the amounts owed to us, we may experience a further material adverse effect on our financial position.

Aiming to revolve existing debts with the municipalities to which we provide water on a wholesale basis, in 2015 we intensified the process of collecting the debts for the provision of water and basic sanitation through the Single Registry of Debtors of São Paulo (*Cadastro Único de Devedores de São Paulo*), or State CADIN. With regard to three municipalities to which we provide water on a wholesale basis, Santo André, Guarulhos and Mauá, in October 2015 and January 2016 we had executed Protocols of Intentions with each of them, to prepare studies and evaluations aimed at resolving commercial relations and exiting debts between these municipalities and us.

For more information on wholesale operations, see “Item 4.B. Business Overview—Our Operations—Description of Our Activities—Wholesale Operations”.

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\$12.5 billion in the period from 2016 through 2020. In 2015 we recorded R\$3.5 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.

20

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—Capital Sources—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 to the release of untreated sewage into waterways and the disposal of sludge generated by treatment plants. We are also involved in proceedings challenging the extraction of water resources in the face of the current water crisis. Any unfavorable judgment in relation to these proceedings, or any material unforeseen 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—Sewage Treatment and Disposal", "Item 4.B Business Overview—Environmental Matters" and "Item 4.B. Business Overview—Environmental Regulation". For further information on the Water Crisis, see "Item 4.B. Business Overview—The Current 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. Increased frequency of extreme weather events may also further 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, 2015, the total value of all outstanding claims against us was R\$47,936.8 million (net of R\$386.3 million in escrow deposits). 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 provisioned a total aggregate amount of R\$1,082.2 million (net of escrow deposits) as of December 31, 2015 to cover probable losses related to legal proceedings. This provision does not cover all legal proceedings involving monetary claims filed against us and it may be insufficient to cover our liabilities related to 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”.

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 51% of the aggregate market capitalization of the BM&FBOVESPA as of December 31, 2015.

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, Law No. 6,404 of December 15, 1976, as amended ("Brazilian Corporate Law") and Brazilian capital markets regulations will be resolved by arbitration conducted pursuant to the BM&FBOVESPA 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

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

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

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

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

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 2013, according to the 14th edition of the *Pinsent Masons Water Yearbook 2012-2013*, the most recent edition released of this study). 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, 2015, we generated net revenue of R\$11,711.6 million and net income of R\$536.3 million. Our total assets amounted to R\$33,706.6 million and our total shareholders' equity amounted to R\$13,716.6 million as of December 31, 2015.

As of December 31, 2015, we provided water and sewage services to a broad range of residential, commercial, industrial and governmental customers in 364 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. At year-end 2015 we lacked formal agreements for 53 of the municipalities we serve, each of which we are currently in the process of renegotiation. From January 1, 2016 through 2030, 36 further concessions will expire, and we will seek to replace them with program agreements. In addition to the 364 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 5 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 3.1 million). 4 of these municipalities also utilize our sewage treatment services. For the year ended December 31, 2015, the São Paulo metropolitan region (including the municipalities to which we provide water on a wholesale basis) accounted for 67.3% of our gross operating revenue (excluding revenues relating to the construction of concession infrastructure), while the Regional Systems accounted for 32.7%.

As of December 31, 2015, we provided water services through 8.4 million water connections to approximately 25.5 million people, representing approximately 60% of the urban population of the state of São Paulo, and had a water coverage ratio of approximately 99% in respect of all regions. As of that date, we provided sewage services through 6.9 million sewage connections to approximately 22.8 million people and had an effective sewage coverage ratio of 86%. As of December 31, 2015, we operated using 71,705 kilometers of water pipes and water transmission lines and 48,774 kilometers of sewer lines.

We also provide water and/or sewage services to 4 other municipalities through special purpose companies. In addition, we provide consulting services regarding the rational use of water and financial, commercial and operational management in Panama, Honduras and Nicaragua. We serve Panama and Honduras through an agreement with the consultancy firm Latin Consult. We also have two partnerships with other companies: Aquapolo Ambiental S.A., a joint venture with a private sanitation services operator, and Attend Ambiental S.A., a joint venture with Estre Ambiental 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. Attend Ambiental commenced operations in the second half of 2014 to operate a pre-treatment plant for non-domestic effluent in the São Paulo metropolitan region.

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 April 22, 2016, 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 the last 85 years, of which the Cantareira System, our largest water system, was the most affected. As a result of the drought and the low water inflow in the Cantareira System, DAEE and ANA, since 2014, have continuously regulated the volume of water we are permitted to extract from this system, authorizing us to extract between 13 m³/s and 14 m³/s in the most drastic moments of the crisis. Until the renewal of our water right which shall occur in May 2017, the volume of water that we have been authorized to extract from the Cantareira System has been communicated to us via monthly notices according to the behavior of rainfall, water inflow, level of water in our reservoirs and our requests to extract water based on this information. Due to the return of normal rainfall levels beginning in October 2015, as of February 2016 we have been allowed to extract 23 m³/s of water.

In order to balance supply and demand despite the restricted water availability, we adopted throughout 2014 and 2015 a series of initiatives, amongst which including: (i) using treated water from other production systems to serve consumers originally supplied by the Cantareira system; (ii) to offer discounts (bonus) to consumers that 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 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”. Due to the return of normal rainfall levels in the rainy season beginning in October 2015, as of January 2016 it was no longer necessary to pump water out of the technical reserve of the Cantareira system and we modified the rules for obtaining discounts (bonus) in February 2016. In addition, as of December 2015, the time period during which water is pumped out at reduced pressure in the water distribution lines is returning to the normal nighttime period, as it was prior to the water crisis. In March 2016, as a result of the increased level of rainfall and increased predictability of the level of water in our reservoirs, we requested to ARSESP the cancellations of our Water Consumption Reduction Incentive Program and of the Contingency Tariff. ARSESP approved our requests in the end of March 2016 and the aforementioned policy changes shall be applied to water meter readings recorded as of May 1, 2016.

For further information on the water crisis see “Item 4.B. Business Overview—The Current Water Crisis”.

Our Strengths

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

Well established business with significant size, scale and know how to operate in complex urban settings. We believe we are one of the largest water and sewage service providers in the world. We provide water services directly to approximately 25.5 million people and supply water on a wholesale basis to an additional urban population of approximately 3.1 million people. As of December 31, 2015, we had an effective water coverage ratio of approximately 99% in respect of all regions in which we operate. We also provide sewage services directly to approximately 22.8 million people, achieving an effective sewage coverage ratio of 86% in respect of all regions in which we operate as of December 31, 2015. 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 45 million as of December 31, 2015. The city of São Paulo had an estimated total population of 11.1 million as of the same date, while the São Paulo metropolitan region had a total population of 21.4 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 2013, representing approximately 32.1% 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, 2015, we executed 30 year agreements with 278 of the 364 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, 2015, income from these 30 year agreements accounted for 78.6% 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 BM&FBOVESPA, 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 1, 2007 until 2015, we were part of the BM&FBOVESPA Corporate Sustainability Index, or ISE. Due to the need to focus the attention of all our departments to overcome the water crisis, we decided not to participate in the selection process to be a part of the ISE in 2016.

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 and our goal for the future 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 safety, quality in the provision of services, sustainability, integration and fostering relationships, innovation and technology, valorization of our personnel and increasing sewage treatment. Our strategic objectives also focus on our political and institutional relationships as well as on our commitment to the market to increase shareholder value. Due to changes in macroeconomic conditions, the water crisis and consequent impacts on our business, our strategy is currently under revision. Commencing in late 2015 and continuing in 2016, this revised strategy will determine our objectives and targets for the next decade. We seek to implement these guiding principles through the following strategies:

Continue to seek growth while improving our financial results by reducing operating costs, increasing productivity and profitability and prudently managing our levels of indebtedness. 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.

Improve operating efficiency and reduce water loss. We seek to reduce both physical water loss, which results mainly from leakage; non physical water loss, which results primarily from inaccurate water meters installed at customers' premises and at our water treatment facilities; and clandestine and illegal water use. In order to achieve more consistent long term results, we have developed a comprehensive 12 year program to reduce our water loss rate. The first four years of the program from 2009 to 2012 were funded by *Banco Nacional de Desenvolvimento Econômico e Social*, or "BNDES". From 2013 to 2019, part of the program will be funded by a loan granted by the government of Japan through the Japan International Cooperation Agency, or "JICA". In October, 2015, we asked JICA for a term extension in order conclude construction work that is within the scope of financing, due to changes in economic conditions in Brazil. The exchange rate changed significantly last year, with the depreciation of *real*. This situation, combined with the negative impact of the current water crisis on our revenue for 2015 and the need to prioritize investment in water production, impacted our ability to invest, resulting in the need to increase the term of JICA loan. Therefore, the period the program will be funded by the JICA loan will extend until 2019. For more

information on the program to reduce water loss, see “Item 4.B. Business Overview— Corporate Program for Reduction of Water Loss”.

27

Ensure the quality and availability of our services in our existing service area. Our goal is to maintain an effective water coverage ratio of around 100%, coupled with a high standard of quality and availability, and meet the expected population growth by adding 816 thousands water connections between 2016 and 2020. We also intend to increase our sewage coverage ratio to 95% by 2020 by adding 1.19 million sewage connections. In addition, we are also developing short, medium and long term marketing strategies, such as client segmentation and tailor made solutions for different types of clients, which we believe will help us increase our customer base. We also seek to improve our customer support strategies by modernizing our telephone-based and internet based customer support and to continuously measure the level of satisfaction of our clients.

Maintain and continue to expand our existing service areas. 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. 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, 2015 accounted for 48.2% of our gross operating revenues (excluding revenues relating to the construction of concession infrastructure). Between January 1, 2007 and December 31, 2015, we entered into agreements with 278 municipalities (including our services agreement with the city of São Paulo), of which 4 were entered into in 2015. These 278 municipalities accounted for 78.6% of our total revenues for the year ended December 31, 2015 and 68.4% of our intangible assets as of the same date. As of December 31, 2015, 53 of our concessions had expired and are currently being renegotiated. These 53 municipalities accounted for 12.9% of our total revenues for the year ended December 31, 2015 and 21.6% of our intangible assets as of the same date. From January 1, 2016 through 2030, 36 concession agreements, accounting for 7.8% of our revenues for the year ended December 31, 2015 and 7.4% of our intangible assets as of the same date, will expire.

In 2015 we invested R\$3.5 billion and between 2016 and 2020 we plan to invest an additional R\$12.5 billion to improve and expand our water and sewage system, 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 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 17 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. We also intend to study and take advantage of opportunities in other Brazilian states and in other countries to expand our services and increase our market share.

Expand our water and sewage services. We had an effective sewage coverage ratio of 86% as of December 31, 2015 and plan to increase this ratio to 95% by 2020 by adding over 1.19 million sewage connections and sewage treatment from 78% to 95% by 2020. 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 17 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. Furthermore, we seek to deepen our relationships with strategic clients that consume high volumes of water (more than 500 cubic meters per month) by applying special tariffs to these clients. For more information, see “Item 4.B. Business Overview—Description of our Activities—Sewage Operation” and “Item 4.B. Business Overview—Competition” and “Item 4.B. Business Overview—Tariffs”.

Seek selective opportunities to expand our business. 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 allowed to act, in a subsidiary form, in other Brazilian locations and abroad. 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.

28

The following services have already been completed:

- Under an agreement with Latin Consult, we provided consulting services to seven municipalities in Honduras to implement a new commercial and operational management model.
- We worked with the basic sanitation company of the state of Alagoas to provide technology for the reduction of water loss in the city of Maceió. Under this type of contract, we were remunerated based on our success rate, or more specifically, we profited based on the reduction of water loss achieved in the city of Maceió.
- We developed the sanitation plan for the municipality of Barro Alto in the state of Goiás.
- We concluded the implementation and the customization of our Aqualog software in the Sanitation Company of Espírito Santo (*Companhia Espírito Santense de Saneamento's - CESAN*) water treatment plant in the municipality of Nova Venécia in the state of Espírito Santo.
- Attend Ambiental S.A., a joint venture with Estre Ambiental S.A., commenced operation of a pre treatment and processing plant for non-domestic effluent in the São Paulo metropolitan region during the second half of 2014.

The following services are still in the process of completion:

- An agreement with Latin Consult, we are providing consulting services to the *Instituto de Acueductos y Alcantarillados Nacionales*, the company responsible for water and sewage services in Panama, to assist with sustainable water use and implement a new model for commercial, financial and operational planning and management. The contract is expected to end in 2016.
- Since 2014, we have been working in Nicaragua, focusing on consulting and training in management and in the reduction of water loss. This work is scheduled to end in 2016 and is part of an agreement between Brazil and Japan, in which a bilateral technical cooperation agreement was formalized between us and *Empresa Nicaragüense de Acueductos y Alcantarillados (ENACAL)* in Nicaragua.
- We formed Paulista Geradora de Energia, a joint venture with *Servtec Investimentos e Participações Ltda.* and *Tecniplan Engenharia e Comércio Ltda.*, in which we will install two small hydroelectric power plants with a total capacity of 7 MW. One of the hydroelectric power plants will be built in our water treatment plant in Guaraú. The plants are scheduled to begin operating in the second half of 2017.

Establish efficient and competitive ways of attracting, retaining and motivating our personnel. We intend to become a reference in human resource management, providing our personnel with growth opportunities and recognition. We seek to raise workplace satisfaction levels by establishing programs for the professional and personal development of our employees, setting competitive benefit packages and creating a healthy and collaborative work environment.

Streamline internal processes. We are implementing plans 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. To this end, we invest in information technology to guarantee the resiliency of our business, thus providing an environment of agile, dynamic and secure information technology, capable of absorbing the demand elasticity of our mission-critical systems and of guaranteeing its continuity in case of datacenter failure (including systematic, technological and infrastructure remodeling) and procedures to conform to the best information technology and corporate governance practices.

Additionally, in 2012 we began implementing an enterprise resourcing planning, or “ERP system”, to replace our commercial and management information systems. We contracted through a bidding process the Águas Claras Consortium, currently Consórcio Nascente, which consists of Accenture and Engineering and which will provide us with SAP’s ERP system and the Net@suite system. We estimated that the ERP system would have been implemented in 2014 and the Net@suite in 2015, but during the test phase we concluded that some important system functionalities should have been adjusted and exhaustively tested before being implemented in order to minimize risks to our business which led us to postpone the implementation to 2016 and 2017, respectively.

29

Manage the current adverse climate conditions and mitigate their negative impact. Our goal is to consistently meet the needs of our consumers with our services, and in 2014 and 2015, we managed to do so despite the water crisis. In 2014 and 2015, we invested approximately R\$730 million to mitigate the impacts of the water crisis and provide the São Paulo metropolitan region with better access to water sources, more robust production and transport capacity of treated water and increase treated water capacity. Furthermore, we have planned a series of short-term and medium-term measures that we expect 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 “— Business Overview—The Current Water Crisis”.

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 conditions.

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 45 million as of December 31, 2015. The city of São Paulo, capital of the state of São Paulo, had an estimated total population of 11.1 million, with a total population of 21.4 million inhabitants in the São Paulo metropolitan region, as of December 31, 2015. The São Paulo metropolitan region encompasses 39 municipalities and is the largest metropolitan region in the Americas and the fourth largest metropolitan region in the world, according to the United Nations’ World Urbanization Prospects, 2014 Revision, with approximately 47% of the total population of the state of São Paulo as of December 31, 2015.

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 2013, representing approximately 32.1% 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.

30

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 limited company (*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 364 of the 645 municipalities in the State, including in the city of São Paulo. We also supply water on a wholesale basis to 5 municipalities in the São Paulo metropolitan region in which we do not operate water distribution systems, and 4 of these municipalities also utilize our sewage treatment services. According to the 14th edition of the *Pinsent Masons Water Yearbook* (2012–2013), the most recent edition released of this study, we are the 5th 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 BM&FBOVESPA under the ticker “SBSP3” since June 4, 1997.

In 2002, we joined the *Novo Mercado* segment of the BM&FBOVESPA, 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.

31

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

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.

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 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, regulatory affairs and ombudsman. 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, quality and social responsibility, legal affairs, information technology, asset management, supplies, contracts and new business ventures;
- the Chief Financial 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, is part of the committee on regulatory matters and is responsible for implementing the committee's guidelines with the support of our division responsible for regulatory matters;
- 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 and innovation; 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. Moreover, the Chief Operating Officers are part of the committee on regulatory matters and implemented the committee's guidelines in their respective management teams with the support of our division on regulatory matters. 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 meet the maximum demand for treated water;
- (II). to expand the percentage of households connected to our sewage system;

32

- (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\$12.5 billion from 2016 through 2020. We invested R\$3.5 billion, R\$3.2 billion and R\$2.7 billion in 2015, 2014 and 2013, respectively.

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

	Planned Capital Expenditures					Total
	2016	2017	2018	2019	2020	
	<i>(in millions of reais)</i>					
Water	1,170	1,208	1,119	852	935	5,284
Sewage Collection	466	917	1,044	1,040	1,061	4,528
Sewage Treatment	164	429	571	704	771	2,639
Total	1,800	2,554	2,734	2,596	2,767	12,451

Our capital expenditure program from 2016 through 2020 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 364 municipalities we served as of December 31, 2015 and in the municipality of Santa Isabel, with which we signed a water contract that became effective in 2016.

The recent drought has prompted a continuous reduction in the volume of water billed 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, in 2015 we had to adjust our investment programs for subsequently modify the scheduled amounts of investments for the next few years.

Main Projects of Our Capital Expenditure Program

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

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, we plan on increasing treated water production capacity by approximately 7 m³/s until 2018, with an emphasis on the construction of the São Lourenço System, which shall increase production capacity by approximately 6.0 m³/s. By the end of 2017, we shall also

conclude the interconnection of the Jaguari (part of the Paraíba do Sul Basin) and Atibainha (part of the PCJ Basin) reservoirs.

In 2015, we invested approximately R\$378.1 million in the Metropolitan Water Program. Between 2016 and 2020, we predict investments of over R\$1.2 billion in the Metropolitan Water Program, with a special emphasis on the interconnection of the Jaguari and Atibainha.

Interconnection of Jaguari and Atibainha Reservoirs

33

We are interconnecting 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 investments of R\$555 million in 2016 and 2017, this construction will allow the transfer of up to 8.5 m³/s and 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 is expected to be concluded in 2017.

Other emergency actions to increase the São Paulo metropolitan region's water security supply are also being implemented. For more information, see “—Business Overview—The Current Water Crisis”.

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 are, under a PPP contract, currently developing a new supply system called São Lourenço, which will expand our production capacity by 6.4 m³/s and should be able to benefit a population of almost 1.5 million people. The PPP contract was executed in August 2013 and construction began in April 2014. The project is being 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 new system is expected to begin operation in late 2017. For more information on Public Private Partnerships, see “—Business Overview—Public Private Partnerships”.

The contract amounts to approximately R\$6.0 billion (the estimated amount monetarily restated through December 31, 2015 is approximately R\$7.5 billion) and it has a 25-year term, four years of which will be 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 station and disposal of the waste thus generated; electromechanic and civil maintenance of the untreated water pumping stations, of the water treatment station and the untreated water pipeline; preservation and cleaning, surveillance and property security.

Tietê Project

The Tietê river crosses the São Paulo metropolitan region and receives most of the region's run off 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 reduce pollution 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 BNDES, directly and indirectly

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 five principal sewage treatment facilities in the São Paulo metropolitan region have an aggregate installed capacity of 18 cubic meters of sewage per second and currently treat an aggregate of 16 cubic meters of sewage per second.

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.

Following completion of the third phase of the Tietê Project, the sewage collection system, will serve an additional 1.5 million people and the sewage treatment system will serve an additional 3.0 million people. We have invested approximately R\$1.9 billion in the third phase, R\$355.9 million of which was invested in 2015.

Continuing our efforts to eliminate the disposal of *in natura* sewage in the bodies of water of the São Paulo metropolitan region near the areas we serve, 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, which resulted in approximately R\$377.9 million in total investments in 2015.

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 have invested R\$3.4 billion in this project so far, including R\$525.9 million invested in 2015, and we anticipate total investments of approximately R\$5.5 billion throughout the term of the program. Funding for the program will come from our own resources as well as from credit facilities provided by JICA, *Caixa Econômica Federal* and BNDES.

The program aims to reduce the incidence of water loss from 436 liters per connection per day in December 2008 to 258 liters per connection per day by 2020, which is equivalent to reducing the Water Billed Loss Index from 27.6% in December 2008 to 18.2% in 2020 and to reducing the Water Metered Loss Index (based on measured consumption) from 34.1% in December 2008 to 27.6% in 2020. In 2015, our water loss measured 258 liters per connection per day. In 2015, our Water Billed Loss Index was 16.4% and our Water Metered Loss Index averaged 28.5%.

It is worth noting that the reduction in the water loss indicators in 2015 was due to the intensification of pressure management in the supply systems, an operational practice designed to manage the current water shortage by reducing its impact on the supply of water available to the population. This operational practice has been implemented to serve the current temporary and atypical situation. We note that, when the water supply system returns to being operated as it was prior to the water shortage, there shall be an increase in the pressure in the distribution network which might make it possible for there to be an increase in the loss indicators.

For more information on the measure we have adopted to confront the water crisis, see “—Business Overview—The Current Water Crisis”.

Water Source Program

The Water Source Program (*Programa Mananciais*), created in 2009, consists of various projects that focus 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 are 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 includes the protection of green spaces and the urbanization of shantytowns (*favelas*) and is expected to directly benefit 58,000 families. In 2015, R\$84.2 million was invested in the Water Source Program.

Clean Stream Program

The Clean Stream Program (*Programa Córrego Limpo*), an agreement between the State, acting through our company, and the municipality 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.

35

Since 2007, 148 urban streams have been decontaminated, benefiting approximately 2.2 million people. In 2015, we had invested R\$3.8 million in the Clean Stream Program. Part of the investment related to the Tietê Program benefit the Clean Stream Program.

The effects and the consequences of the drought, as well as the difficulty of the state government to remove and relocate low-income households in risk areas, led us to revise the goals of this program. We are currently negotiating with the municipality of Sao Paulo on new goals for 2017 and beyond, taking into account the future budgets of the institutions involved.

Regional Systems Investment Programs

We currently have a number of projects in progress and planned for our Regional Systems. These relate to the abstraction of water as well as to the collection, removal and disposal of sewage. The main projects of the Regional Systems are the following:

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 95% 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 two phases, the first of which has already begun and the second of which is in the planning phase. The first phase, which aims to increase the sewage collection rate to 88%, is expected to be completed by 2020. The funds will come from our own resources as well as from loan agreements entered into with JICA and from the Government Severance Indemnity Fund for Employees (*Fundo de Garantia por Tempo de Serviço*), or “FGTS”.

In 2015, we invested R\$172 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 71% in 2015. 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, 2015, we completed approximately 94.6 thousand sewage connections. By 2018, we will complete an additional 23 thousand sewage connections.

Under the program’s first phase, we plan to execute by 2020 the expansion and renovation of the Oceanic Sewage Disposal System in the city of Praia Grande, located in the Baixada Santista metropolitan region, is expected to be concluded by 2019.

The second phase of the Clean Wave Program is in planning for the period between 2019 and 2025. We estimate investments of approximately R\$1.8 billion in order to enlarge and implement sewage collection and treatment systems and complete 57 thousand new connections. The goal of the second phase is to provide full coverage of sewage services in the Baixada Santista metropolitan region.

Northern Coast Clean Wave Program

The Northern Coast Clean Wave Program (*Programa Onda Limpa Litoral Norte*) aims to expand the collection and treatment of sewage on the northern coast of the state of São Paulo, intending to benefit 800 thousand people, including the local population as well as tourists that visit the region each year. The program aims to increase the

sewage collection rate in the region from 36.0% in 2008 to 85.0% in 2016, thereby improving the health and well-being of the population and stimulating economic development through an increase in tourism. As of 2015, the sewage collection rate was 56%. In 2015, we invested R\$7 million in this 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*.

36

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 stations, 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.

In 2015, we invested R\$68.3 million in the Coastal Water Program. The second phase of the program is in planning, with the goal of increasing even further the availability of treated water for the local population and tourists and improving the quality of the water available to the population in the Baixada Santista metropolitan region in the coming years.

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, a 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 two million people who consume the water from the basin. Our actions in this project were carried out on three fronts: (i) we installed drains to collect residue from rivers in the Guarapiranga basin; (ii) we have developed diagnosis and control services for the withdrawal of water plants that obstruct water extraction; and (iii) we have removed and disposed deposit garbage at the bottom of the basin's dam.

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 8 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 2015 we completed approximately 23 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

Water is Life

The Water is Life program, established in November 2011, aims to provide water and sewage services to low income and isolated communities in the regions of Alto Paranapanema and Vale do Ribeira. We have expected to cover 81 communities in 30 municipalities, benefiting approximately 15 thousand people. In this project we are responsible for supplying water and for offering technical support to the municipalities, which with financing from the state government, will include installing Individual Sanitary Units (*Unidades Sanitárias Individuais*), a technology better suited for isolated communities. As of December 31, 2015, we concluded projects in 16 communities and we are currently working in 8 others. We executed more than 83 kilometers of networks and pipelines and we began to operate 24 new wells in these communities.

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

B. Business Overview

37

Our Operations

As of December 31, 2015, we provided water and sewage services to 364 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 5 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 3 other municipalities (Cajobi, Iperó e Macatuba). For more information, see “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”. Between January 1, 2007 and December 31, 2015, we entered into agreements with 278 municipalities (including our services agreement with the city of São Paulo) in accordance with the Basic Sanitation Law, of which 4 were entered into in 2015. As of December 31, 2015, these 278 municipalities accounted for 78.6% 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, 2015, 53 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, 2016 through 2030, 36 concessions will expire.

For more information on laws and regulations related to our concession operations, see “Item 4.B. Business Overview—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, 2015.

Operating segments are presented in our annual report in a manner consistent with the internal reporting provided to management, comprised of the board of directors and the board of executive officers, pursuant to 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 management did not review the results of this business. Following our conversion to IFRS, our management decided to continue to exclude the construction results from the management reporting of our revenues and expenses, thus not basing his decisions on discrete financial information for that business. The characteristics described in paragraph 5(b) of IFRS 8 for separate operating segments are thus not fulfilled for this particular business. 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 management as such and is not the basis for operational decisions.

We set forth below a description of our activities.

Wholesale Operations

B. Business Overview

Wholesale Water Services

We provide water services on a wholesale basis to 5 municipalities located in the São Paulo metropolitan region (Guarulhos, Mauá, Mogi das Cruzes, Santo André e 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 2015, the revenues from wholesale water services were R\$66.6 million. 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”.

38

Wholesale Sewage Services

Currently, we provide sewage services on a wholesale basis to the municipalities of Mauá, Mogi das Cruzes, Santo André e São Caetano do Sul. We also provided these services to the municipality of Diadema, but in March 2014, we executed a contract to resume direct supply of water and sewage services to the municipality of Diadema. 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 2015 we treated approximately 30.6 million cubic meters of sewage from these municipalities. We believe this illustrates our commitment to social and environmental responsibility. In 2015, our revenues from wholesale sewage services were R\$26.5 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 such services will only commence when the works on linking the Guarulhos sewage to our sewage system are finalized. These works are the responsibility the Guarulhos sanitation company.

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 2015, we produced approximately 2,466.6 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 67.9% of water invoiced by volume in 2015.

The reduction in the volume of water produced in 2015, as compared to 2014, is a result of the water crisis that affects our area of operation. 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 resulted in a significant decrease in the volume of water billed and revenues from services we provide, which had a material adverse effect on our company and that may worsen if the drought escalates in severity" and "—The Current Water Crisis". The following table sets forth the volume of water that we produced and invoiced for the periods indicated:

	Year ended December 31,		
	2015	2014	2013
	<i>(in millions of cubic meters)</i>		
Produced:			
São Paulo metropolitan region	1,679.4	2,001.1	2,220.6
Regional Systems	787.2	839.3	832.0
Total	2,466.6	2,840.4	3,052.6
Invoiced:			
São Paulo metropolitan region	1,084.3	1,172.4	1,206.9
Wholesale	215.5	256.8	299.0
Regional Systems	613.9	639.4	628.1
Total	1,913.7	2,068.6	2,134.0

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

39

- 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 254 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 75.5 m³/s, not including an additional 6.5 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 52.0 m³/s during 2015. The Cantareira, Guarapiranga and Alto Tietê systems produce 79.0% of the water we distributed in the São Paulo metropolitan region in 2015.

In 2015, the Cantareira system accounted for 27.1% 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 67.3% 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”.

For further information on droughts see “Item 3.D Risk Factors—Risks Relating to Our Business—The measures we took to mitigate the effects of the drought resulted in a significant decrease in the volume of water billed and revenues from services we provide, which had a material adverse effect on our company and that may worsen if the drought escalates in severity” and “—The Current Water Crisis”.

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 158 employees on the 21 State River Basin Committees and the four 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⁾		
2015	2014	2013

*(in cubic meters per second)***Water production system:**

Cantareira	14.1	23.7	32.6
Guarapiranga	14.9	14.2	13.6
Alto Tietê	12.1	13.8	12.1
Rio Claro	3.9	3.9	3.9
Rio Grande (Billings reservoir)	5.0	4.8	4.8
Alto Cotia	0.9	0.9	1.2
Baixo Cotia	1.0	0.8	0.8
Ribeirão da Estiva	0.1	0.1	0.1
Total	52.0	62.2	69.1

(1) Average of the twelve months ended December 31, 2015, 2014 and 2013.

40

We own all of the reservoirs in our production systems other than the Guarapiranga and Billings reservoirs and a portion of some of the reservoirs of the Alto Tietê system, which is owned by other companies controlled by the State. We currently do not pay any charges with respect to the use of these reservoirs. In December 2001, we entered into an agreement with the State whereby the State, among other things, agreed to transfer the remaining reservoirs in the Alto Tietê system to us. 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”. In the interior cities of São Paulo, our principal source of water consists of surface water from nearby rivers and from wells.

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 226.0 thousand, 231.6 thousand and 226.4 thousand, new water connections in 2015, 2014 and 2013, respectively. Throughout 2014 and 2015, we adopted various measures to mitigate the current water crisis, which allowed us to provide water to the population despite the decreased water availability. We were able to balance supply and demand for water in the São Paulo metropolitan region, as a result of: (i) using treated water from other production systems to serve consumers originally supplied by the Cantareira system; (ii) to offer discounts (bonus) to consumers that 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”. For more information on the effects of the drought on the water supply, see “—The Current Water Crisis”.

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 5 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\$4.3 billion from 2016 to 2020 to increase our water production and distribution capacities as well as to improve the water supply systems. In 2015, our total investment in water supply systems amounted to R\$2.2 billion, of which R\$1.8 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 235 treatment facilities, of which 8 are a part of the Metropolitan Production System—located in the São Paulo metropolitan region and account for approximately 68% of all water we produced in 2015. 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

Edgar Filing: COMPANHIA DE SANEAMENTO BASICO DO ESTADO DE SAO PAULO-SABESP - Form 20-F
through the networks in order to maintain adequate pressure and continuous water supply.

41

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,		
	2015	2014	2013
Water distribution pipes and water transmission lines (in kilometers)	71,705	70,800	69,619
Number of connections (in thousands)	8,420	8,210	7,888

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, 2015, our water distribution pipes and water transmission lines included: (i) 37,448 kilometers in the São Paulo metropolitan region; and (ii) 34,257 kilometers in the Regional Systems.

As of that date, we had 387 storage tanks in the São Paulo metropolitan region with a total capacity of 2.1 million cubic meters, and 1,959 storage tanks in the Regional Systems. Furthermore, we had 210 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						
	2016	2017	2018	2019	2020	2021	2016 – 2021
São Paulo metropolitan region	100	95	97	92	92	92	568
Regional Systems	72	69	67	66	66	66	406
Total	172	164	164	158	158	158	974

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) in %; and
- Water Loss per Connection, (TLDC) in liters per connection per day.

These indicators are calculated by applying the following formulas:

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

Where:

V_{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, 2015, we experienced 277 liter/connection per day of water loss in the São Paulo metropolitan region and 230 liter/connection per day in the Regional Systems, averaging 258 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 258 liters/connection, Water Billed Loss Index to 18.2% and the Water Metered Loss Index to 27.6% 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 18.5% in December 2015. 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.

43

For more information on the measure we have adopted to confront the water crisis, see “—The Current 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.

44

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 62.0 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 (NSF) and the American Water Works Association (AWWA) to eliminate toxic substances that are harmful to human health. From time to time, we face problems with the proliferation of algae, which may cause an unpleasant taste and odor in the water. In order to mitigate this problem, we work on: (i) fighting algae growth at the water source and (ii) using advanced treatment processes at the water treatment facilities that involve the use of powdered activated carbon and oxidation by potassium permanganate. The algae growth creates significant additional costs for water treatment because of the higher volumes of chemicals used to treat the water. We participate 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 “—New 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, 2015, we collected approximately 87% and 82% 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 2015, we collected approximately 86% of all the sewage produced in the municipalities in which we operated in the state of São Paulo. We installed 226.1 thousand, 244.3 thousand and 236.6 thousand new sewage connections in 2015, 2014 and 2013, 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, 2015, we were responsible for the operation and maintenance of 48,774 kilometers of sewage lines, of which approximately 26,082 kilometers are located in the São Paulo metropolitan region and 22,692 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:

45

	As of December 31,		
	2015	2014	2013
Sewage lines (in kilometers)	48,774	47,992	47,103
Sewage connections (in thousands)	6,861	6,660	6,340

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 and its discharge 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 into the public sewage system and stipulates that such effluents be subject to pretreatment in order to comply with the established standards. These standards are defined in State Decree No. 8,468/1976, as amended by State Decree No. 54,487/2009.

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 Sao Paulo Sanitation Technology Company (*Companhia Ambiental do Estado de São Paulo*), or “CETESB”, is notified in order for the applicable measures to be taken.

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, with approximately 69% of all residences in the coastal region currently connected to our sewage network as of December 31, 2015.

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:

2016	2017	2018	2019	2020	2021	2016	2021
<i>in thousands</i>							

São Paulo metropolitan region	136	132	130	136	129	137	800
Regional Systems	106	110	107	101	108	100	632
Total	242	242	237	237	237	237	1,432

Sewage Treatment and Disposal

In 2015, approximately 68% and 97% of the sewage we collected in the São Paulo metropolitan region and the Regional Systems, respectively, or 78% of the sewage we collected in the state of São Paulo, was treated at our treatment facilities and afterwards discharged into receiving water bodies such as rivers and the Atlantic Ocean, in accordance with applicable legislation. Though we have not yet reached full coverage of sewage collection and treatment services in the regions where we operate, we are making efforts to reach this goal.

We currently operate 9 ocean outfalls and 530 sewage treatment facilities, of which the five largest, located in the São Paulo metropolitan region, have treatment capacity of approximately 18 cubic meters of sewage per second.

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

Sewage treatment in the Regional Systems will vary according to the particularities of each area. In the interior region of São Paulo State, treatment consists largely of stabilization ponds. There are 428 secondary treatment facilities in the interior region of São Paulo State that have treatment capacity of approximately 15 cubic meters of sewage per second. Similar to our disposal process for treated sewage collected in the São Paulo metropolitan region, the majority of sewage collected in the coastal region receives treatment and disinfection and is then discharged into rivers and also into the Atlantic Ocean through our ocean outfalls, in accordance with applicable legislation. We have 78 sewage treatment facilities in the coastal region.

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

Sludge Disposal

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

Currently, the sludge generated through our business activity goes mainly to landfills. In turn, we treat the slurry generated in these landfills.

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

In our sewage treatment station in Barueri, the largest treatment station in Latin America, we aim to reduce the quantity of sludge sent to landfills by seeking partnerships to conduct sludge drying. By drying sludge, 500 tons of sludge are reduced to 140 tons, transforming the dried sludge into cylindrical pellets that are used as a source of fuel for the generation of thermoelectric energy. The energy generated by the dried sludge pellets is used in the sludge drying process. We also use dried sludge to generate electric energy which may be sold or used in our own sewage treatment stations.

In the interior and coastline regions of São Paulo, we have initiatives for the implementation of thermosolar sludge drying systems. By combining the remains of tree stubs and eucalyptus shells to the dried sludge, the sludge produced may be used as a fertilizer for agriculture.

Part of the R\$14.7 million invested in research and development in 2015 was used for approached to the disposal and beneficial use of sludge, in order to meet the Principles for Cleaner Production. For more information, see “Item 5.C. Operating and Financial Review and Prospects—Research and Development, Patents and Licenses, Etc”

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

Principal Markets in Which We Operate

As of December 31, 2015, we operated water and sewage systems in 364 of the 645 municipalities in the state of São Paulo. In addition, we currently supply water on a wholesale basis to 5 municipalities located in the São Paulo metropolitan region with an urban population of approximately 3.1 million people.

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

	Year ended December 31,		
	2015	2014	2013
	<i>(in millions of R\$)</i>		
São Paulo metropolitan region	6,021.9	6,235.3	6,984.4
Regional Systems	2,924.9	2,670.1	2,555.7
Total	8,946.8	8,905.4	9,540.1

The following table provides a breakdown of gross revenues from water supply and sewage services by category of activity for the periods indicated:

	Year ended December 31,		
	2015	2014	2013
	<i>(in millions of R\$)</i>		
Water supply	5,045.5	4,896.7	5,276.1
Sewage services	3,901.3	4,008.7	4,264.0
Total	8,946.8	8,905.4	9,540.1

Competition

In the state of São Paulo, there are approximately 276 municipalities that operate their own water and sewage systems and that collectively have a total population of approximately 14.2 million, or approximately 31% of the population of the state of São Paulo, excluding the population of the municipalities to which we provide water services on a wholesale basis.

The competition for municipal concessions arises mainly from the municipalities, as they may resume the water and sewage services that were granted to us and start providing these services directly to the local population. In this case, the municipal governments would be required to indemnify us for the unamortized portion of our investment. See “Item 3.D. —Risk Factors—Risks Relating to Our Business—Municipalities may terminate our concessions before they expire in certain circumstances”. In the past, municipal governments have terminated our concessions agreements before the expiration date. Furthermore, municipal governments have tried to expropriate our assets in an attempt to resume the provision of water and sewage services to local populations. See “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”. We negotiate expired concession agreements and concession agreements close to expiration with the municipalities in an attempt to maintain our existing areas of operations. In the state of São Paulo we face competition from private and municipal water and sewage service providers.

In recent years, we have also experienced an increasing level of competition in the market of water supply to industrial customers. Several large industrial customers located in municipalities we serve use their own wells to meet their water needs. In addition, competition for the disposal of non residential, commercial and industrial sludge in the São

Paulo metropolitan region has increased in recent years as private companies offer stand alone water treatment solutions inside the facilities of their customers. We have also established new tariff schedules for commercial and industrial customers in order to assist us in retaining these customers. For this group of certain industrial customers, ARSESP has given us special authorization to establish fixed demand agreements. Since these fixed demand agreements (take-or-pay contracts) with certain of our industrial customers are not covered by our bonus program, we stopped requiring the fulfillment of this fixed demand contract to encourage lower water consumption. In 2015, due to the water crisis, we did not formalize new contracts or increment the volume of water supplied and stopped requiring the fulfillment of this fixed demand contract. For more information about the water crisis, see “—The Current Water Crisis”. For more information on Take-or-pay Contracts see “—Tariff Structure—Fixed Demand Agreements (Take-or Pay)”.

48

Billing Procedures

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

The majority of the bills for water and sewage services are delivered to our customers in person, mainly through one of our employees or through independent contractors who are also responsible for reading water meters. The remainder, by judicial determination, is sent by mail. Water and sewage bills can be paid at some banks and other locations in the state of São Paulo. These funds are paid over to us after deducting average banking fees ranging from R\$0.29 to R\$1.21 per transaction for collection and remittance of these payments.

Customers must pay their water and sewage bills by the due date if they wish to avoid paying a fine. We generally charge a penalty fee and interest on late bill payments. In 2015, 2014 and 2013, we received payment of 90.4%, 94.6% and 95.2%, respectively, of the amount billed to our retail customers, and 90.2%, 94.3% and 95.0%, respectively, of the amount billed to those customers other than State entities, within 30 days after the due date. In 2015, 2014 and 2013, we received 96.2%, 101.1% and 100.5%, respectively, of the amount billed to the State entities. Amounts in excess of 100.0% reflect our recovery of amounts billed in prior years. With respect to wholesale supply, in 2015, 2014 and 2013, we received payment of 43.8%, 32.8% and 45.8%, respectively, of the amount billed within 30 days.

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

Tariffs

Tariff adjustments follow the guidelines established by the Basic Sanitation Law, ARSESP and our contracts, when applicable. The guidelines also establish procedural steps and the terms for the annual adjustments. The adjustments have to be announced 30 days prior to the effective date of the new tariffs, which previously became effective in September. As of the tariff revision conducted in 2014, the definition of the base date and future adjustments occur in April, and become effective in May.

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

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

In regards to municipalities that have not explicitly selected ARSESP as their regulator, the Basic Sanitation Law allows the municipality to create other regulatory agencies of their own. In 2007, the municipality of Lins decided to

create its own regulatory authority, although it revised this decision in 2010, transferring to ARSESP the regulation of the water activities performed in Lins, including for the setting of tariffs. The municipality of Lins has reserved, however, the power to ultimately approve the tariff set by ARSESP.

In addition, in 2011, the municipalities located in the hydrographic basins of the Piracicaba, Capivari and Jundiaí rivers created a consortium known as ARES/PCJ to regulate and supervise our activities in those areas, and for similar purposes, in November 2013 the Regulatory Agency of São Bernardo do Campo (AR/SBC) was created. As a result of the creation of the ARES/PCJ, we are currently involved in legal proceedings in which ARES/PCJ is claiming that it has jurisdiction over the regulation and supervision of our activities in three municipalities (Piracaia, Mombuca and Santa Maria da Serra). We cannot predict the outcome of this case or how it may impact our business. See “Item 3.D. Risk Factor—Risks Relating to Our Business—Current regulatory uncertainty, especially with regard to implementation and interpretation of the Brazilian Basic Sanitation Law, may have an adverse effect on our business”.

The number of judicial disputes related to the regulation and oversight of services in areas served by us and regulated by ARSESP has recently increased since 2012. Regional and municipal agencies may continue to be created and may dispute with ARSESP regarding the regulation and oversight of our services.

In 2009, ARSESP invited public discussion and hearings to take place regarding the methodology for tariff revisions. In 2010, ARSESP issued Resolution No. 156/2010. This resolution established the methodology and general criteria for the valuation of our regulatory asset base to be used for purposes of tariff review processes and auditing. In May 2011, ARSESP disclosed the applicable weighted average cost of capital (8.06%) and disclosed in April 2012 the methodology for tariff revisions. In November 2012, ARSESP published a preliminary technical note for public consultation, proposing a preliminary initial maximum average tariff (P0) and X Factor, based on a preliminary evaluation of assets held by us.

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

On November 1, 2013, ARSESP issued Resolution No. 435/2013 which authorizes us to implement a tariff adjustment. Initially, this adjustment considered an inflation rate of 6.2707% as measured by the IPCA for the period from August 2012 to July 2013. From this number, ARSESP deducted the efficiency factor, or “X Factor”, of 0.4297% for the period, and this resulted in an adjustment of 5.8410%. Additionally, ARSESP estimated the gain that we had with the preliminary tariff revision of 2.3509% beginning in April 2013, and this resulted in a further reduction of 0.9249% in the indicator. Moreover, ARSESP also estimated our loss of 0.6538% resulting from the delay in the repositioning of the IPCA and added that estimated amount. The product of these estimations and considerations resulted in a linear increase of 3.1451% in tariffs beginning December 11, 2013.

In April 2014, ARSESP issued Resolution No. 484/2014 (further ratified by ARSESP Resolution No. 520/2014), which, among other things: (i) establishes that, as of May 11, 2014, a tariff repositioning index of 5.4408% in relation to our current tariffs and an annual X Factor of 0.9386%, which will be deducted in the upcoming annual tariff adjustments, shall be applied to water services bills; (ii) allows us to apply the repositioning index arising from the tariff revision at a more opportune future date, when we shall proceed with a recalculation and monetary adjustment of the applicable amounts, in order to ensure our economic and financial balance, taking into account the atypical situation in our market due to the lack of rainfall and our measures to encourage water savings in order to ensure supply; (iii) establishes that the next annual tariff adjustments will occur on April 11, 2015 and April 11, 2016, with the next tariff revision on April 11, 2017; and (iv) ratifies the readjustment rules set forth on Resolution No. 406/2013 and updated the X Factor for the tariff cycle from 0.836% to 0.9386%. The current tariff structure will be kept with respect to our services until the new structure is approved by ARSESP and implemented. Considering what has been established by Resolution No. 484/2014, we decided to postpone the application of the repositioning index to an opportune date no later than the end of December 2014.

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

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

50

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

II. a 100% increase on the tariff amount applicable to the water consumption portion that exceeds more than 20% of the average.

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

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

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

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

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

II. Resolution No. 615/2015, also published in December 2015, authorized the extension of the Water Consumption Reduction Incentive Program until December 31, 2016, or until hydrological conditions become more predictable, and updated of the reference consumption value used to determine when discounts should be offered to our customers. Prior to this resolution, the reference consumption value by which we calculated the discounts was the average consumption of our customers in the period between February 2013 and January 2014. As of December 2015, we modified the reference consumption value, which is currently set at 78% of the prior reference consumption value. The updated reference consumption value began to be applied to our customers' bills as of February 1, 2016. The bonus ranges of 10%, 20% and 30%, were maintained, following the rules of our discount (bonus) program which established that if a client consumes 10% less water during a certain period compared to his reference consumption value, he will obtain a discount of 20% in his water bill, and if the client consumes 20% less water, he obtains a discount of 30%.

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

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

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

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

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

- In March 2013, ARSESP issued Resolution No. 407/2013, authorizing us to pass on to our consumers the 7.5% transfer to the Municipal Fund for Environmental Sanitation and Infrastructure, as defined by municipal legislation. Pursuant to the Program Contracts and the Sewage and Water Supply Service Contracts, this charge must be considered in the tariff revision.
- In April 2013, ARSESP issued Resolution No. 413/2013, which effectively suspended Resolution No. 407/2013 until the tariff revision process is concluded, thereby postponing our authorization to pass on to our consumers' service bill the charge for the Municipal Fund for Environmental Sanitation and Infrastructure. The postponement of Resolution No. 407 was due to a request from the Government of the State of São Paulo to analyze, among other matters, methods of reducing the impact on consumers.
- In May 2014, ARSESP issued Resolution No. 488/2014, which maintained the suspension of ARSESP Resolution No. 407/2013 until the outcome of the revision of the contract signed between us, the city of São Paulo and the State of the São Paulo is known, thereby delaying the authorization to pass on to our consumers' service bill the charge for the Municipal Fund for Environmental Sanitation and Infrastructure. We cannot be certain when the contract will be revised or when we will be able to pass the 7.5% charge on to consumers through the service bill.

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

Tariff Structure

Regarding the tariff structure, ARSESP Resolution No. 463/2014, published in January 2014, established April 10, 2014, as the deadline for publication of the timetable for implementation of our new tariff structure. However, on April 17, 2014, ARSESP issued Resolution No. 484/2014, which maintains the current Tariff Structure and does not set a date for implementation of the new tariff structure. Until the new tariff structure is approved by ARSESP, we will continue to use our current tariff structure. As such, we currently divide tariffs into two categories: residential and non residential. The residential category is subdivided into standard residential, residential-social and shantytown (*favela*). The residential-social tariffs apply to residences of low income families, residences of persons unemployed for up to 12 months and collective living residences. The *favela* tariffs apply to residences in shantytowns characterized by a lack of urban infrastructure. The latter two sub categories were instituted to assist lower income customers by providing lower tariffs for consumption. The non residential category consists of: (i) commercial, industrial and public customers; (ii) "not for profit" entities that pay 50.0% of the prevailing non residential tariff; (iii) government entities that have entered into a water loss reduction agreement with us and pay 75.0% of the

prevailing non residential tariff; and (iv) public entities that have entered into program agreements, for municipalities with a population of up to 30.0 thousand and with half or more classified according to their degree of social vulnerability by the Social Vulnerability Index of São Paulo (*Índice Paulista de Vulnerabilidade Social*) 5 and 6, of the SEADE, obtained through the analysis of the 2000 Census figures, and start to receive tariff benefits, in accordance with our normative ruling, for the category of public use, at the municipality level. The tariffs are equal to those offered to the commercial/entity of social assistance and that corresponds to 50.0% of the public tariffs without contractual provisions referred to in item (iv) above.

52

Fixed Demand Agreements (Take or Pay)

We established a new tariff schedule, effective May 2002, for commercial and industrial customers that consume at least 5,000 cubic meters of water per month and that enter into fixed demand agreements (take or pay) with us for at least one year terms. In October 2007, the minimum volume for entering into these agreements was reduced from 5.0 thousand cubic meters per month to 3.0 thousand cubic meters per month. We believe this tariff schedule will help prevent our commercial and industrial customers from switching to the use of private wells. Since 2008, we have been authorized by ARSESP to establish tariffs for non residential customers, such as industrial and commercial customers, that consume more than 3.0 thousand cubic meters per month, with a maximum tariff equal to the tariffs applicable to non residential customers that consume more than 50 cubic meters per month. In 2010, ARSESP authorized a reduction in the minimum volume of consumption for customers that enter into fixed demand agreements with us to a minimum of 500 cubic meters per month.

In 2015, due to the water crisis, we did not formalize new contracts or increment the volume of water supplied and stopped requiring the fulfillment of this fixed demand contract. These fixed demand agreements are not covered by the water consumption reduction program, and are comprised in the contingency tariff that was implemented in January 2015. For more information about the water crisis, see “—The Current Water Crisis”.

Water and sewage services tariffs

We establish separate tariff schedules for our services in each of the São Paulo metropolitan regions and each of the interior region of São Paulo State and coastal regions which comprise our Regional Systems. Each tariff schedule incorporates regional cross subsidies, taking into account the customers' type and volume of consumption. Tariffs paid by customers with high monthly water consumption rates exceed our costs of providing water service. We use the excess tariff billed to high volume customers to compensate for the lower tariffs paid by low volume customers. Similarly, tariffs for non residential customers are established at levels that subsidize residential customers. In addition, the tariffs for the São Paulo metropolitan region generally are higher than tariffs in the interior region of São Paulo State and coastal regions.

Sewage charges in each region are fixed and are based on the same volume of water charged. In the São Paulo metropolitan region and the coastal region, the sewage tariffs equal the water tariffs. In the interior São Paulo State region, sewage tariffs are approximately 20.0% lower than water tariffs. Wholesale water rates are the same for all municipalities served in the São Paulo metropolitan region. We also make available sewage treatment services to those municipalities in line with the applicable contracts and tariffs. In addition, various industrial customers pay an additional sewage charge, depending on the characteristics of the sewage they produce.

Each category and class of customer pays tariffs according to the volume of water consumed. The tariff paid by a certain category and class of customer increases progressively according to the increase in the volume of water consumed. The first category (0-10) corresponds to the minimum fee that is charged to our customers for the consumption of water. The following table sets forth the water and sewage services tariffs by (i) customer category and class; and (ii) volume of water consumed, charged in cubic meters during the years and period stated in the São Paulo metropolitan region:

Customer Category Consumption	As of June 4 2015	As of December 27, 2014	As of December 11, 2013
Residential			
Standard Residential:			
0-10 ³	2.06	1.79	1.68

(reais per m³)

11 20	3.23	2.80	2.63
21 50	8.07	7.00	6.57
Above 50	8.89	7.71	7.24
Social:			
0 10 ⁽¹⁾	0.70	0.61	0.57
11 20	1.21	1.05	0.99
21 30	4.28	3.71	3.48
31 50	6.10	5.29	4.97
Above 50	6.74	5.85	5.49
Shantytown (<i>favela</i>):			
0 10 ⁽¹⁾	0.53	0.46	0.44
11 20	0.61	0.53	0.50
21 30	2.02	1.75	1.64
31 50	6.10	5.29	4.97
Above 50	6.74	5.85	5.49
Non Residential			
Commercial/Industrial/Governmental:			
0 10 ⁽¹⁾	4.15	3.60	3.38
11 20	8.07	7.00	6.57
21 50	15.45	13.41	12.59
Above 50	16.10	13.97	13.12
Social Welfare Entities:			
0 10 ⁽¹⁾	2.07	1.80	1.69
11 20	4.03	3.50	3.29
21 50	7.76	6.73	6.32
Above 50	8.06	6.99	6.56
Government entities that employ the Rational Use of Water Program (<i>Programa de Uso Racional da Água – PURA</i>), with reduction agreement:			
0 10 ⁽¹⁾	3.11	2.70	2.53
11 20	6.04	5.24	4.92
21 50	11.63	10.09	9.47
Above 50	12.08	10.48	9.84

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

In 2015, 2014 and 2013, the average tariff calculated for the Regional Systems was approximately 25% below the average tariff of the São Paulo metropolitan region.

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

Government Regulations Applicable to our Contracts

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

- the granting of concessions to provide water and sewage services;
- the development of PPPs;
- the need of a public bidding process for the appointment of private water and sewage services providers;
- the need of setting up an agreement for the appointment of public water and sewage services providers;
- the joint management of public services through cooperation, allowing for a program agreement without the need for a public bidding process for the service provider, subject to the condition that the planning, execution and monitoring activities are not executed by the service provider;
- minimum requirements for water and sewage services;
- water usage;
- water quality and environmental protection; and
- governmental restrictions on the incurrence of debt applicable to state controlled companies.

PLANASA

54

In 1978, the tariffs and terms of operations of basic sanitation services, integrated to the National Plan of Basic Sanitation (*Plano Nacional de Saneamento Básico*), or “PLANASA”, were regulated by Law No. 6,528/1978, which regulated and supervised SABESP, created by State Law No. 119/1973 as a mixed capital company to provide basic sanitation services to the municipalities of the state of São Paulo.

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

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

The Basic Sanitation Law

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

The Basic Sanitation Law establishes the following guiding principles for the public service of basic sanitation: universalization, integrality, efficiency and economic sustainability, transparency of actions, social control and integration of infrastructure and services with the management of water resources. It does not define the ownership of the sanitation services, but establishes the minimum liability for the exercise of ownership, such as the development of the sanitation plan, definition of the entities responsible for the regulation and control of sanitation services and the establishment of the rights and obligations of the users and of social control mechanisms. It also defines the laws and regulations under which a water and basic sanitation provider may provide its services to several regions controlled by different owners (*i.e.*, one single provider serves two or more owners, for which there may be one plan for the combination of services).

In addition, the Basic Sanitation Law defines the rules for the delegation of water and sewage services by the states and municipalities to contracted parties. The Basic Sanitation Law also significantly amends Article 42 of the Concessions Law, which establishes the termination of concessions prior to the expiration date and the reversibility conditions for unamortized assets. The amendment to Article 42 establishes that when a concession is terminated prior to its expiration date, the service provider must be compensated for unamortized assets, preferably through an amicable settlement between the parties defining the criteria for the calculation and payments of indemnity. Federal Decree No. 7,217/2010, enacted on June 21, 2010, (as modified by Federal Decree No. 8,211/2014 of March 21, 2014) and Law No. 11,445/2007, implemented the first series of new principles under the Basic Sanitation Law, including the following:

- for public-private partnership contracts (or program contracts), public hearings must be held with respect to bid announcements, and technical and economic viability studies must be performed;

- the rights and obligations of customers and service providers, including penalties, are determined by the owner of the public service, not by the regulatory agency (since its function is to ensure full compliance of legislative and contractual conditions);
- the regulatory agency's function is to ensure compliance with the law and with the contractual conditions;
- the technical and financial viability of the provision of water and sewage services should be determined based on (i) capital contributions necessary to offer the services and (ii) expected revenues from the provision of the service; and

55

- when a regulated service is to be provided by different service providers, those providers must execute an agreement regulating their respective activities.

The Basic Sanitation Law defines the principles and guidelines which must be respected when securing public funds generated or operated by agencies or entities of the federal government, and foresees the possibility of using subsidies as an instrument of social policy in order to ensure access to basic sanitation services to everyone, particularly for low income families. The subsidies may be granted either directly, through tariffs, or indirectly, depending on the characteristics of the beneficiaries and on the source of the funds.

Furthermore, the Basic Sanitation Law also provides that the provision of sanitation services may be interrupted by the service provider, in the event of a default of payment of the tariffs by the customer, among other reasons. The provision of sanitation services may only be interrupted after a written notice, and as long as minimum health requirements are met. The Basic Sanitation Law defines the criteria for the reversal of assets at the time of termination of the agreement and, which also encompasses concession agreements, such as those that have expired or are effective for an indefinite term, or those that were not formalized by an agreement. In addition, the Basic Sanitation Law provides the basis for calculating the amount of an indemnity due, which must be calculated by a specialized institution chosen by mutual agreement between the parties.

Pursuant to the Basic Sanitation Law, the parties involved in a concession may enter into an agreement with respect to the payment of the indemnification due to the concessionaire. However, in the absence of an agreement, the Basic Sanitation Law establishes that the indemnification must be paid in no more than four equal and successive annual installments, with the first installment payable by the last business day of the fiscal year in which the assets are reversed.

According to the Basic Sanitation Law, the existing concessions will remain in effect until payment of indemnification is made based on the valuation of the investments. The Basic Sanitation Law provides that our new concession agreements must be planned, supervised and regulated by the municipalities together with the State under a new model of associated management that will allow for better control, supervision, transparency and efficiency in the provision of public services.

Contracts for the Provision of Essential Basic Sanitation Services in Brazil

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

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

Concession Agreements

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

56

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

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

Public Private Partnerships

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

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

In our case, payment is conditional upon performance and is collected through the use of resources from the budget. For more information, see “Item 4 Information the company – A. History and development the company – Capital Expenditure Program.

Program Agreements

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

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

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

57

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

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

Agreements with Municipalities and Metropolitan Regions

We provide basic sanitation services for municipalities and metropolitan regions. With regard to local operations, the municipalities are responsible for providing basic sanitation services. Thus, we operate through new contracts executed pursuant to a legal waiver of public tender under cooperation agreements between the state and municipalities which permit sharing the management of basic sanitation services.

With regard to metropolitan regions, we conduct our operations based on state legislation and contracts and note pending litigation addressing the delineation of responsibilities regarding basic sanitation services in municipalities and metropolitan regions. There are pending cases before the Brazilian Supreme Court regarding whether the right to execute concession and program agreements in metropolitan regions belongs to the states or to the municipal governments. We note that on February 28, 2013, the Brazilian Supreme Court decided a pending case connected to the state of Rio de Janeiro, whose effects may impact other ongoing legal proceedings. In its decision, the majority of the court held that the state of Rio de Janeiro must establish new entities to oversee the planning, regulation and auditing of basic sanitation services in its metropolitan region with the non-partisan participation of relevant municipalities.

In March 2013, the court ruled that this holding would come into effect in the state of Rio de Janeiro after a remaining appeal of its holding is decided. The court’s holding represents a new paradigm in the management and provision of public water and sewage services. The Brazilian Supreme Court has yet to clarify the effects and extension of its decision which modifies the ability of independent municipalities in metropolitan regions to exercise their constitutional competencies, including those related to the provision of basic sanitation services, due to public interest initiatives designed to provide adequate and continuous service to the residents of these municipalities.

With respect to the oversight and sharing of responsibilities between states and municipalities of basic sanitation services, the Brazilian Supreme Court has ruled that the state must establish a public entity, with the non-partisan participation of the municipalities, in order to plan, regulate, and oversee basic sanitation services in these locations. Nevertheless, appeals were filed against this holding and are currently pending.

In January 2015, the Federal Government issued the Metropolitan Bylaws (Law No. 13,089/2015), which within the next three years will establish: (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 international governance instruments; and (iii) the criteria to

receive federal loans for initiatives related to international governance in the area of urban development. This law is expected to enter into effect within the next three years.

In these municipalities, operations are regionalized and contracts are structured considering the financial and economic conditions of the entire region. The regulation including taxes, control and oversight are the responsibilities of ARSESP (LCE 1,025/2007 – Articles No. 6 and No. 10).

58

Establishment of ARSESP

On June 8, 2006, the State of São Paulo enacted Decree No. 50,868/2006, creating the Commission for the Regulation of Sanitation Service of the State of São Paulo (*Comissão de Regulação do Serviço de Saneamento do Estado de São Paulo*), or “CORSANPA”, to regulate basic sanitation services. CORSANPA is directly subordinated to the State Secretariat for Sanitation and Water Resources. On August 5, 2009, the State of São Paulo enacted Decree No. 54,644/2009, which revoked Decree No. 50,868 and regulated the composition, organization and operation of the State Sanitation Council (*Conselho Estadual de Saneamento*), or “CONESAN” created by Supplementary Law No. 7,750/1992.

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

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

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

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

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

- the compliance with and enforcement of state and federal basic sanitation legislation;
- the publication of the organizational platform for the services, indicating the types of services provided by the State, as well as the equipment and facilities that compose the system;
- the acceptance, where applicable, of the legal attributions of the jurisdictional authority;
- the establishment, in accordance with the tariff guidelines defined by Decree No. 41,446/96, of tariffs and other methods that provide compensation for our services, adjustment and review of such tariffs and methods to ensure the financial economic balance of services and low cost tariffs through mechanisms that increase service efficiency and

lead to the distribution of productivity gains to society; and

- the approval, oversight and regulation (including tariff issues) of the sewage treatment and wholesale water supply agreements entered into between the state supplier and other suppliers, pursuant to Article 12 of the Basic Sanitation Law.

59

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

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

Rules Enacted by ARSESP

In 2009 ARSESP enacted rules regarding the following:

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

Consumer Relations in the State of São Paulo

In 2011, ARSESP altered the standard contract that we are required to use in our relationships with retail customers. This alteration requires that invoices be sent to the user of the service rather than the owner of the property. Since 2011, we have implemented several measures and instituted new rules to update our client registry. Currently, more than 90% of our water and sewage connections are billed to the user of our services, as foreseen under current regulations. We estimate that this change will affect ongoing legal disputes, particularly those regarding collection procedures, as well as business discussions in general. However, since this change is still being implemented, we are not currently able to predict its impact on our business. Regarding changes to the communication process for the reporting of failures, ARSESP has modified the rules and standards for supervision and reporting of incidents. We have implemented these requested changes. Currently, we receive a portion of the reported incidents online, through the Incident Reporting System ("*Sistema de Comunicação de Incidentes*") established by ARSESP, which introduces greater transparency and control to our operations.

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

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

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

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

In April 2011, we created a specific department in our Financial, Economic and Investor Relations Office responsible for costs and tariffs, given the subject's importance to the continuation of our business. We also created a statutory Regulatory Affairs Committee. The committee is composed of our Chief Executive Officer, our Chief Financial Officer and Investor Relations Officer, our Metropolitan Officer and our Regional Systems Officer and is responsible for defining the guidelines, strategies and regulatory recommendations for our Company and coordinating the work of the Regulatory Affairs Department.

60

Our Current Concession Agreements

The current concessions are based on a standard form of agreement between us and the relevant municipality. Each agreement received the prior approval of the legislative council of each municipality. The assets comprising the existing municipal water and sewage systems are transferred from the municipality to us in order for us to provide the contracted services. Until 1998, we acquired municipal concessions and the existing water and sewage assets in exchange for our common shares issued at book value. Since 1998, we have acquired concessions and water and sewage assets by paying the municipality an amount equal to the present value of 30 years of estimated cash flows from the date of acquisition of the concession, assuming a discount of at least 12%. For reference purposes, ARSESP has set the discount rate for our contracts at 8.06% since 2011.

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

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

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

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

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

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

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

61

As of December 31, 2015, we provided water and sewage services to 364 municipalities. The majority of these concessions have 30 year terms. Due to court orders, we temporarily suspended our services in 3 other municipalities (Iperó, Macatuba and Cajobi). For more information, see “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”. Between January 1, 2007 and December 31, 2015, we entered into agreements with 278 municipalities (including our services agreement with the city of São Paulo) in accordance with the Basic Sanitation Law, of which 4 were entered into in 2015. As of December 31, 2015, these 278 municipalities accounted for 78.6% 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, 2015, 53 of our agreements or concessions had expired but we continued to provide water and sewage services to these 53 municipalities and were in negotiations with these municipalities to execute program agreements to substitute the expired concessions. From January 1, 2016 through 2030, 36 concessions will expire.

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

The receivables owed to us by Mauá, due to the termination of the concession, total R\$85.9 million and have not been recognized in our financial statements due to the uncertainty of our ability to collect them as of December 31, 2015. Despite these developments, we currently supply water on a wholesale basis to Mauá. In January 2016, the municipality of Mauá executed a Protocol of Intentions with us for the preparation of studies and evaluations aiming to resolve commercial relations and existing debts between the municipality and us. We currently do not anticipate that other municipalities will seek to terminate concessions due to our close relationship with municipal governments, recent improvements in the water and sewage services we provide, and the obligation of the municipality to repay us for the return of the concession. However, we cannot be certain that other municipalities will not seek to terminate their concessions in the future. See “Item 3.D. Risk Factors—Risks Relating to Our Business—Municipalities may terminate our concessions before they expire in certain circumstances. The indemnification payments we receive in such cases may be less than the value of the investments we made”.

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

Operations in the City of São Paulo and Certain Metropolitan Regions

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

The State of São Paulo, pursuant to Article No. 25, Paragraph 3 of the Brazilian Constitution, enacted the LCE to create the metropolitan regions of São Paulo (LCE No. 94/1974), Baixada Santista (LCE No. 815/1996), Campinas

(LCE No. 870/2000), Vale do Paraíba and Litoral Norte (LCE No. 1,166/2012), and Sorocaba No. (LCE 1,241/2014) and the urban clusters of Piracicaba (LCE No. 1,178/2012) and Jundiaí (LCE No. 1,146/2011).

62

In January 2015, the Federal Government issued the Metropolitan Bylaws (Law No. 13,089/2015), which within the next three years will establish: general guidelines for the planning, management and performance of public interest initiatives in metropolitan regions and in urban clusters instituted by the states; the general planning standards for integrated urban development and other international governance instruments; and the criteria to receive federal loans for initiatives related to international governance in the area of urban development. This law is expected to enter into effect in the next three years.

There are some pending cases before the Brazilian Supreme Court regarding whether the right to execute concession and program agreements in metropolitan regions belongs to the states or to the municipal governments. In March 2013, the Brazilian Supreme Court decided a pending case on this matter related to the state of Rio de Janeiro. In its decision, a majority of the court held that the state of Rio de Janeiro must set up new entities to oversee the planning, regulation and auditing of basic sanitation services in its metropolitan region with the non-partisan participation of relevant municipalities. The Brazilian Supreme Court has yet to clarify the effects and extension of its decision which modifies the ability of independent municipalities in metropolitan regions to exercise their constitutional competencies, including those related to the provision of basic sanitation services, due to public interest initiatives designed to provide adequate and continuous service to the residents of these municipalities.

The São Paulo metropolitan region accounted for 67.3% of our gross operating revenue in 2015 (excluding revenues relating to the construction of concession infrastructure). We cannot predict how the shared management of these operations will be carried out in the São Paulo metropolitan region and other metropolitan regions we operate in or what effect it may have on our business, financial condition or results of operations. See “Item 3.D. Risk Factors—Risks Relating to Our Business—Current regulatory uncertainty, especially with regard to implementation and interpretation of the Brazilian Basic Sanitation Law, may have an adverse effect on our business”.

On June 18, 2009, Municipal Law No. 14,934/2009 revoked Law No. 13,670/2003, which had assigned to the municipalities alone the responsibility of planning, regulating and overseeing water and sewage service provision in the city of São Paulo. On June 23, 2010, the state and the city of São Paulo executed a formal agreement which aims to: share the performance of planning; delegate to ARSESP the responsibility of overseeing and regulating, including tariff regulation; and authorize the continuation of water and sewage services in the city of São Paulo for a 30 year period, with the option of extending for an additional 30 year period. See “Item 3.D. Risk Factors—Risks Relating to Our Business—The terms of our agreement to provide water and sewage services in the city of São Paulo could have a material adverse effect on us”.

Tariff Regulation in the State of São Paulo

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

On December 16, 1996, the Governor of the State of São Paulo issued a decree which updated the rules of the tariff system allowing us to continue to set our own tariffs according to the guidelines determined by these rules. We used to set our tariffs based on the general objectives of maintaining our financial condition and preserving “social equality” in terms of the provision of water and sewage services to the population while providing a return on investment. The governor’s decree also directs us to apply the following criteria in determining our tariffs:

- category of use;
- capacity of the water meter;
- characteristics of consumption;

- volume consumed;
- fixed and floating costs;
- seasonal variations of consumption; and

63

- social and economic conditions of residential customers.

With the enactment of the Basic Sanitation Law and Federal Consortium Law, we are prohibited from planning, overseeing and regulating services, which includes determining the tariff policy to be adopted. Such activities are to be exercised by the owner of the concession. Other than the responsibility for planning, the remaining activities may not be delegated.

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

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

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

The number of judicial disputes concerning the regulation and oversight of services in areas served by us and regulated by ARSESP has increased since 2012. Agencies may continue to be created to regulate and oversee our services.

The Current Water Crisis

Prior to 2014, we planned our supply of water to the São Paulo metropolitan region according to the water supply during the driest period on record, from 1953 to 1954. However, water inflow to the Cantareira reservoirs throughout 2014 and most of 2015 was less than half the inflow of the previously most critical year, 1953. Consequently, the volume of water stored in the reservoirs in 2014 and 2015 significantly declined until September 2015, which was the first month since the beginning of the current water crisis that our reservoirs stored more water than the year before. Average monthly water production in 2015 was of 52.0 m³/s, compared to 62.2 m³/s in 2014 and 69.1 m³/s in 2013.

From May 2014 to December 2015, it was not possible to withdraw water by gravity from the PCJ River Basin reservoirs intake. Pumping water out from the technical reserve, whose elevation is below the intake, was necessary. Water production in the Cantareira system decreased from 31.77 m³/s in February 2014 to 14.93 m³/s in December 2015. In December 2015, the volume of water of the technical reserve was restored, allowing us to withdraw water by gravity from the PCJ River Basin reservoirs intake and making it no longer necessary to pump water out from the technical reserve. As a result of the increase of the volume of water stored in our reservoirs in February 2016, we requested that ANA and DAEE increase the volume of water that we are permitted to extract from the Cantareira System. As of February 2016, we are permitted to extract 23.0 m³/s of water from the Cantareira System. Together with other water systems that were used to support the Cantareira System, the Alto Tietê System reached its maximum production capacity during the crisis period, which allowed for the transfer of treated water to areas previously supplied by the Cantareira System.

The Guarapiranga System, with a storage capacity of 171 billion liters of water, has kept favorable levels of water availability since the beginning of the drought and has been the system with the greatest treated water production since February 2015 and throughout the year of 2015. Accordingly, its water production levels have been high, allowing for the transfer of more treated water to areas that were previously supplied by the Cantareira System. Water production in this system increased from 13.77 m³/s in February 2014 to 15.33 m³/s in December 2015. In January 2016, the Cantareira System regained its post as the main water producing system in the Metropolitan Region of São Paulo, servicing a population of 5.7 million people, while the Guarapiranga System serviced 5.2 million people in the same time period. Monthly production of the Cantareira System was of 15.88 m³/s in January 2016 compared to 14.06 m³/s in January 2015.

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

Cantareira System

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

Under normal conditions, this system supplies water to approximately 8.9 million people, with an average extraction of up to 33 m³/s to serve the São Paulo metropolitan region. An additional 5 m³/s may be released to serve the metropolitan region of Campinas and Jundiaí that is located downstream from the reservoirs.

Water Inflow to the Cantareira System

During the October 2013 – March 2014 rainy season rainfall and water inflow levels into the reservoirs reached the lowest levels in 84 years of recorded rainfall in the region. This drought persisted in the rainy season between October 2014 and March 2015, making rainfall and water inflow levels reach the lowest levels in 85 years of recorded rainfall in the region. During the October 2015 – March 2016 rainy season, the level of rainfall in the region returned to the normal levels expected for the season.

The table below sets forth water inflow (volume of water that flows into the reservoirs or natural inflow from river basin), taking into account: (i) historical average and minimum flows; (ii) 1953 as the driest year on record; (iii) flow along the hydrological year, from October to September; (iv) inflow during the 2014-2015 hydrological year and (v) inflow during the uncompleted 2015-2016 hydrological year (up to March 2016).

	For the month of											
	Oct.	Nov.	Dec.	Jan.	Feb.	March	April	May	June	July	Aug.	Sep.
	<i>(in m³/s)</i>											
Water Inflow												
Historical Average	30.6	35.0	53.1	70.9	73.9	66.9	48.4	38.4	35.3	28.8	24.5	25.6
Historical Minimum	14.0	14.0	21.8	26.9	27.6	28.1	24.7	19.9	16.5	13.9	12.0	11.8
Drought of 1953	17.5	26.0	31.5	26.9	34.5	29.8	34.6	23.8	20.7	17.6	16.3	16.2
2013/14	25.1	22.1	22.5	15.4	10.5	18.9	17.2	10.1	10.0	6.4	8.2	9.0
2014/15	5.2	8.8	16.0	11.5	40.7	42.6	18.1	14.0	16.2	11.3	5.8	18.3

2015/16	14.8	27.1	52.3	73.8	49.6	69.8	24.1
---------	------	------	------	------	------	------	------

65

Since March 2014, ANA and DAEE have regulated the volume of water we were permitted to extract from the Cantareira System, which affected our supply of water to the São Paulo metropolitan region. The volume of water we are allowed to extract from the Cantareira system is communicated to us by DAEE and ANA via monthly notices according to the behavior of rainfall, water inflow, level of water in our reservoirs and our requests to extract water based on this information. Compared to the 33 m³/s we were allowed to extract from the PCJ River Basin and Juqueri River Basin before March 2014, in December 2015 we were permitted to extract 13.5 m³/s. As a result of the return of normal rainfall levels in the rainy season that began in October 2015 and the return of normal water inflow levels to the reservoirs in the Cantareira system, as of February 2016 we have been allowed by ANA and DAEE to extract 23.0 m³/s from the Cantareira System.

The following table sets forth the level of water stored in the systems that serve the São Paulo metropolitan region as of December 2014, March 2015 and December 2015, and March 2016, at the end of the rainy season:

	For the month				Total Storage Capacity
	March 2016	December 2015	March 2015	December 2014	
	<i>(in millions of m³)</i>				
Cantareira	641.90	290.69	186.74	71.18	1,269.5*
Guarapiranga	150.01	147.12	145.81	69.57	171.19
Rio Grande	108.41	106.18	109.34	80.94	112.18
Rio Claro	14.02	9.71	5.96	4.51	13.67
Alto Tietê	247.94	135.55	130.91	69.63	573.81
Cotia	16.53	14.20	10.75	5.20	16.50

(*) Cantareira system total storage capacity = 982.0 million m³ availability above water intake plus (+) 287.5 million m³ availability below water intake (technical reserve).

In order to continue to meet consumer demand of the São Paulo metropolitan region and decrease water production at the Cantareira System to the limits set by ANA and DAEE, in 2014 and 2015 we adopted the following measures to maintain continuous water supply to the São Paulo metropolitan region:

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

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

As a result of the return of normal rainfall levels in the rainy season which began in October 2015, as of January 2016 it was no longer necessary to pump water out of the technical reserve of the PCJ River Basin and we modified the rules for the offer of discounts (bonus) in February 2016. On March 24, 2016, as a result of the increased level of rainfall and increased predictability of the level of water in our reservoirs, we requested to ARSESP the cancellations of our Water Consumption Reduction Incentive Program and of the Contingency Tariff. ARSESP approved our requests on March 31, 2016 and the aforementioned policy changes shall be applied to water meter readings recorded as of May 1, 2016. In addition, as of December 2015, the time period during which water is pumped out at reduced pressure in the water distribution lines is returning to the normal nighttime period, as it was prior to the water crisis.

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

66

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

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

Due to its proximity, the Alto Tietê System has become the main support system for the Cantareira System, which consequently led to the decrease in the volume of water stored in the Alto Tietê reservoirs. As a precautionary measure, water production in this system was decreased from 14.97 m³/s in February 2014 to 11.91 m³/s in March 2015. As a result of the improvement in water levels in the Cantareira System, water production in the Alto Tietê System decreased from 13.24 m³/s in December 2015 to 11.57 m³/s in March 2016.

Moreover, the Guarapiranga System, with a storage capacity of 171 billion liters, during the water crisis supplied water to an additional 1.4 million people of the south and southeast regions of the city of São Paulo who were previously served by the Cantareira System. As a result, the number of people served by the Guarapiranga System increased from 3.8 million people before the current water crisis to 5.2 million during the crisis. Water production in this system increased from 13.77 m³/s in February 2014 to 14.65 m³/s in March 2015. This system produced 15.33 m³/s of water in December 2015 and 13.95 m³/s in March 2016.

Throughout 2014 and 2015, with the adoption of these measures, almost 3 million people who used to be served by the Cantareira System were then served by other systems.

Bonus Program

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

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

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

In December 2014, we extended the validity of the Water Consumption Reduction Incentive Program until the end of 2015 or until reservoir levels normalize, whichever occurs first.

In December 2015, we modified our discounts (bonus) program, which aims to incentivize consumers to reduce their water consumption through the offer of discounts (bonus) to consumers that would below average amounts of water, by updating the reference value used to determine the discounts. Prior to this modification, the reference value by which we calculated the discounts was the average consumption of our customers in the period between February 2013 and January 2014. As of December 2015, we modified the reference value, which is currently set at 78% of the prior reference consumption value. The updated reference value began to be applied to our customers' bills as of February 1, 2016. The bonus ranges of 10%, 20% and 30%, were maintained, following the rules of our discount (bonus) program, which established that if a client consumes between 10% and 15% less water during a certain period compared to his reference value, he will obtain a discount of 10% in his water bill, if he consumes between 15% and 20% less water during a certain period compared to his reference value, he will obtain a discount of 20% in his water bill, and if the client consumes 20% less water, he will obtain a discount of 30%.

67

On March 24, 2016 as a result of the increased level of rainfall and increased predictability of the level of water in our reservoirs, we requested to ARSESP the cancellation of our Water Consumption Reduction Incentive Program. ARSESP approved our request on March 31, 2016 and the aforementioned policy change shall be applied to water meter readings recorded as of May 1, 2016.

Contingency tariff

In January 2015, ARSESP authorized us to implement a contingency tariff mechanism consisting of additions to water bills for customers who do not reduce their consumption. This contingency tariff mechanism is such that up to a 20% increase from the average consumption results in a tariff increase of 40% and consumption that exceeds 20% of the average results in a tariff increase of 100%.

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

On March 24, 2016 as a result of the increased level of rainfall and increased predictability of the level of water in our reservoirs, we requested to ARSESP the cancellation of the Contingency Tariff. ARSESP approved our request on March 31, 2016 and the aforementioned policy change shall be applied to water meter readings recorded as of May 1, 2016.

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

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

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

As a result of the return of normal rainfall levels in the rainy season which began in October 2015, as of December 2015, the time period during which water is pumped out at reduced pressure in the water distribution lines is returning to the normal nighttime period, as it was prior to the water crisis.

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

One of the measures adopted to offset the decreased volume of water extracted from the Cantareira System was to reduce the volume of water transferred to municipalities located in the area covered by the Cantareira System that we serve on a wholesale basis. The volume of water transferred was reduced by almost 2 m³/s.

Extracting Water from the Technical Reserve

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

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

Water Savings

As of March 2016, the measures we adopted produced the following results:

- the implementation of the bonus program accounted for 22.8% of water savings;
- the reduction of pressure in water distribution lines and initiatives mitigating water losses accounted for 35.9% of water savings;
- the transfer of water between production systems accounted for 34.8% of water savings;
- the adjustment of the volume of treated water sold to municipalities that operate their own distribution network accounted for 6.5% of water savings.

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

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

By the end of the decade, our production of treated water shall expand by 10.9 m³/s and an additional 10.6 m³/s will be available to our reservoirs through interconnections to other reservoirs in the state of São Paulo, which may be used by us if there are low levels of water in our reservoirs. The conclusion of these projects will result in improved water security for SIM. The main projects include:

- Alto Tietê System – transfer of an additional 1 m³/s from the Guaió River to the Taiaçupeva reservoir, in order to recover the reserve volume of the Alto Tietê reservoir. This project was concluded in June 2015;
- Alto Tietê System – transfer of additional 4.0 m³/s from Rio Grande - Billings reservoirs to the Alto Tietê System. This project was concluded in September 2015;
- Guarapiranga System – transfer of an additional 1 m³/s of which results from the expansion of the transfer capacity of the Billings reservoir to the Guarapiranga reservoir; This project was concluded in December 2015;
- Interconnection of the Jaguari (Paraíba do Sul River Basin) and Atibainha (Cantareira System River Basin) reservoirs – The purpose of this project is to recover water levels and increase the water security of the Cantareira System. The interconnection will allow water availability to increase in the Cantareira System by 5.13 m³/s (annual average) to 8.5 m³/s (maximum) by transferring water from the Jaguari reservoir to the Atibainha reservoir. The construction on the interconnection began in February 2016 and is expected to be concluded in 2017. For more information, see “—History and Development of the Company—Capital Expenditures Program”.
- Alto Tietê System – transfer of an additional 2.5 m³/s from the Itapanhaú river to the Biritiba reservoir, providing more volume to the Alto Tietê river. This project is currently under development and is expected to be

concluded in 2017;

- Guaraparinga System – transfer of an additional 1 m³/s from the Alto Juquiá river to the Santa Rita Creek, in order to increase the volume of water in the Guarapiranga reservoir. This project is currently under development and is expected to be concluded in 2017; and

69

- Implementation of the São Lourenço Production System: the project was initiated in April 2014 and is expected to begin operations at the end of 2017. This system will have an average water treatment capacity of 6.0 m³/s. For more information, see “—History and Development of the Company—Capital Expenditures Program”.

The Drought Committee

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

The Drought Committee’s main purposes are exchanging information and planning joint actions between its members in relation to the drought affecting regions in the state. The Drought Committee shall be composed of the Secretaries of (a) Sanitation and Water Resources (who shall chair the Drought Committee); (b) Chief of Staff; (c) Health; (d) Public Security; (e) the Environment; (f) Agriculture and Supplies; (g) Energy; and (h) the State Coordinator of Civil Defense. In addition, if invited, the following parties may also compose the Drought Committee: the mayors of São Paulo and Campinas, as well as the Chairmen of (a) the Intermunicipal Greater ABC Consortium (*Consórcio Intermunicipal do Grande ABC*); (b) the Development Consortium of the Alto Tietê Municipalities (*Consórcio de Desenvolvimento dos Municípios do Alto Tietê*); (c) the Intermunicipal Consortium of the Juqueri Basin (*Consórcio Intermunicipal dos Municípios da Bacia do Juqueri*); (d) the Intermunicipal Consortium of the Western Region of the São Paulo Metropolitan Area (*Consórcio Intermunicipal da Região Oeste Metropolitana de São Paulo*); and (e) the Intermunicipal Consortium of the Southeast Region of Greater São Paulo (*Consórcio Intermunicipal da Região Sudeste da Grande São Paulo*). Representatives of professional associations, civil society groups and public administration entities may also be included in the Drought Committee by means of invitations. The State Chief of Staff will monitor the Drought Committee.

In order to fulfill its purposes, the Drought Committee will be in charge of: (i) providing the mayors of the respective São Paulo metropolitan cities and the users of the water system with information regarding the status of the water systems, the severity of the water crisis and the decisions made on a governmental level regarding the water supply, in order to provide sufficient time for adaptation; (ii) examining alongside the city mayors the need to implement restrictions on the use of drinking water for purposes other than human consumption and animal consumption, by means of enacting local law; (iii) obtaining from the city mayors information necessary to update and/or amend contingency plans; and (iv) communicating to the public measures and risks related to restrictions on the supply of drinking water.

Marketing Channels

As of December 31, 2015, we were the concessionaire for the provision of water supply and collection, treatment and disposal of sewage services directly to end consumers for 364 municipalities of the state of São Paulo. We also supply water on a wholesale basis to five municipalities located in the São Paulo metropolitan region. It is the responsibility of these municipalities to then distribute the water to end consumers. We provide sewage services to four of these municipalities. Because of our distribution infrastructure, end consumers to whom we offer water services on a wholesale basis cannot alternatively acquire such services directly from us. For more information on service concessions, see “—Wholesale Operations”.

Energy Consumption

Energy is essential to our operations, and as a result we are one of the largest users of energy in the state of São Paulo. In the year ended December 31, 2015, we used approximately 1.64% of the total energy consumption in the state of São Paulo. To date, we have not experienced any major disruptions in energy supply. Any significant disruption of energy to us could have a material adverse effect on our business, financial condition, results of operations or prospects.

Energy prices have a significant impact on our results of operations. In 2015, approximately 44% of our total energy consumption occurred within the “free market,” where we can more efficiently negotiate the supply of energy, the rest of our energy consumption comes from the Regulated Market. Regarding the conventional electricity free market during the year 2015, our need of energy was supplied through two contracts, one with AES Tietê (37%) and another with Tractebel Energia SA (63%). The energy supply on the open market for the 2016 period will be attended by three new contracts already signed.

70

Most of the energy produced in Brazil comes from hydroelectric power plants. The severe drought in the southeast and central-west regions of Brazil since the end of 2013, associated with the decisions taken by the Federal Government in recent years, led to a huge increase in energy prices in 2015. Considering this scenario, in 2015 the total energy costs increased 36.5% compared to 2014.

For more information on energy, see “Item 3.D. Risk Factors—Risks Relating to Our Business—We are exposed to risks associated with the provision of water and sewage services”.

Insurance

We maintain insurance covering, among other things, fire or other damage to our property and office buildings and third party liability. We also maintain insurance coverage for directors’ and officers’ liability (D&O insurance). We currently obtain our insurance policies by means of public bids involving major Brazilian and international insurance companies that operate in Brazil. As of December 31, 2015, we had paid a total aggregate amount of R\$6.9 million in premiums. In addition, we paid R\$2.6 million for a D&O insurance policy, covering R\$4.0 billion in assets, third party liabilities and D&O insurance. We do not have insurance coverage for business interruption risk because we do not believe that the high premiums for such insurance are justified by the low risk of major interruption of our activities. In addition, we do not have insurance coverage for liabilities arising from water contamination or other problems involving our water supply to customers and for environmental related liabilities and damages. We believe that we maintain insurance at levels customary in Brazil for our type of business.

Intellectual Property

Trademarks

We have secured registration of our logo and composite trademark at the Brazilian Institute of Industrial Property (Instituto Nacional da Propriedade Industrial), or INPI. We have registered with the INPI the following trademarks: “Sabesp”, “Sabesp Soluções Ambientais”, “Projeto Tietê”, “Programa Córrego Limpo”, “Programa Onda Limpa”, “Prol – Programa de Reciclagem do Óleo De Fritura”, “Revista DAE”, “Ligação Sabesp”, “Agente da Gente – Sabesp na Comunidade”, “PURA – Programa de Uso Racional da Água”, “Sabesp Inteligência Ambiental”, “Reúso da Água”, “Uso Racional da Água”, “Parque da Integração”, “Clubinho Sabesp”, “Cauã”, “Denis”, “Gabi”, “Gotucho”, “Gota Borradeira”, “D. Iara”, “Ratantan”, “Sayuri”, “Cadu”, “SuperH2O”, “Sabesp Semana do Meio Ambiente”, “Água”, “Sabesp Aquífero Guarani”, “Sabesp Estação Cantareira”, “Contrato de Fidelização Sabesp”, “Esgotos não Domésticos Sabesp”, “Cine Sabesp”, “PEA – Programa de Educação Ambiental” and “Sabesp Abraço Verde”. Cauã, Denis, Gabi, Gotucho, Gota Borradeira, Dr. Gastão, Iara, Sayuri, Ratantan, Cadu and Super H2O are some of the characters of our children’s club (Clubinho SABESP), which is a tool for environmental education directed to children through our website.

We have also filed applications with the INPI for registration of the following trademarks: “Parque Da Integração”, “Programa de Recuperação Ambiental”, “Signos Sistema De Informação Geográfica No Saneamento”, “Signos Net Sistema De Informação Geográfica No Saneamento”, “Scorpion”, “Sabesp Semana do Meio Ambiente”, “Água de Reúso Sabesp”, “Água Sabesp Aquífero Guarani”, “Água Sabesp Estação Cantareira”, “Contrato de Fidelização Sabesp”, “Esgotos não Domésticos Sabesp”, “Cine Sabesp”, “Ecoposto Sabesp”, “PEA – Programa de Educação Ambiental”, “Projeto Tietê”, “Sabesp Abraço Verde”, “Super H2O”, “Programa Córrego Limpo”, “Parque da Integração”, “Eu Sou Guardião das Águas Sabesp Eu Não Desperdiço”, “Calculadora de Sonhos”, “Signos Sistema de Informações Geográficas no Saneamento”, “Acertando Suas Contas Com a Sabesp”, “Parque Sabesp Mooca”, “Parque Sabesp Cangaíba” and “Parque Sabesp Butantã”.

Patents

We have a patent granted by the INPI for a constructive device in a building hydraulic simulator used for didactic purposes. We have also filed patent requests for the following additional devices:

- a biofilter odor control unit;
 - a device for the removal of supernatants in the treatment of sewage;
 - a mobile device for the calibration of hydrometers;
 - rotary devices used to clean water reservoirs transported by trucks with high-pressure hydrojetting systems;
- and
- leakage detection digital system.

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

Software

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

We have also developed certain computer programs for management and control of water and sewage treatment facilities, as well as for third party services management, called “AQUALOG” (Control Water Treatment Plants), “SGL” (Bid Management System), “SCORPION” (Software to Operational Control), “Electronic Price Quotation” (*Cotação Eletrônica de Preços*), “PREGÃO SABESP ONLINE”, “SISDOC – Sistema de Controle de Documentos”, “Sistema de análise do comportamento metrológico de hidrômetros”, “Modelo padronizado de Laudo técnico MPLT”, “SGH hydrometry management system” (*Sistema de Gestão de Hidrometria*), “SIA – Sistema de Informações de Auditoria”, “CSI - Sistema Comercial: Serviços e Informações”, “NETCONTROL – Sistema de Automação de Laboratórios de Controle Sanitário”, “SACE- Sistema de Atendimento Comercial Externo”, “SAN – Sistema de Apoio à Navegação”, “online software for managing specific articles published in the DAE magazine”, “Dashboard”, “COP - Online Control of Water Losses”, “Sistema de Gestão de Energia Elétrica – GEL”, “CADGEO”, “LIGGEO” and “Sistema de Gestão de Propriedade Intelectual”. We have also secured registration of these programs at the INPI.

AQUALOG is a Brazilian software designed to monitor water treatment through the employment of artificial intelligence. In 2001, we completed the first rendering of services based on the AQUALOG software to a third party with the automation of a water treatment plant in the city of Jaguará do Sul, State of Santa Catarina. We have entered into an agreement to license the software to Sanesul, in the state of Mato Grosso do Sul and to Teuto’s drugs factory, in the city of Anapólis, state of Goiás.

SGL is an electronic price quotation system that allows us to view and control all bid and acquisition proceedings in real time.

Domain Names

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

- www.sabesp.com.br;

B. Business Overview

- www.corregolimpo.com.br;
- www.projetotiete.com.br;
- www.revistadae.com.br;
- www.blogdasabesp.com.br;

72

- www.blogsabesp.com.br;
- www.sustentabilidadesabesp.com.br;
- www.inovasabesp.com.br;
- www.ondalimpa.com.br;
- www.programaondalimpa.com.br;
- www.clubinhosabesp.com.br; and
- www.superh2o.com.br.

Environmental Matters

Our environmental management, which is guided by the directives established in our environmental policy, is inherent to the provision of our services and the essence of our business. In order to consolidate our environmental culture, we prioritize the internal and external dissemination of knowledge and experience on the best environmental practices. There are actions of our environmental management corporate program that rely on the involvement of collaborators, the communities we service and partnerships with non-governmental organizations.

We have the following ongoing environmental management programs:

- development of the Corporate Greenhouse Gas Management Program (*Programa Corporativo de Gestão de Emissões de Gases de Efeito Estufa*), in line with the guidelines from the São Paulo State Climate Change Policy (PEMC), including the preparation of inventories of greenhouse gases, totaling eight inventories concluded since 2007;
- continuation of the actions set forth in the corporate programs for obtaining and maintaining environmental licenses and grants for the right to use water;
- the implementation of the Environmental Education Program (*PEA-SABESP*), an important tool for the effectiveness of our sanitation activities, which propitiates connections with the communities we service through over a hundred environmental education projects. The activities developed by the PEA are organized with the following objectives: increment the intrinsic value of water; protect the environment; preserve the streams; improve the quality of the environment; valorize sanitation activities; valorize the conscious use of water; direct capacitation and production of guiding material. Under the PEA, we developed actions and projects including: ecological horseback rides, the release of fingerlings, bike rides, the planting of trees, monitored visits to treatment plants and historical archives, mobilizations for the rational use of water, educational speeches and meetings with the community. In 2015, we held approximately 4.4 thousand educational speeches in schools, communities and companies, which combined were delivered to an audience of around 492.1 thousand people. We also held 1.5 thousand monitored visits to treatment plants, with a total of 77.6 thousand visitors;
- management of our institutional representation in the State and National Systems of Water Resources, including training of company representatives to participate in: (i) the creation of criteria for water usage charges, (ii) the monitoring of river basin plans (*Planos de Bacias*), (iii) review of water bodies' classifications, and (iv) analysis of legislation regarding the protection of water sources;

- implementation of the SABESP 3 Rs Program (*Programa SABESP 3Rs*) for the reduction, re use and recycling of waste from administrative activities, in partnership with waste and recycling collecting cooperatives and which includes employee training enabling them to act as multipliers in the roll-out of the program; and

73

- implementation of an Environmental Management System, or “EMS”, in our water and sewage treatment stations. In order to expedite the implementation of EMS in all stations by 2024, we are strategically reprioritizing our efforts and we have adopted a mixed model since 2015. The ISO 14001 model will be maintained in the certified stations and may be expanded according to our strategy. The other stations will adopt our own EMS model (SGA-SABESP). As of March 2015, we had 51 stations with ISO 14001 certification. As a result of the new strategy implemented in 2015, there has been a reduction in the number of ISO 14001 certified stations. In April 2015, we requested and obtained the recommendation for the ISO 14001 recertification of 35 stations. A new external auditing cycle occurred in March 2016 maintaining the ISO 14001 certification in 35 stations. Currently, the EMS has been installed in 95 stations and is being installed in 34 other stations, totaling 129 stations by the end of 2016.

In addition to corporate environmental management initiatives, we have several projects and initiatives underway to benefit the environment by engaging the population at large. In 2015, we invested R\$18.4 million in environmental programs and projects directly concerned with the development and implementation of corporate environmental management programs as well as the Program for Rational Use of Water (*Programa de Uso Racional da Água – PURA*), among other initiatives. Other investments and related costs related to environmental management are included in the total value of operational expenses and investments mentioned in this annual report.

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

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

The São Paulo State Climate Change Policy (Law No. 13,798/2009), enacted on November 9, 2009, and regulated by Decree No. 55,947 of June 21, 2010, aims to reduce global emissions of carbon dioxide by 20.0% by 2020 compared with 2005 levels. Brazil’s Climate Change Policy (Law No. 12,187/2009), enacted on December 29, 2009 and regulated by Decree No. 7.390/2010 establishes a voluntary national commitment to reduce Brazil’s currently projected GHG emissions for 2020 by a percentage between 36.1% and 38.9%. Such targets have not been established for the sanitation sector yet. In this sense we are currently developing a Corporate Greenhouse Gas Management Program, aimed at reducing the amount of greenhouse gases released into the atmosphere, including the creation of an inventory to record releases of greenhouse gases.

In 2015, we concluded the corporate inventory of greenhouse gases for 2014, thus totaling eight inventories since 2007. We noted that the trend observed in the previous inventories persists, specifically that activities regarding sewage collection and treatment remain our largest sources of greenhouse gas release, representing approximately 84% of total greenhouse gas release. Electric energy represents approximately 14% and other activities represent approximately 2%.

We also participate in initiatives that produce clean energy, such as the installation of a small hydroelectric power plant, which contribute to the reduction of the amount of greenhouse gases released into the atmosphere. We have projects in the research and development stages that entail using biogas generated in the sewage treatment process and recycling sewage sludge as means to reduce the gases released in the treatment processes. We also have initiatives to reduce our emission of greenhouse gases, such as the coverage of stabilization ponds and the implementation of composting systems.

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

Edgar Filing: COMPANHIA DE SANEAMENTO BASICO DO ESTADO DE SAO PAULO-SABESP - Form 20-F
consumers. See “—Tariffs”.

74

Physical Effects of Extreme Weather Events

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

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

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

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

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

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

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

Regarding the drought that affected the Cantareira System throughout 2014 and 2015, see “Item 3.D. Risk Factors—Risks Relating to Our Business—The measures we took to mitigate the effects of the drought resulted in a significant decrease in the volume of water billed and revenues from services we provide, which had a material adverse effect on our company and that may worsen if the drought escalates in severity” and “—The Current Water Crisis”.

Public Bidding Procedures

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

75

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

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

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

Water Usage

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

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

Among other instruments established by this Policy, the competent public authority grants for the right to use water for the implementation of any enterprise that demands the use of surface or underground water resources (for water collection and release of effluents), as well as for the execution of services that alter the regime or quality of such water resources. In the case of rivers under the federal government's domain (rivers crossing more than one state), ANA is the public authority which grants the authorization. With respect to the rivers under a state's domain, the applicable state authority has jurisdiction to grant the right of use. In the state of São Paulo, DAEE is the public authority responsible for granting such authorizations.

In conducting our principal activities, we have the majority of grants for the rights to use water, and there is a multi-annual corporate program in place to obtain and maintain the rights to use water for the remaining activities. However, all of our water-usage activities included in the corporate program have filed requests for grants for the right to use water with the competent authority; many of these requests have been granted and others are under analysis by DAEE and ANA. Another phase of the corporate program is predicted to meet new demands.

76

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

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

Charging for the use of water is under gradual implementation by the State of São Paulo, where the largest individual contributors are located, and it is a management tool of the Policy on Water Resources to promote the rational use of water and finance programs and actions established by the basin plans. In 2015, we paid approximately R\$43 million for the use of water resources.

Charging for the use of water from rivers of federal domain began in 2003 in the Paraíba do Sul basin, and charging for the use of water from rivers of state domain began in 2007 in the Paraíba do Sul, Piracicaba, Capivari and Jundiá basins. Subsequently, charges were implemented for the use of water from the Sorocaba, Médio Tietê and Baixada Santista basins. In 2013, charges were implemented for the use of water from the Baixo Tietê basin and, in April 2014, for the use of water from the Alto Tietê River Basin. It is probable that the same will occur in 2016 in the other river basins of the State of São Paulo.

Water Quality

Administrative Rule No. 2,914/2011, issued by the Ministry of Health of the federal government, provides the standards for potable water for human consumption in Brazil. This rule is similar to the U.S. Safe Drinking Water Act and the regulations enacted by the U.S. Environmental Protection Agency, which establishes rules for sampling and limits related to substances that are potentially hazardous to human health.

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

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

Environmental Regulation

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

The control and environmental planning instruments are defined by several legal instruments, such as State Law No. 997/1976, which regulates environmental pollution control; CONAMA Resolution No. 05/1988, which requires licensing of sanitation projects that cause significant alterations to the environment; CONAMA Resolution No. 237/1997, which regulates (i) environmental licenses, (ii) federal, state and local jurisdiction over environmental issues, (iii) the list of activities subject to licensing, and (iv) environmental impact studies and reports; State Decree No. 47,400/2002 and related articles from State Law No. 9,509/1997 regarding environmental licensing; State Decree No. 8,468/1976, CONAMA Resolution No. 357/2005, and CONAMA Resolution No. 397/2008, which establish standards of quality for receiving bodies of water; State Decree No. 8,468/1976 and CONAMA Resolution No. 430/2011 which establish the standards for discharge of effluents; and *Portaria Departamento de Águas e Energia Elétrica No. 717/1996*, which regulates the concession of grants for the right to use water and rights to interfere in water resources.

77

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

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

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

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

We have been implementing a multi-annual corporate program to obtain and maintain the environmental licenses for our water treatment stations and sewage treatment stations in order to comply with environmental regulations. The corporate program to obtain and maintain the licenses for our sewage pumping stations is currently being reviewed by CETESB.

Sewage Requirements

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

The CETESB is authorized under State law to monitor discharges of effluents into the water bodies, among other things. The CETESB also issues the environmental licenses to the polluting sources, including sewage treatment stations. For more information, see “Item 4.B. Business Overview—Environmental Matters”.

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

Governmental Restrictions on Incurrence of Debt

On June 30, 1998, the CMN issued Resolution No. 2,515/1998 amending certain conditions that must be observed with respect to external credit operations (i.e., foreign currency borrowings) of states, the Federal District of Brasília, municipalities and their respective *autarquias* (agencies), foundations and non financial companies, including us. This resolution provides, among other things, that, with certain exceptions applicable to the importation of goods and services:

78

- the proceeds of external credit operations must be exclusively used to refinance outstanding financial obligations of the borrower, with preference given to those obligations that have a higher cost and a shorter term, and, until used for such purposes, the proceeds shall remain deposited, as directed by the Central Bank, in a pledged account; and
- the total amount of the contractual obligation must be subject to monthly deposits in a pledged account, equal to the total debt service obligation, including principal and interest, divided by the number of months that the obligation is to be outstanding.

The CMN resolution further provides that the requirements described above do not apply to financing transactions involving multilateral or official organizations such as the International Bank for Reconstruction and Development, or “IBRD”, the IADB or the JICA. The Central Bank regulation implementing this resolution provides, among other things, that the account referred to in the first bullet point above must be an account opened in a federal financial institution, which is to hold such funds until released for the purpose of refinancing outstanding obligations of the borrower. The Central Bank regulation further provides that the account described in the second bullet point above must be an escrow account to be opened in a federal financial institution and to secure the payment of principal and interest on the external debt.

Our foreign currency denominated transactions are also subject to the approval of the National Secretariat of Treasury (*Secretaria do Tesouro Nacional*) and the Central Bank. After reviewing the financial terms and conditions of the transaction, the National Secretariat of Treasury and the Central Bank will issue an approval for the closing of the foreign exchange transaction relating to the entry of the funds into Brazil and, following such entry and at our request, an electronic certificate of registration through which all scheduled payments of principal, interest and expenses will be remitted by us. The electronic certificate of registration grants the borrower access to the market for foreign exchange.

Lending Limits of Brazilian Financial Institutions

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

Scope of Business

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

C. Organizational Structure

Not applicable.

D. Property, Plant, Equipment and Intangible Assets

Our principal property, plant and equipment comprise administrative facilities which are stated at historical costs less depreciation. The reservoirs, water treatment facilities, water distribution networks consisting of water pipes, water transmission lines, water connections and water meters, sewage treatment facilities, and sewage collection networks consisting of sewer lines and sewage connections are recorded as intangible assets (concession assets). As of December 31, 2015, we operated through 71,705 kilometers of water pipes and water transmission lines and 48,774 kilometers of sewer lines. As of that same date, we operated 235 water treatment facilities and 539 sewage treatment facilities (including 9 ocean outfalls), as well as 16 water quality control laboratories.

79

As of December 31, 2015, the total net book value of our property, plant and equipment and intangible assets (including concession assets) was R\$28,838.7 million.

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

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

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

A. Operating and Financial Review and Prospects

Overview

As of December 31, 2015, we operated water and sewage systems in the state of São Paulo, including in the city of São Paulo, Brazil's largest city. Our operations extended into a total of 364 municipalities, or 56% of all municipalities in the state. We also provided water services on a wholesale basis to five municipalities located in the São Paulo metropolitan region in which we did not operate water distribution systems.

The São Paulo metropolitan region, which includes the city of São Paulo, is our most important service region. With a total population of approximately 21.4 million, the São Paulo metropolitan region accounted for 67.3%, 70.0% and 73.2% of our gross operating revenue in 2015, 2014 and 2013 (excluding revenues relating to the construction of concession infrastructure), respectively. As of December 31, 2015, 60.6% of the concession intangible assets reflected on our balance sheet were located in this region. In an effort to respond to demand in the São Paulo metropolitan region and because the region represents the principal opportunity to increase our net operating revenue, we have concentrated a major portion of our capital expenditure program to expand the water and sewage systems and to increase and protect water sources in this region. Our capital expenditure program is our most significant liquidity and capital resource requirement.

Factors Affecting Our Results of Operations

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

Effects of Tariff Increases

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

- political considerations arising from our status as a State controlled company;
- anti inflation measures enacted by the federal government from time to time; and

80

- when necessary, the readjustment to maintain the original balance between each party's obligation and economic gain (*equilíbrio econômico financeiro*) under the agreement.

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

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

	Year ended December 31,		
	2015	2014	2013
Increase in average tariff ⁽¹⁾	15.24%	6.50%	5.84%
Inflation – IPC – FIPE	11.07%	5.20%	3.88%
Inflation – IPCA	10.67%	6.41%	5.91%
Inflation – IGP M	10.54%	3.69%	5.51%

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

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

Effects of Brazilian Economic Conditions

As a company with all of its operations in Brazil, our results of operations and financial condition are affected by general economic conditions in Brazil, particularly by the economic activity and the inflation rate. For example, the general performance of the Brazilian economy may affect our cost of capital and inflation may affect our costs and margins. The Brazilian economic environment has been characterized by significant variations in economic growth rates. However, as our product is viewed as essential, in normal conditions our sales revenue demonstrates high stability. In 2015, our business was significantly affected by the most severe drought recorded in our service area in the last 85 years.

General Economic Conditions

In 2013, Brazilian GDP increased 2.3% in comparison with 2012. Also in 2013, Brazil had US\$375 billion in currency reserves and its trade surplus was US\$2.6 billion, the worst in 13 years, and its trade balance fell 86% in comparison with 2012. The average unemployment rate in Brazil's principal metropolitan regions was 5.4%, the lowest rate in history at that time, according to the IBGE.

In 2014, Brazilian GDP increased 0.1% in comparison with 2013. Also in 2014, Brazil had US\$374.0 billion in currency reserves and its trade deficit was US\$3.9 billion, the first negative annual balance since 2000 and the worst since 1998. The average unemployment rate in Brazil's principal metropolitan regions was 4.8%, the lowest rate in history according to the IBGE.

In 2015, Brazilian GDP decreased 3.8% in comparison with 2014, the worst result in 25 years. Also in 2015, Brazil had US\$368.4 billion in currency reserves and its trade surplus was US\$19.7 billion, which is the largest since 2011. The average unemployment rate in Brazil's principal metropolitan regions was 6.9%, which is the highest rate since 2009 according to the IBGE.

Interest Rates

As a political monetary instrument of the federal government, the SELIC rate influences the behavior of other interest rates in the country, including the rates related indebtedness denominated in local currency. In 2011, until the month of August, the Central Bank continued increasing the SELIC rate, reaching 12.50% in July. In the month of August, the Central Bank started decreasing the SELIC, closing 2011 at 11.00%. This downward trend was maintained in 2012, with the SELIC rate closing the year of 2012 at 7.25%. In 2013, the SELIC rate was kept at 7.25% until April, after which the Central Bank started to gradually raise it. The SELIC rate was 9.9% at December 31, 2013 and increased to 11.65% at December 31, 2014. The SELIC rate increased to 14.15% at December 31, 2015.

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

Inflation

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

Inflation adjustments derive from collections from or payment to third parties, as contractually required by law or court decision, and are recognized on an accrual basis. Inflation adjustments included in these agreements and decisions are not considered embedded derivatives, since they are deemed as inflation adjustments for us. See Notes 3.20, 5.1 and 27 of the financial statements for the impacts of inflation adjustments on our financial performance and debt.

Currency Exchange Rates

We had total foreign currency denominated indebtedness of R\$6,617.8 million as of December 31, 2015, of which R\$901.2 million relates to the current portion of our long-term foreign currency denominated obligations. In the event of significant devaluations of the *real* in relation to the U.S. dollar or other currencies, the cost of servicing our foreign currency denominated obligations would increase as measured in *reais*, particularly as our tariff and other revenue is based solely in *reais*. In addition, any significant devaluation of the *real* will increase our financial expenses as a result of foreign exchange losses that we must record. In 2013, the 14.64% depreciation of the *real* against the U.S. dollar offset by the 5.91% appreciation of the *real* against the yen led to a foreign exchange loss of R\$267.8 million. In 2014, the 13.39% depreciation of the *real* against the U.S. dollar and the 0.45% appreciation of the *real* against the yen led to a foreign exchange loss of R\$345.1 million. In 2015, the 47.01% depreciation of the *real* against the dollar and the 45.95% depreciation of the *real* against the yen led to a foreign exchange loss of R\$1,992.0 million. However, since most of our debt denominated in foreign currencies is long-term debt with a long amortization schedule, a devaluation of the *real* would principally impact cash flows regarding the current portion of our long-term debt.

We do not have any exposure to derivatives tied to foreign currencies.

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

	Year ended December 31,		
	2015	2014	2013
	<i>(in reais, except percentages)</i>		
Depreciation (appreciation) of the <i>real</i> versus U.S. dollar ⁽²⁾	47.0%	13.4%	14.6%
Period end exchange rate – US\$1.00	3.9048	2.6562	2.3426
Average exchange rate – US\$1.00 ⁽¹⁾	3.3387	2.3547	2.1605

(1) Represents the average for period indicated.

(2) Represents the comparison with period-end exchange rate.

Source: Central Bank.

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

82

	Year ended December 31,		
	2015	2014	2013
	<i>(in reais, except percentages)</i>		
Depreciation (appreciation) of the <i>real</i> versus yen ⁽²⁾	46.0%	(0.45)%	(5.9)%
Period end exchange rate – ¥1.00	0.0324	0.0222	0.0223
Average exchange rate – ¥1.0 ⁽¹⁾	0.0276	0.0222	0.0221

(1) Represents the average for period indicated.

(2) Represents the comparison with period-end exchange rate.

Source: Central Bank.

During the years ended December 31, 2015, 2014 and 2013 we had no forward exchange transactions.

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

Effects of Extreme Weather Events

The southeastern region of Brazil, particularly the southern region of the state of Minas Gerais, the PCJ River Basin (from which we extract the water used in the Cantareira System), and the northern area of the São Paulo metropolitan region, experienced below average rainfall since 2012. In the October 2013 – March 2014 rainy season, rain levels and water inflow into the reservoirs reached the lowest levels in 84 years of recorded rainfall in the region, a scenario that continued in the October 2014 – March 2015 rainy season. During the October 2015 – March 2016 rainy season, the level of rainfall in the region returned to the normal levels expected for the period. Improved rainfall in the rainy season that began in October 2015, the collaborative efforts between us and the population we serve and emergency construction works conducted by us throughout 2014 and 2015 to combat the water crisis, resulted in a partial restoration of the water levels of the Cantareira system..

As of December 31, 2015, the reservoirs in the São Paulo metropolitan region, where our largest market is located, contained 703 billion liters of bulk water storage for treatment, compared to 301 billion liters available for treatment as of December 31, 2014. Under normal circumstances, we withdraw 6.2 billion liters per day (equivalent to the total water production of 71.4 m³/s in February 2014 for the São Paulo metropolitan region) from the reservoirs. This volume decreased to 4.7 billion during the drought (equivalent to the total water production of 54.8 m³/s in December 2015 for the São Paulo metropolitan region). The extent and the consequences of the drought have provoked a continuous reduction in the volume of water billed. Throughout 2015, the water volume billed decreased 8.0% compared to 2014.

Even with the return of normal rainfall levels throughout the October 2015 – March 2016 rainy season, the need to recover the volume of water stored in the reservoirs of the Cantareira system will persist throughout the next rainy season. The Cantareira system’s maximum storage capacity, including the technical reserve, is 1,269.5 million 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 . In December 2015, 5.3 million inhabitants were serviced by this system, compared to 8.9 million in February 2014.

In order to balance supply and demand despite restricted water availability, we adopted from February 2014 until January 2016 a series of measures, including: (i) use treated water from other production systems to serve consumers originally supplied by the Cantareira system; (ii) offer discounts (bonuses) to consumers that would use below average amounts of water, compared to average consumption; (iii) reduce pressure in the water distribution lines in order to decrease losses due to leakage; (iv) adjusting the volume of water sold to municipalities that operate their own distribution network, due to reduced water availability; and (v) use pumps in order to extract water located below the intakes of the Cantareira system, from the so-called “technical reserve”, an unprecedented measure. As a result of the return of normal rainfall levels in the rainy season that began in October 2015, as of February 2016 we modified the rules for the offer of discounts (bonuses) and as of January 2016 it was no longer necessary to pump water out of the technical reserve of the Cantareira system, as water levels returned to a volume at which they could be naturally extracted. On March 24, 2016, as a result of the increased level of rainfall and increased predictability of the level of water in our reservoirs, we requested to ARSESP the cancellations of our Water Consumption Reduction Incentive Program and of the Contingency Tariff. ARSESP approved our requests on March 31, 2016 and the aforementioned policy changes shall be applied to water meter readings recorded as of May 1, 2016. In addition, as of December 2015, the time period during which water is pumped out at reduced pressure in the water distribution lines is returning to the normal nighttime period, as it was prior to the water crisis. See “Item 4.B. Business Overview—The Current Water Crisis”.

Critical Accounting Estimates and Judgments

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

Allowance for Doubtful Accounts

We record an allowance for doubtful accounts in an amount that our management considers sufficient to cover probable losses, based on an analysis of customer accounts receivable, in accordance with the accounting policy stated in Note 3.4 to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013. Provisions for the allowance for doubtful accounts are included in selling expenses, net of recoveries. The net charge to this allowance was R\$2.4 million, R\$139.6 million and R\$103.9 million in 2015, 2014 and 2013, respectively. Wholesale sales losses, amounting to R\$273.0 million, R\$219.7 million and R\$218.7 million in 2015, 2014 and 2013, respectively, were also recorded as revenue reduction.

The methodology for determining the allowance for doubtful accounts requires significant estimates, considering a number of factors, including historical collection experience, current economic trends, estimates of forecast write offs, the aging of the accounts receivable portfolio and other factors. While we believe that the estimates used are reasonable, actual results could differ from those estimates.

Intangible Assets Arising from Concession and Program Contracts

As of December 31, 2015, we had intangible assets of R\$28,513.6 million.

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

The fair value of construction and other work on the infrastructure is recognized as revenue, at its fair value, when the infrastructure is built, provided that this work is expected to generate future economic benefits. The accounting policy for the recognition of construction revenue is described in Note 3.3 "Operating Income" to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013.

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

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

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

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

Provision

As of December 31, 2015, we were party to judicial and administrative proceedings, relating to civil, environmental and tax matters, amounting to R\$1,082.2 million (deducting the amount of R\$330.7 million related to escrow deposits) with respect to which we considered the risk of loss as probable. As of that date, proceedings with respect to which we considered the risk of loss as possible amounted to R\$5,410.5 million, and those with respect to which we considered the risk of loss as remote amounted to R\$41,444.1 million.

We are a party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among other types, disputes with customers and suppliers and tax, labor, civil, environmental and other proceedings. For a more detailed discussion of these legal proceedings, see Note 19 to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013. We accrue provisions for legal proceedings in which it is probable that an outflow will be necessary to settle the liability and the amount of such loss can be reasonably estimated. Therefore, we are required to make judgments regarding future events for which we often seek the advice of legal counsel. As a result of the significant judgment required in assessing and estimating these provisions for risks, actual losses realized in future periods could differ significantly from our estimates and could exceed the amounts which we have provisioned.

Pension Benefits

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

We determine the appropriate discount rates at the end of each year, which is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension

obligations. The discount rate was increased from 6.09% in 2014 to 7.25% in 2015 under Plan G0 and from 6.11% in 2014 to 7.23% in 2015 under Plan G1 in order to follow the increase in the rates applicable to the Brazilian Government NTN – B, long term notes, which term is similar to the duration of the pension benefits, as described in Notes 3.19 (a) and 20 (b) to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013.

85

Other key assumptions for pension obligations are based in part on current market conditions. Additional information on the pension plans under Plan G0 and G1 is disclosed in Note 20 to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013.

Deferred income tax and social contribution

We recognize and settle taxes on income based on the results of operations verified according to the Brazilian Corporate Law, taking into consideration the provisions of the tax laws. Pursuant to IAS 12, we recognize deferred tax assets and liabilities based on the differences between the accounting balances and the tax bases of assets and liabilities.

We regularly review the recoverability of deferred tax assets and recognize a provision for impairment if it is probable that these assets will not be realized, based on historic taxable income, the projection of future taxable income and the estimated period to reverse temporary differences. These calculations require the use of estimates and assumptions. The use of different estimates and assumptions could result in provision for impairment of all or a significant amount of deferred tax assets.

As of December 31, 2015 and 2014, we have recognized R\$128.2 million and R\$209.5 million, respectively, as deferred income tax assets, net of the deferred tax liabilities, as disclosed in Note 18 to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013.

Certain Transactions with Controlling Shareholder

Reimbursement Due from the State

Reimbursement due from the State for pensions paid represent supplementary pensions (Plan G0) that we pay, on behalf of the State, to former employees of State owned companies which merged to form our Company. These amounts must be reimbursed to us by the State, as primary obligor.

In November 2008, we entered into the third amendment to the agreement with the State relating to payments of pension benefits made by us on its behalf. The State acknowledged that it owed us an outstanding balance of R\$915.3 million as of September 30, 2008, relating to payments of pension benefits made by us on its behalf. In 2008, we provisionally accepted, but it is not recognized in our books, the reservoirs in the Alto Tietê System as partial payment in the amount of R\$696.3 million, subject to the transfer of the property rights of these reservoirs to us which was renegotiated on March 18, 2015, as described below. Since November 2008, the State has been paying the remaining balance in the amount of R\$219.0 million in 114 successive monthly installments. See Note 10 to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013 and “Item 7. Major Shareholders and Related Party Transactions”.

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

As of December 31, 2015 and 2014, the amounts not recorded related to pension benefits paid by us on behalf of the State totaled R\$855.1 million and R\$1,479.7 million respectively. As a result, we also recognized the obligation related to pension benefits, maintained with the beneficiaries and pensioners of Plan G0. As of December 31, 2015 and 2014, the pension benefit obligations of Plan G0 totaled R\$2,167.0 million and R\$2,053.5 million, respectively.

For detailed information on the pension benefit obligations refer to Note 20 of our Financial Statements.

Accounts Receivable from the State for Water and Sewage Services Rendered

Certain of these accounts receivable have been overdue for a long period. We have entered into agreements with the State with respect to these accounts receivable. For further information on these agreements, see Note 10 to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013 and “Item 7. Major Shareholders and Related Party Transactions”.

86

Use of Certain Assets

Empresa Metropolitana de Águas e Energia S.A. – EMAE plans to receive credit and to obtain financial compensation for the use of water from the Guarapiranga and Billings reservoirs, which we use in our operations, as well as reimbursement of damages related to non-payment in due course.

We understand that no amounts are due for the use of these reservoirs given the grants already made. Should these reservoirs not be available for our use, there could be a need to collect water in more distant locations and a risk of not being able to properly render services in the region and an increase in water supply cost.

Several lawsuits were filed by EMAE, among them a lawsuit to enforce an arbitration clause related to the Guarapiranga reservoir, a proceeding which has already begun and another lawsuit, pleading for financial compensation due to our water abstraction from the Billings reservoir for public supply. These two lawsuits allege that this conduct has caused permanent and increasing loss in the capacity of the Henry Borden hydroelectric power plant to generate electricity as well as financial losses.

We understand that the expectation for all cases is of possible losses, and for the time being, it is not feasible to estimate the amounts involved, since they were not determined.

On April 10, 2014, we issued an Announcement to the Market to communicate that we are negotiating with EMAE regarding a potential future agreement. However, no adjustment has been confirmed, and no agreement has been executed by either party as of yet.

Results of Operations

The following table sets forth, for the periods indicated, certain items in our statement of operations, each expressed as a percentage of net operating revenues:

	Year ended December 31,					
	2015	2014		2013		
	<i>(in millions of reais, except percentages)</i>					
Net operating revenues	11,711.6	100.0%	11,213.2	100.0%	11,315.6	100.0%
Cost of sales and services	(8,260.8)	(70.5)%	(7,635.6)	(68.1)%	(6,816.3)	(60.2)%
Gross profit	3,450.8	29.5%	3,577.6	31.9%	4,499.3	39.8%
Selling expenses	(598.1)	(5.1)%	(736.6)	(6.6)%	(637.1)	(5.6)%
Administrative expenses	45.0	0.4%	(924.4)	(8.2)%	(729.1)	(6.4)%
Other operating income (expenses), net and equity results	146.4	1.3%	(5.9)	(0.1)%	5.7	(0.1)%
Operating profit	3,044.1	26.0%	1,910.7	17.0%	3,138.8	27.7%
Financial income (expenses), net	(2,456.5)	(21.0)%	(635.9)	(5.7)%	(483.2)	(4.3)%
Profit before income tax and social contribution	587.6	5.0%	1,274.8	11.4%	2,655.6	23.5%
Income tax and social contribution	(51.3)	(0.4)%	(371.9)	(3.3)%	(732.0)	(6.5)%
Net income for the year	536.3	4.6%	903.0	8.1%	1,923.6	17.0%

Year Ended December 31, 2015 Compared to Year Ended December 31, 2014***Net operating revenues***

Net operating revenues increased by R\$498.4 million, or 4.4%, to R\$11,711.6 million in 2015 from R\$11,213.2 million in 2014.

Net operating revenues relating to water services increased by R\$161.8 million, or 3.5%, to R\$4,723.0 million in 2015 from R\$4,561.2 million in 2014 and net operating revenues relating to sewage services decreased by R\$82.1 million, or 2.2%, to R\$3,651.9 million in 2015 from R\$3,734.0 million in 2014. These variations were principally due to:

87

- An increase of 6.5% in the repositioning tariff index since December 2014;
- An increase of 15.2% in tariffs (7.8% ordinary tariff adjustment and 6.9% extraordinary tariff revision) since June 2015; and
- Application of the contingency tariff, which contributed R\$499.7 million to our revenues in 2015.

These increases were partially offset by the discounts (bonuses) granted within the terms of the Water Consumption Reduction Incentive Program, which amounted to R\$ 926.1 million in 2015, compared to the R\$ 376.4 million granted in 2014 and a decrease of 6.8% in our total billed volume (8.0% in water and 5.2% in sewage).

Gross revenue from construction increased by R\$418.7 million, or 14.3%, to R\$3,336.7 million in 2015 from R\$2,918.0 million in 2014. See Note 3.3(b) to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013 for a description of the accounting policies applicable to our construction services business.

Cost of Sales and Services

The cost of sales and services increased by R\$625.2 million, or 8.2%, to R\$8,260.8 million in 2015 from R\$7,635.6 million in 2014. As a percentage of net operating revenues, cost of sales and services increased to 70.5% in 2015 from 68.1% in 2014.

The increase in costs of sales and services was principally due to the following factors:

- an increase of R\$408.3 million in construction costs due to higher investments in 2015; and
- an increase of R\$217.7 million in the cost of the electricity, mainly due to an average increase of 63.1% in the regulated market tariffs and a corresponding 7.9% decrease in electricity consumption, and an average increase of 161.0% in the Tariff for the Use of Distribution System (TUSD) and a corresponding 13.3% decrease in consumption. The increases were partially offset by a 4.1% decrease in free market tariffs and a 1.0% decrease in the free market consumption.

The increase in costs of sales and services was partially offset by:

- a decrease of R\$19.2 million in expenses related to supplies, mainly due to decreased use of materials in preventive and corrective maintenance in water and sewage systems, expansion of computerized systems and conservation of properties and installations.

Gross Profit

As a result of the factors discussed above, gross profit for the year ended December 31, 2015 decreased by R\$126.8 million, or 3.5%, to R\$3,450.8 million in 2015 from R\$3,577.6 million in 2014. As a percentage of net operating revenues, gross profit decreased to 29.5% in 2015 from 31.9% in 2014.

Selling Expenses

Selling expenses decreased by R\$138.5 million, or 18.8%, to R\$598.1 in 2015 from R\$736.6 million in 2014. As a percentage of net operating revenues, selling expenses decreased to 5.1% in 2015 from 6.6% in 2014. The decrease in selling expenses was primarily due to a decrease of R\$137.2 million in credit write-offs, especially due to the reversal

of the provision for losses with the municipality of Guarulhos, as a result of the receipt of court-ordered debt payments in cash. For more information on the reversal of the provision for losses with the municipality of Guarulhos, 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”.

Administrative Expenses

88

Administrative expenses decreased by R\$969.4 million, or 104.9%, to a revenue of R\$45.0 million in 2015 from an expense of R\$924.4 million in 2014. As a percentage of net operating revenues, administrative expenses decreased to 0.4% in 2015 from 8.2% in 2014.

The decrease in administrative expenses was principally due to:

- a decrease of R\$ 185.5 million in the provisions for lawsuits, mainly due to court decisions in our favor; and
- a credit in the amount of R\$ 696.3 million as a result of an agreement with the government of the state of São Paulo to receive an undisputed amount owed to us related to the payment of the benefits to former employees. See Note 10 (a) (vii) to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013

Other Operating Income (Expenses), Net

Other operating income was of R\$146.4 million in 2015 compared with R\$5.9 million operating expenses in 2014, an increase of 2,563.4%.

Other operating income is comprised of income from the sale of property, plant and equipment, sale of contracts awarded in public bids, rights to sell electricity, indemnities and reimbursements of expenses, collection of fines and collateral, property leases, sales of reused water, consulting services related to PURA projects and provision of services.

Other operating income increased in 2015 mainly due to the sale of properties, in the amount of R\$48.4 million, and higher amounts received from the Hydrographic Basin Depollution Program, in the amount of R\$41.0 million.

Other operating expenses consist mainly of the write-offs of concessions due to obsolescence, discontinued construction works, unproductive wells, economically unfeasible projects, losses on property, plant and equipment and exceeding costs of electricity sold. Other operating expenses decreased in 2015 mainly due to higher provisions for the write-off of construction works, projects and obsolete goods in 2014 totaling R\$58.8 million.

Financial income (expenses), Net

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

Financial expenses, net increased by R\$1,820.6 million, or 286.3%, to a R\$2,456.5 million expense in 2015 from a R\$635.9 million expense in 2014. As a percentage of net operating revenues, financial expenses, net increased to 21.0% in 2015 from 5.7% in 2014.

The increase in financial expenses, net was principally due to the negative variation of R\$1,647.0 million in expenses with exchange rate variation on loans and financing, due to the appreciation of the U.S. dollar and the Japanese Yen against the Brazilian Real in 2015 (47.0% and 45.9%, respectively), when compared to 2014 (13.4% and -0.5%, respectively).

Profit before income tax and social contribution

As a result of the factors discussed above, profit before income tax and social contribution decreased by R\$687.2 million, or 53.9%, to R\$587.6 million in 2015 from R\$1,274.8 million in 2014. As a percentage of net operating revenues, our profit before income tax and social contribution decreased to 5.0% in 2015 from 11.4% in 2014. See reconciliation of the effective tax rate in Note 18 (d) to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013.

Income Tax and Social Contribution

89

Income tax and social contribution decreased by R\$320.6 million, or 86.2%, to R\$51.3 million in 2015 from R\$371.9 million in 2014. This decrease was principally due to a lower taxable income in 2015 and a permanent tax effect related to GESP agreement in the amount of R\$151,5 million.

Net Income for the year

As a result of the factors discussed above, net income decreased to R\$536.3 million in 2015 from R\$903.0 million in 2014. As a percentage of net operating revenues, our net income decreased to 4.6% in 2015 from 8.1% in 2014.

Year Ended December 31, 2014 Compared to Year Ended December 31, 2013

Net operating revenues

Net operating revenues decreased by R\$102.4 million, or 0.9%, to R\$11,213.2 million in 2014 from R\$11,315.6 million in 2013.

Net operating revenues relating to water services decreased by R\$344.8 million, or 7.0%, to R\$4,561.2 million in 2014 from R\$4,906.0 million in 2013 and net operating revenues relating to sewage services decreased by R\$230.9 million, or 5.8%, to R\$3,734.0 million in 2014 from R\$3,964.9 million in 2013. These decreases were principally due to:

- a decrease of R\$376.4 million due to Water Consumption Reduction Incentive Program; and
- an average of 2.2% decrease in both the volume of water and the volume of sewage invoiced in 2014.

These decreases were partially offset by the 3.1% tariff adjustment since December 2013.

Gross revenue from construction increased by R\$473.2 million, or 19.4%, to R\$2,918.0 million in 2014 from R\$2,444.8 million in 2013. See Note 3.3(b) to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013 for a description of the accounting policies applicable to our construction services business.

Cost of Sales and Services

The cost of sales and services increased by R\$819.3 million, or 12.0%, to R\$7,635.6 million in 2014 from R\$6,816.3 million in 2013. As a percentage of net operating revenues, cost of sales and services increased to 68.1% in 2014 from 60.2% in 2013.

The increase in costs of sales and services was principally due to the following factors:

- an increase of R\$133.8 million or 9.5%, in salaries and related charges due to the following factors: (i) an increase of 6.8% in salaries since May 2014 on account of implementation of our career and wage plan, which had an impact of approximately R\$75.6 million; (ii) an increase in the provision of retirement benefits, amounting to R\$35.3 million, based on the increased number of employees who are entitled to request retirement, in addition to the wage increase in the period; and (iii) the increase in overtime pay, amounting to R\$12.4 million, mainly due to a wage adjustment in the period and the increased number of hours worked;
- an increase of R\$116.1 million in depreciation and amortization, mainly due to the increase in operating intangible assets in 2014, arising principally from input of the works in operation;

- an increase of R\$70.4 million or 9.0% in expenses related to services, mainly due to the following factors: (i) expenses totaling R\$32.9 million related to the commencement of operations in Diadema in March 2014; (ii) a reversal of provisions in 2013 in the amount of R\$18.3 million, resulting from the end of the agreement with the municipality of São Paulo; and (iii) higher expenses with the Corporate Program for Reduction of Water Loss, in the amount of R\$19.8 million;

90

- an increase of R\$45.8 million in the cost of electricity, mainly due to the average increase of 19.8% in free market tariffs and of 9.2% in regulated market tariffs, partially offset by an average decrease of 14.5% in the Tariff for the Use of Distribution System (TUSD), as a consequence of Provisional Presidential Decree 579/12 and Law 12,783/13;
- an increase of R\$20.5 million or 8.5% in expenses related to water-treatment materials, mainly due to increased consumption and substitution of water-treatment products in order to meet increased demand while maintaining the same efficiency levels in water treatment;
- an increase of R\$461.0 million in construction costs due to higher investments in 2014.

Gross Profit

As a result of the factors discussed above, gross profit for the year ended December 31, 2014 decreased by R\$921.7 million, or 20.5%, from R\$3,577.6 million in 2013 to R\$4,499.3 in 2014. As a percentage of net operating revenues, gross profit decreased to 31.9% in 2014 from 39.8% in 2013.

Selling Expenses

Selling expenses increased by R\$99.5 million, or 15.6%, to R\$736.6 million in 2014 from R\$637.1 million in 2013. As a percentage of net operating revenues, selling expenses increased to 6.6% in 2014 from 5.6% in 2013. The increase in selling expenses was principally due to the following factors:

- an increase of R\$43.7 million in expenses for services, mainly due to the reversal of provisions in 2013 in the amount of R\$22.6 million, resulting from the end of the agreement with the municipality of São Paulo and higher expenses related to credit recovery services and delivering bills in the amount of R\$18.3 million;
- an increase of R\$35.7 million, or 34.4%, in credit write-offs, mainly due to the higher provision of losses with allowance for doubtful accounts with wholesale customers;
- an increase of R\$18.8 million, or 8.4%, in salaries and related charges due to the increase of 6.8% in salaries since May 2014 on account of implementation of our new job and salary plan.

Administrative Expenses

Administrative expenses increased by R\$195.3 million, or 26.8%, to R\$924.4 in 2014 from R\$729.1 million in 2013. As a percentage of net operating revenues, administrative expenses increased to 8.2% in 2014 from 6.4% in 2013.

The increase in administrative expenses was principally due to the following factors:

- an increase of R\$58.7 million in advertising campaigns, mainly due to the intensification of our water conservation campaign;
- an increase of R\$44.9 million, or 24.4% in general expenses, mainly due to the expenses on judicial proceedings in the amount of R\$37.1 million;
- an increase of R\$43.5 million or 14.7%, in salaries and related charges due to the increase of 6.8% in salaries since May 2014 associated with the implementation of our new job and salary plan.

- an increase of R\$12.1 million in software maintenance; and
- an increase of R\$7.1 million, in hiring of services due to the commencement of operations in Diadema in March 2014.

Other Operating Income (Expenses), Net

91

Other operating expenses were R\$5.9 million in 2014 compared with R\$5.7 million operating income in 2013, an increase of 204.2%. Other operating expenses showed an increase of R\$58.7, mainly due to the following factors: (i) provision for losses of projects amounting to R\$21.3 million; (ii) provision for losses for the agreement payments related to the concession for the municipality of Diadema in the amount of R\$15.0 million; (iii) write-off of obsolete goods in the amount of R\$11.4 million; and (iv) provision for losses of hydrometers in the amount of R\$11.4 million. The decrease was partially offset by (i) higher fines applied to suppliers and service providers in the amount of R\$25.8 million; and (ii) higher income from the Program for Rational Use of Water (*Programa de Uso Racional da Água – PURA*) in the amount of R\$20.9 million.

Financial income (expenses), Net

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

Financial income (expenses), net increased by R\$152.7 million, or 31.6%, to a R\$635.9 million expense in 2014 from a R\$483.2 million expense in 2013. As a percentage of net operating revenues, financial income (expenses), net increased to 5.7% in 2014 from 4.3% in 2013.

The increase in financial income (expenses), net was principally due to:

- an increase in foreign exchange losses related to loans and financing of R\$77.9 million as a result of the new funding in the amount of R\$458.7 million;
- an increase of R\$55.2 million in other financial expenses, mainly due to interest expenses totaling R\$47.9 million related to the commencement of operations of two sewage treatment plants financed through leases;
- an increase of R\$42.8 million in other monetary variations mainly related to inflation adjustments for legal expenses in the amount of R\$38.0 million; and
- an increase of R\$25.6 million in monetary variations on local loans and financing, mainly due to higher IPCA and TR variations in 2014 of 6.4% and 0.9%, respectively, as compared to 2013 variations of 5.9% and 0.2%, respectively.

The increase in financial income (expenses), net was partially offset by:

- an increase of R\$29.9 million, or 9.9% in financial investments indexed to CDI, held in the period, as a result of the increase in the Interbank Deposit Certificate (CDI) in 2014 (10.8%), when compared to 2013 (8.2%); and
- a decrease of R\$21.8 million in interest expenses on local loans and financing, mainly due to the higher interest capitalization occurred in 2014 when compared to 2013.

Profit before income tax and social contribution

As a result of the factors discussed above, profit before income tax and social contribution decreased by 52.0%, to R\$1,274.8 million in 2014 from R\$2,655.6 million in 2013. As a percentage of net operating revenues, our profit before income tax and social contribution decreased to 11.4% in 2014 from 23.5% in 2013.

Income Tax and Social Contribution

Income tax and social contribution decreased by R\$360.1 million, or 49.2%, to R\$371.9 million in 2014 from R\$732.0 million in 2013. This decrease was principally due to a lower taxable income in 2014.

The 2014 effective tax rate of 29%, compared to 28% in 2013, is lower than the 34% standard tax rate because we recorded interest on shareholder's equity as a deductible expense, as is permitted by tax law.

92

Net Income for the year

As a result of the factors discussed above, net income decreased to R\$903.0 million in 2014 from R\$1,923.6 million in 2013. As a percentage of net operating revenues, our net income decreased to 8.1% in 2014 from 17.0% in 2013.

B. Liquidity and Capital Resources

Capital Sources

In order to satisfy our liquidity and capital requirements, we have primarily relied on cash provided by operating activities, long-term borrowings from Brazilian federal governmental financial institutions, and long-term financing from multilateral organizations and from domestic and international development banks, and also from capital markets. As of December 31, 2015, we had R\$1,639.2 million of cash and cash equivalents. The outstanding current portion of our long-term indebtedness was R\$1,526.3 million as of December 31, 2015, of which R\$901.2 million was denominated in foreign currency. Long term indebtedness was R\$11,595.3 million as of December 31, 2015, of which R\$5,716.6 million consisted of foreign currency-denominated obligations.

As a result of the financial impacts of the current water shortage to date, we have taken steps to minimize its negative effects, including amongst actions rearranging investments, reducing budget expenses, negotiating overdue credits (mainly with the State and municipalities served on a wholesale basis), implementing contingency tariffs, and requesting extraordinary tariff revision. For more information, see Note 1 of our 2015 financial statements.

Our management expects that the cash and cash equivalents available on December 31, 2015, the operating cash generation estimated for 2016 and the lines of credit available for investments are sufficient to meet its short-term liabilities and will not compromise the actions necessary to overcome the water shortage and preserve our consumers' water supply.

Cash Flow

Cash Provided by Operating Activities

Cash provided by operating activities is the single largest source of our liquidity and capital resources, and we expect that it will continue to be so in the future. Our cash generated by operating activities was R\$2,641.4 million, R\$2,480.3 million and R\$2,777.2 million in 2015, 2014 and 2013, respectively. The main driver of our cash flow from operating activities relates to our revenue, which is due to the nature of our business and to the fact that we are expanding our infrastructure. The increase in cash generated in 2015 is due principally to a lower taxable income in 2015.

Cash Used in Investing Activities

Our cash used by investing activities was R\$2,459.5 million, R\$2,757.7 million and R\$2,281.5 million in 2015, 2014 and 2013, respectively. The main driver of our cash flow from investing activities relates to the need to adjust the amount we invested in 2015, principally due to the water crisis and its impacts on our revenues. Despite the adverse scenario faced as a result of the water crisis, we invested in the São Lourenço PPP, a construction project planned and initiated before the water crisis, approximately R\$700 million (including capitalized interest) that did not impact our cash flow in 2015.

Cash Provided and Used in Financing Activities

Our cash used in financing activities was R\$265.7 million in 2015, our cash provided in financing activities was R\$218.5 million in 2014, and our cash used in financing activities was R\$629.7 million in 2013. The main driver of our cash flow from financing activities relates to the proceeds and repayments of loans used to finance purchases of intangible assets related to our concession and program contracts, in order to support the expansion of our services and our payment of interest on shareholders' equity.

93

Indebtedness Financing

Our total financial indebtedness increased by 21.7%, from R\$10,785.8 million as of December 31, 2014 to R\$13,121.6 million as of December 31, 2015. In addition, during the same period, our total foreign denominated indebtedness recorded increased by 31.5%, from R\$4,346.3 million as of December 31, 2014 to R\$6,617.8 million as of December 31, 2015.

As of December 31, 2015, we had R\$11,595.3 million in long-term indebtedness outstanding (excluding the current portion of long-term indebtedness), of which R\$5,716.6 million consisted of foreign currency-denominated long-term debt. We had an outstanding current portion of long-term indebtedness of R\$1,526.3 million as of December 31, 2015. As of December 31, 2015, R\$901.2 million of this current portion of long-term indebtedness was denominated in foreign currency. As of December 23, 2015, our Standard & Poor's Rating Service domestic rating was brA+ and our S&P international rating was BB. Since July 2013 we also started to be covered by Moody's America Latina Ltda, by whom our national rating was Aa2.br and our global rating was Ba2, as of August 28, 2015.

Various contractual agreements we have entered into, including certain financing agreements with *Caixa Econômica Federal* and BNDES, provide for liens over a portion of our cash flows from the payment of water and sewage provision tariffs. In addition, we provide as guarantees a portion of our cash flow generation to transactions related to PPPs. Under these agreements, cash received from operations is required to pass through designated accounts. In the event of a default under the relevant agreement, such cash and future cash flows that are required to be deposited in such accounts become restricted and are subject to security interests in favor of the relevant creditor. As of December 31, 2015, a substantial portion of our monthly cash flows from operations was subject to these liens. As of that date, the total amount of our secured debt, including indebtedness benefiting from these liens, was R\$4,190.3 million. See “—Indebtedness Financing—Financial Covenants—Local currency denominated indebtedness” and Note 16 to our financial statements.

The following table sets forth information on our indebtedness outstanding as of December 31, 2015:

	December 31, 2015			
	Current	Noncurrent	Total	Final Maturity*
Denominated in local currency:				
10 th issue debentures	39,619	155,815	195,434	2020 TJLP + 1.92% (1 st & 3 rd series) & IPCA + 9.53% (2 nd series)
12 th issue debentures	45,450	385,667	431,117	2025 TR + 9.5%
14 th issue debentures	38,519	210,961	249,480	2022 TJLP + 1.92% (1 st & 3 rd series) & IPCA + 9.19% (2 nd series)
15 th issue debentures	94,819	728,529	823,348	2019 CDI + 0.99% (1 st series) & IPCA + 6.2% (2 nd series)
17 th issue debentures	140,144	997,259	1,137,403	2023 CDI + 0.75% (1 st series) & IPCA + 4.5% (2 nd series) & IPCA + 4.75% (3 rd series)
18 th issue debentures	3,167	247,683	250,850	2024 TJLP + 1.92% (1 st and 3 rd series) & IPCA + 8.25% (2 nd series)
19 th issue debentures	-	498,587	498,587	2017 CDI + 0.80% to 1.08%
20 th issue debentures	-	494,500	494,500	2019 CDI + 3.80%
<i>Caixa Econômica Federal</i>	49,491	1,014,850	1,064,341	2015/2037 TR + 5% to 9.5%

National Bank for Economic and Social Development (BNDES) Coastal region	16,368	49,104	65,4722019 2.5% + TJLP
National Bank for Economic and Social Development (BNDES) PAC	10,329	66,984	77,3132023 2.15% + TJLP
National Bank for Economic and Social Development (BNDES) PAC II 9751	4,264	31,206	35,4702027 1.72% + TJLP
National Bank for Economic and Social Development (BNDES) PAC II 9752	2,308	23,660	25,9682027 1.72% + TJLP
National Bank for Economic and Social Development (BNDES) Onda Limpa	22,347	184,082	206,4292025 1.92% + TJLP
National Bank for Economic and Social Development (BNDES) Tietê III	17,725	265,663	283,3882028 1.66% + TJLP
Financial leasing	11,955	522,940	534,8952035 7.73% to 10.12% + IPC 2015/2018 TJLP + 2% (Fehidro) & TR + 12.00% (Presidente Prudente)
Other	649	1,270	1,919
Interest and others charges	127,862	-	127,862
Total denominated in local currency	625,016	5,878,760	6,503,776

94

Denominated in foreign currency:

Inter-American Development Bank (IADB) US\$560,826,000 (2014 - US\$541,097,000)	148,983	2,031,386	2,180,369	2016 to 2035 1.52% to 3.35%
International Bank for Reconstruction and Development (IBRD) US\$61,158,000 (2014 - US\$45,860,000)	-	238,464	238,464	2034 0.69%
Eurobonds - US\$ 140,000,000 (2014 - US\$ 140,000,000)	546,570	-	546,570	2016 7.50%
Eurobonds - US\$ 350,000,000 (2014 - US\$ 350,000,000)	-	1,362,570	1,362,570	2020 6.25%
JICA 15 - ¥ 16,134,020,000 (2014 - ¥ 17,286,450,000)	37,373	485,853	523,226	2029 1.8% & 2.5%
JICA 18 - ¥ 14,506,240,000 (2014- ¥ 15,542,400,000)	33,603	436,548	470,151	2029 1.8% & 2.5%
JICA 17 - ¥ 1,565,564,000 (2014 - ¥ 1,029,992,000)	-	50,201	50,201	2035 1.2% & 0.01%
JICA 19 - ¥ 21,701,103,000 (2014 - ¥ 14,208,068,000)	-	701,978	701,978	2037 1.7% & 0.01%
IADB 1983AB - US\$ 130,289,000 (2014 - US\$ 154,231,000)	93,490	409,578	503,068	2023 Libor + 1.88% to 2.38%
Interest and others charges	41,227	-	41,227	
Total denominated in foreign currency	901,246	5,716,578	6,617,824	
Total loans and financing	1,526,262	11,595,338	13,121,600	

* TR was 0.2250% per month as of December 31, 2015; CDI stands for Interbank Deposit Rate (*Certificado de Depósitos Interbancários*), which was 14.14% per annum as of December 31, 2015; IGP M was 10.54% per annum as of December 31, 2015; TJLP stands for Long term Interest Rate (*Taxa de Juros a Longo Prazo*), published quarterly by the Central Bank, which was 7.0% per annum as of December 31, 2015.

The following table shows the maturity profile of our debt, as of December 31, 2015, for the period indicated:

	2016	2017	2018	2019	2020	After 2021	Total
	<i>(in millions of reais)</i>						
Loans and financing	1,526.3	1,435.0	1,315.8	1,435.9	2,226.9	5,181.7	13,121.6

Referring to all of our foreign currency denominated indebtedness, the amount of R\$4,831.1 million, net of transaction costs, as of December 31, 2015 was denominated in U.S. dollars and R\$1,745.6 million was denominated in Japanese yen. This indebtedness consisted principally of:

- R\$2,180.4 million (US\$560.8 million) in U.S. dollar denominated loans contracted with the Inter-American Development Bank, or the IADB, composed of the following: (i) two loans to finance the first phase of the Tietê Project in 1992 and one loan to finance the second phase in 2000, under which payments of principal are made in semiannual installments with final maturity in December 2016, December 2017 and July 2025. The principal amount

of this loan is adjusted semiannually for the variation of the U.S. dollar, and accrues interest at a rate varying from 1.14% to 3.00% plus LIBOR; (ii) credit agreement executed in September 2010 with the IADB for the financing of the third phase of the Tietê Project. This loan matures on September 3, 2035. Amortizations will be made in semiannual installments starting in March 2017 after a grace period of six years. The principal amount accrues interest at USD LIBOR;

95

- R\$238.5 million (US\$61.2 million) in U.S. dollar denominated loans contracted with the IBRD which was entered into on October 28, 2009, amounting to US\$100.0 million, for the financing of the Water Source Program (*Programa Mananciais*). The loan matures in March 2034. Amortizations will be made in semiannual installments starting in September 2019 after a grace period of ten years. The principal amount accrues interest at the USD LIBOR plus a variable spread;
- R\$503.1 million (US\$130.3 million) in U.S. dollar denominated loans from the AB Loan financing contracted with the IADB in May 2008. Under this loan, payments of principal are made in annual installments with final maturity in May 2023. The principal amount is adjusted semiannually for the LIBOR plus spread and accrues interest at a rate varying from 1.88% to 2.38%. The proceeds were used to repay an outstanding series of debt securities in connection with the implementation of our investment plan;
- R\$1,909.1 million (US\$490.0 million) in U.S. dollar denominated Eurobonds issued in November 2006 (US\$140.0 million with an interest rate of 7.5%) and in December 2010 (US\$350.0 million with an interest rate of 6.25%). Under these bonds, the payments of interest are made in semi annual installments and principal will be paid at the final maturity in 2016 and 2020, respectively. The proceeds from the offering were used to repay financial commitments throughout 2007 and 2011; and
- R\$1,745.6 million (¥53,906.9 million) in Japanese yen denominated loans contracted with the JICA, composed of the following: (i) ¥21,320.0 million denominated loans contracted in August 2004 for the financing of the environmental recovery program for the Baixada Santista metropolitan region, called the Clean Wave Program (*Programa Onda Limpa*). Under these loans, the payments of principal are made in semi annual installments with final maturity in August 2029. The principal amount accrues interest at rates that vary from 1.8% to 2.5% per year; (ii) ¥6,208 million in denominated loans contracted in October 2010 for the financing of the environmental improvement program in the basin of the Billings dam. The loan matures in October 2035. Amortizations will be made in semiannual installments after a grace period of seven years, starting in October 2017. The principal amount accrues interest at a rate that varies from 0.01% to 1.2% per year; (iii) ¥19,169.0 million denominated loans contracted in February 2011 to complement the financing for the first stage of the Clean Wave Program (*Programa Onda Limpa*), with commercial conditions similar to the loan entered into in August 2004. These funds were used for the provision of works and services in the Baixada Santista metropolitan region. The credit agreement expires in 18 years and interest varies from 1.8% to 2.5% per year; and (iv) ¥33,584 million denominated loan in February 2012 for the financing of the Corporate Program for Water Loss Reduction (*Programa Corporativo para Redução de Perdas*). The loan matures in February 2037. Amortizations will be made in semiannual installments after a grace period of seven years, starting in February 2019. The principal amount accrues interest at rates that vary from 0.01% to 1.7% per year.

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

Our outstanding domestic debt was R\$6,503.8 million as of December 31, 2015 and consisted primarily of *real* denominated loans from federal and state owned banks, in particular, *Caixa Econômica Federal* and BNDES, as well as debentures issued in November 2009, June 2010, February 2011, February 2012, January 2013, October 2013, December 2013, December 2014 and July 2015, and financial leasing.

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

- from 2003 to 2014, we have entered into several financing agreements with *Caixa Econômica Federal*, pursuant to which amortizations of principal are paid in up to in 60, 120, 180 or 240 months in monthly installments commencing 30 days following the applicable grace period, which varies from 14 to 48 months from the date of signature of the line of credit agreement. The final maturity is 2038. The principal amount accrues interest from 5.0% to 9.5%. The financing agreements are collateralized (i) by collections of daily billings of water supply and sewage services up to the total amount of the debt, or (ii) by a monthly plan of billings corresponding to the minimum of three times the monthly charge, depending on the terms of the relevant financing agreement. In September 2015, we settled our financing contracts celebrated between 1996 and 1998.
- in November 2007, we entered into a R\$129.9 million financing agreement with BNDES. Amortizations of the principal amount are being made in 96 successive monthly installments, with final maturity in 2019. The principal amount accrues interest at the TJLP, but limited to 6.0% per year, plus 2.50% per year. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The financing agreement is collateralized by part of the billings from the provision of water and sewage services;
- in May 2008, we entered into a R\$174.0 million financing agreement with BNDES. Amortizations of the principal amount are being made in 150 successive monthly installments, with final maturity in 2023. The principal amount accrues interest at the TJLP, but limited to 6.0% per year, plus 2.15% per year. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The financing agreement is collateralized by part of the billings from the provision of water and sewage services;
- in March 2010, we entered into a R\$294.3 million financing agreement with BNDES. Amortizations of the principal amount are being made in 156 successive monthly installments, with final maturity in 2025. The principal amount accrues interest at the TJLP, but limited to 6.0% per year, plus 1.92% per year. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The financing agreement is collateralized by part of the billings from the provision of water and sewage services;
- in 2011, we entered into financial leases in the total amount of R\$49.6 million with certain contractors for the construction of infrastructure on land we own. During the construction phase, we recognize an intangible assets and the related liability of the lease at fair value. Upon the conclusion of the construction, we began paying the rental of the infrastructure (in 240 installments) and the lease was updated accordingly to the contract. On August 31, 2013, SES Campo Limpo Paulista and Várzea Paulista started operations, and the corresponding amount as of December 31, 2014 was of R\$138,602 million;
- in March 2012, we entered into a R\$180.8 million financing agreement with BNDES. Amortization of the principal amount is being made in up to 156 successive monthly installments, with the final maturity in 2027. The principal amount accrues interest at the TJLP but it is limited to 6.0% per year plus a yearly 1.72%. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services;
- in February 2013, we entered into a R\$1.3 billion financing agreement with BNDES. Amortization of the principal amount shall be paid in up to 144 successive monthly installments after the grace period of 36 months, with the final maturity in 2028. The principal amount accrues interest at the TJLP but is limited to 6.0% per year plus a yearly 1.66%. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services;

- in December 2013, we entered into a R\$415.8 million financing agreement with BNDES. Due to the water crisis, the investment plan was revised and in January 2016 this financing agreement was cancelled.
- in June 2014, we entered into a R\$61.1 million financing agreement with BNDES. Amortization of the principal amount shall be paid in up to 108 successive monthly installments after the grace period of 36 months, with the final maturity in 2026. The principal amount accrues interest at the TJLP but is limited to 6.0% per year plus a yearly 1.76%. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services;
- in June 2015, we entered into a R\$ 747.4 million financing agreement with BNDES. Amortization of the principal amount shall be paid in up to 204 successive monthly installments after the grace period of 36 months, with the final maturity in 2035. The principal amount accrues interest at the TJLP but is limited to 6.0% per year plus a yearly 2.18%. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services; and
- in October 2015, we entered into a R\$48.3 million financing agreement with FINEP – Financiadora de Estudos e Projetos. Amortizations of the principal amount shall be paid in up in 91 successive monthly installments after the grace period of 30 months, with the final maturity in 2025. The principal amount accrues interest at the TJLP but it limited to 6.0% per year plus a yearly 1.5%. If TJLP exceeds 6% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services.

Under BNDES program, in the amount of R\$826.1 million, we issued three tranches of debentures. In November 2009, we issued our tenth tranche of debentures in the aggregate principal amount of R\$275.4 million. The debentures are divided in three series: the first and third series will mature in November 2020 and the second in December 2020. The debentures of the first and third series, in the aggregate principal amount of R\$77.1 million and R\$115.7 million, respectively, bear interest at 1.92% per year, plus the TJLP. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The debentures of the second series, in the aggregate principal amount of R\$82.6 million, bear interest at the rate of the IPCA index plus 9.53% per year. This issuance was entirely subscribed by BNDES. In February 2011, we issued our fourteenth tranche of debentures, the second tranche out of those three, also subscribed exclusively by BNDES. These debentures are divided in three series: the first and third series will mature in February 2022 and the second, in March 2022. The debentures of the first and third series, in the aggregate principal amount of R\$77.1 million and R\$115.7 million, respectively, bear interest at 1.92% per year, plus the TJLP. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The debentures of the second series, in the aggregate principal amount of R\$82.6 million, bear interest at the rate of the IPCA index plus 9.20% per year. In October 2013, we concluded our eighteenth issuance of debentures, the third tranche out of those three also subscribed exclusively by BNDES. These debentures are divided in three series: the first and third series will mature in October 2024 and the second, in November 2024. The debentures of the first and third series, in the aggregate principal amount of R\$77.1 million and R\$115.7 million, respectively, bear interest at 1.92% per year, plus the TJLP. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The debentures of the second series, in the aggregate principal amount of R\$82.6 million, bear interest at the rate of the IPCA index plus 8.26% per year. In December 2013, BNDES subscribed to the debentures of the first and second series. In December 2014 and July 2015, BNDES subscribed in part to the debentures of the third series and will subscribe to the other debentures of the third series in 2016. We have used the funds raised from the three issuances for investments primarily in the Corporate Program for Water Loss Reduction and on improvements and reforms of the Rio Grande's water treatment plant, including other projects for water supply and sewage collection systems in the São Paulo Northern Coast, Paraíba Valley and Mantiqueira Regions.

Additionally, in June 2010, we issued 500,000 debentures to the FGTS, based on the FGTS's program to finance companies in the sanitation, transport and real estate businesses (our twelfth issuance). The debentures bear interest based on the TR plus 9.5% per year and will mature in June 2025. The debentures bear a grace period of four years in respect of payments. We used the proceeds from the twelfth issuance to fund a portion of our capital expenditure program in the water supply and sewage system.

98

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

In November 2012, we carried out our sixteenth debentures issuance of R\$500 million, with a maturity date of November 2015 and bearing interest, each quarter with an interest rate of between 0.30% and 0.7% per year plus the CDI rate. The proceeds of this issuance were used to pay our financial commitments for 2012 and 2013.

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

In June 2014, we carried out our nineteenth debentures issuance of R\$500 million, with a maturity date of June 2017 and bearing interest, each semester with an interest rate of between 0.80% and 1.08% per year plus the CDI rate. The proceeds of this issuance were used to pay our financial commitments for 2014 and 2015.

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

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

Financial Covenants

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

Foreign currency denominated indebtedness

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

The financial covenants in our Loans Nos. 713, 896 and 1212 from the IADB require as follows:

- (a) our tariff revenues must be sufficient to cover the operational expenses of our system, including administrative, operating and maintenance expenses, and depreciation;
- (b) our tariff revenues must provide a return on the balance sheet value of our property, plant, and equipment of not less than 7%; and

- (c) during project execution, the balance of our short-term borrowings must not exceed 8.5% of our total equity.

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

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

In a Letter Agreement executed on September 30, 2015, the IADB irrevocably agreed not to exercise its right to accelerate its loans to us if our ratio of Net Debt to Adjusted EBITDA is equal to or exceeds 3.65:1.00 for one fiscal quarter only during the period from September 30, 2015 to October 1, 2016. As a result, the IADB will only be able to accelerate its loans to us if we breach this ratio for more than one quarter during that period. For further information, see Note 16 to our financial statements.

The indentures relating to our US\$ 140.0 million 7.5% notes due 2016 and US\$ 350.0 million 6.25% notes due 2020 prohibit, subject to some exceptions, the incurrence of additional debt in the event that: (i) the ratio of Adjusted Total Debt to adjusted EBITDA (as defined in the related indentures) is greater than 3.65:1.00; or (ii) the Debt Service Coverage Ratio (as defined in the related indentures) is less than 2.35:1.00. This agreement has a cross-default clause, i.e. the early maturity of any debt in connection with our loans or the loans of any of our subsidiaries in a total principal amount of US\$25.0 million or more (or the corresponding amount in other currencies) shall imply this agreement's early maturity. See Note 16 to our financial statements.

In addition, any significant devaluation of the *real* will affect the total debt portion denominated in foreign currencies when measure in *reais*. As a result, the Adjusted Total or Net Debt in *reais* will be affected, with consequent impacts in the ratio between Adjusted Total or Net Debt to adjusted EBITDA.

As of December 31, 2015 and 2014, we had met all the requirements set forth by these loans and financing agreements.

Local currency denominated indebtedness

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

The covenants clauses apply to all of SABESP's indebtedness with BNDES, including the 10th, 14th, and 18th issuances of debentures held by BNDES, which totaled R\$1,312.5 million as of December 31, 2015. The only financing agreement which is exempt from the renegotiated financial is contract No. 08.2.0169. See Note 16 (a) (ii) to our financial statements.

In summary, the BNDES financings specify two bands for the ratios of Adjusted Net Debt / Adjusted EBITDA, Adjusted EBITDA / Adjusted Financial Expenses, and Other Onerous Debt / Adjusted EBITDA. The financings also specify a collateral mechanism by which we assign a portion of its tariff payment receivables to BNDES in order to provide a partial guarantee of the amounts due under the financings. Under this mechanism, each month we must ensure that a portion of the tariff payments which we receive are deposited on a daily basis into a blocked collateral account, before being released to a regular movements account later in the day provided that BNDES has not notified the bank that we are in default. If the ratio of Adjusted EBITDA / Adjusted Financial Expenses is equal to or higher than 3.50, the ratio of Adjusted Net Debt / Adjusted EBITDA equal to or lower than 3.00, and the Other Onerous Debt / Adjusted EBITDA equal to or lower than 1.00, the amount that must pass through this blocked collateral account is R\$170.2 million per month. If one of the three aforementioned ratios are not met in any two or more quarters, consecutive or not, within a twelve-month period, yet remain within the following band of ratios: Adjusted EBITDA / Adjusted Financial Expenses lower than 3.50 but equal to or higher than 2.80, Adjusted Net Debt / Adjusted EBITDA equal to or lower than 3.80 but higher than 3.00, and Other Onerous Debt / Adjusted EBITDA equal to or lower than 1.30 but higher than 1.00, the amount that must pass through the blocked collateral account is automatically increased by 20%, to R\$204.3 million per month.

The current covenant clauses are:

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

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

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

100

B. If any one of the ratios specified in A. above are not met in any two or more quarters, consecutive or not, within a twelve-month period, we shall be deemed to be in non-compliance with the first band ratios and must, as a result, automatically increase the amount passing through the blocked collateral account by 20%, to R\$204.3 million per month, provided that the following second band ratios are met:

- Adjusted EBITDA / Adjusted Financial Expenses lower than 3.50 but equal to or higher than 2.80;
- Adjusted Net Debt / Adjusted EBITDA equal to or lower than 3.80 but higher than 3.00; and
- Other Onerous Debt / Adjusted EBITDA equal to or lower than 1.30 but higher than 1.00.

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

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

As of December 31, 2015, the amount that must pass through the blocked collateral account is R\$204.3 million per month, not including the financial guarantees for financing contract No. 08.2.0169.1.

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

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

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

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

In addition, all of our financing agreements with *Caixa Econômica Federal* and our financing agreements with BNDES established in November 2007, May 2008 and March 2012 are subject to a Performance Improvement Agreement (*Acordo de Melhoria de Desempenho*). The Performance Improvement Agreement, dated May 28, 2007, as amended in August 2012, was entered into between us and the federal government, and *Caixa Econômica Federal*

and BNDES as intervening parties. Pursuant to this agreement, we were required to comply with at least four of eight financial and operating ratios stipulated for the period 2012 to 2016. If we fail to comply with any of the ratios required by *Caixa Econômica Federal* and BNDES, either may suspend our credit lines and we will be prevented from entering into any other financing agreements with those entities. We have the ability, however, to renegotiate the ratios if needed. On March 14, 2013, the Ministry of Cities revoked Normative Instruction 05 of 2008, which regulated the Agreement on Performance Improvement (*Acordo de Melhoria de Desempenho*), or API. According to the Instruction, the APIs executed by March 14, 2013 will remain valid until their respective expiration dates, and it is not necessary to execute or reschedule APIs for new contracts.

101

Our financing agreements with *Caixa Econômica Federal* do not contain material financial covenants. The agreement with *Caixa Econômica Federal* has a cross-default clause. See Note 16 to our financial statements.

With respect to our outstanding debentures, the twelfth debenture issuance requires us to maintain an adjusted current ratio (current assets divided by current liabilities, excluding from current liabilities the current portion of noncurrent debts incurred by us that is recorded in current liabilities) higher than 1.0:1.0 and an EBITDA/financial expenses ratio equal to or higher than 1.5:1.0. The twelfth debenture issuance has an accelerated maturity clause, which is triggered if our credit ratings are downgraded two levels below the “brAA-” Brazil National Scale rating assigned to our debentures by the credit rating agency Standard & Poor’s at the time of their issuance. On May 11, 2016, our credit rating and the one assigned to the twelfth debenture issuance by Standard and Poor’s were both “brA+”. This issuance also has a cross-default clause. See Note 16 to our financial statements.

The tenth, fourteenth and eighteenth issuances follow the covenants set forth with BNDES, as described above, and contain a cross-default clauses. See Note 16 to our financial statements.

The fifteenth, sixteenth, seventeenth, nineteenth and twentieth issuances require us to maintain an EBITDA/paid financial expenses ratio equal to or higher than 1.5:1.0 and an adjusted total debt/EBITDA ratio equal to or lower than 3.65:1.0. These issuances have a cross-default clause. See Note 16 to our financial statements.

The table below shows the more restrictive covenants ratios and our financial covenants ratios as of December 31, 2015.

	Restrictive Ratios	Ratio as of December 31, 2015
Adjusted EBITDA / Adjusted financial expenses	Equal to or higher than 2.80:1.00	4.71
Adjusted net debt / Adjusted EBITDA	Equal to or lower than 3.80:1.00	2.84:1.00
Net debt / Adjusted EBITDA	Equal to or lower than 3.65:1.00	3.26:1.00
Other onerous debt ^{1/} / Adjusted EBITDA	Equal to or lower than 1.30:1.00	0.70
Adjusted current ratio	Higher than 1.0	1.45:1.00
EBITDA/Paid financial expenses	Equal to or higher than 2.35:1.00	5.59:1.00

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

As of December 31, 2015 and 2014, we had met all the requirements set forth by these loans and financing agreements.

Capital Requirements

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

Capital Expenditures

Historically, we have funded and plan to continue funding our capital expenditures with funds generated by operations and with long term financing from international and national multilateral agencies and development banks. We generally include in our capital expenditure program for the following year the amount of investment that was not realized in the previous year. In 2015, we recorded R\$3.5 billion to improve and expand our water and sewage system and to protect our water source in order to meet the growing demand for water and sewage services in the state of São Paulo. We have budgeted investments in the amount of approximately R\$12.5 billion from 2016 through 2020. See “Item 4.A. History and Development of the Company – Capital Expenditure Program”.

Dividend Distributions

We are required by our bylaws to make dividend distributions, which can be made as payments of interest on shareholders’ equity to our shareholders in an amount equal to or higher than 25% of the amounts available for distribution. We declared dividends of R\$149.9 million, R\$252.3 million and R\$537.5 million in 2015, 2014 and 2013, respectively. See “Item 7.B. Related Party Transactions – Dividends”.

102

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

Our policy is to invest continually in the modernization of equipment and identify and evaluate the technology needed to improve our provision of basic sanitation services while promoting environmental protection and maintaining our competitiveness and profitability. In 2015, 2014 and 2013, we invested R\$14.7 million, R\$10.7 million and R\$6.4 million, respectively, in research and development.

With respect to our partnership with FAPESP to develop and support research projects involving researchers from graduate schools, the State of São Paulo and our employees, the projects are equally financed by us and FAPESP. Under this partnership, two phases of projects were carried out. In the first phase, 10 projects have been approved and 9 of them have been executed and concluded. They are related to: (i) the development of technology related to the use of membrane filtration in water and sewage treatment, (ii) alternatives for the treatment, use and disposal of sludge from water and sewage treatment plants, (iii) new technologies for the implementation, operation and maintenance of water distribution and sewage collection systems, (iv) new technologies for improvements in unitary operations processes, (v) monitoring water quality; (vi) energy efficiency and (vii) the sanitary economy.

The 9 projects concluded in the first round have led to several patents and software registrations, including:

- “Use of Autonomous Microlaboratories to Monitor Phosphorus in Real Time” – This project consists of the development of a microlaboratory to detect phosphorus in water bodies using a more efficient method than traditional processes;
- “Intensive Monitoring of São Paulo Metropolitan Region Reservoirs, with emphasis on cyanobacteria and its correlation with physical and chemical parameters: the Billings case” – One of the results of this project was the development of a forecasting model to determine the concentration of cyanobacteria in water sources;
- “Specialized System for the Detection and Diagnosis of Leaks in Urban Water Lines” – This project represents the first phase of the development of a water leakage detection system with less dependence on manual detection by the field operators. The acoustic signals derived from the leak are recorded on a portable GPS device that generates a database to be posteriorly correlated and analyzed; and
- “Development and Application of a Continuous Monitoring System of Flocs for Flocculation/Coagulation and Filtration Optimization” – This project resulted in the construction of a prototype for online detection of the water flocculation index, optimizing the quantity of chemicals used in a water treatment station.

Some of the research institutions with whom we have partnered on the abovementioned projects are the University of São Paulo (*Universidade de São Paulo - USP*), the Aeronautic Technical Institute (*Instituto Tecnológico de Aeronáutica - ITA*), São Paulo State University (*Universidade Estadual Paulista – UNESP*), Federal University of São Paulo – UNIFESP, and the National Institute of Spacial Research (*Instituto Nacional de Pesquisas Espaciais – INPE*).

In May 2013, we launched the second phase of our agreement with FAPESP. In this second phase, the seven lines of research were defined in greater detail in order to precisely contemplate our needs. In this phase, 37 proposals were submitted, 10 proposals were approved according to the technical-scientific criteria and 8 of them had their agreements signed in 2015, as follows:

- Development of a National Correlated Signal Optimized for Locating and Detecting Leaks in Underground SABESP Water Pipes - UNESP;

- Development of an Aerobic Granular Sludge for Simultaneous Removal of Organic Matter, Nitrogen and Phosphorous from Sanitary Sewage – USP;

103

- Sewage Sludge Composting: Evaluation of the Process, Generated Product and its Costs;
- Diagnosis, Management and New Treatment Alternatives – USP;
- Saxitoxins in Water Supply: Production of Analytical Standards, Development of Analytical Methodologies and the Degradation Study – USP;
- Feasibility of the Use of Water Treatment Sludge as Landfill Cover Material and in the Construction of Compacted Soil Landfills - USP;
- Online Analysis of Water Quality – USP; and
- Separation Systems by Membranes for the Public Supply of Water: Hiring Projects Mechanisms and Treatment of Contaminated Underground Water – USP.

In 2015, we entered into a financing agreement with the Brazilian Agency for Innovation – FINEP for the “Sabesp – Technological Innovations for the Sanitation Sector” plan. This plan is part of the “FINEP Innovates Brazil” program and aims at supporting Brazilian companies’ plans for strategic investment in innovation. This plan must detail a company’s targets and goals for the period during which they will receive financing, pursuant to the Federal Government’s “Greater Brazil Plan – PBM”. This plan consists of four projects, whose costs total approximately R\$60 million, as follows: (i) production system for reused water in urban and industrial uses; (ii) biofiltration units for odor control; (iii) sludge dryer based on solar radiation for sewage treatment stations in the city of Franca, Franca Sewage Treatment Station; and (iv) plasma gasification system for solid waste from sewage treatment plants.

We also entered into an agreement with the Fraunhofer Institute in Germany in 2011 in order to obtain biomethane from the sewage treatment process to be used as fuel for cars. The objective is to mobilize a fleet of 49 cars using biomethane fueled by a sewage treatment process instead of gasoline. This project has been delayed due to a judicial dispute between the supplier of the equipment and the Fraunhofer Institute which has temporarily impeded the importation of equipment donated to the Fraunhofer Institute. In 2015, the dispute was resolved and the project proceeded. In 2016, we expect to receive the imported equipment and execute the construction for their installation.

Seeking energy efficiency in our operations, we projected an equipment to calculate the correct oxygen dosage to be used in air diffusors, which are used in the sewage treatment process. The project aims also to find the best cleaning period and when these devices have to be replaced.

Additionally, we have developed custom made biofilters to reduce the odor from sewage pumping stations and sewage treatment plants.

D. Trend Information

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

- the interests of our controlling shareholder;
- regulations issued by ARSESP regarding several aspects of our business, with respect to our ability to adjust our tariffs and the competency of state and municipalities to manage their sanitation affairs;
- Brazilian economic conditions;

- the effects of extreme weather events;
- the effects of any continuous international financial turmoil that may affect liquidity in the Brazilian capital and lending markets;

104

- the effects that further changes in the Basic Sanitation Law and its interpretation may have on the basic sanitation industry in Brazil and on us;
- the effects of inflation in our results of operations;
- the effects of fluctuations in the value of the Brazilian real and in interest rates on our net interest income;
- the renewal of our concession agreements;
- the impact on our business of the water consumption reduction incentive program and other measures we took in 2014, 2015 and in the first months of 2016 as well as any other measures we may need to take until the water levels of our reservoirs are normalized and sufficient to continuously serve the customers in the São Paulo metropolitan region;
- the impact on our business of lower water consumption practices adopted by our customers during the current water crisis, which may remain in place even after the water levels of our reservoirs normalize;
- decisions by DAEE and ANA limiting 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, and the measures that we may be required to take to ensure the provision of water to our customers; and
- the formalization of agreements with certain of the municipalities we serve.

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

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

E. Off Balance Sheet Arrangements

We had no off balance sheet arrangements as of December 31, 2015.

F. Tabular Disclosure of Contractual Obligations

Our debt obligations and other contractual obligations as of December 31, 2015 were as follows:

	Less than 1 year	1 3 years	3 5 years	More than 5 years	Total
	(in millions of <i>reais</i>)				
Loans and financing	1,526.3	2,750.8	3,662.8	5,181.7	13,121.6
Estimated interest payments ⁽¹⁾	504.1	1,075.2	813.5	1,126.9	3,519.7
Accounts payable to suppliers and contractors	248.2	-	-	-	248.2
Services payable	387.3	-	-	-	387.3
Program contract commitments	238.9	65.5	28.6	16.8	349.8
Purchase obligations ⁽²⁾	3,293.5	3,130.3	1,368.6	7,641.1	15,433.5
Total	6,198.3	7,021.8	5,873.5	13,966.5	33,060.1

(1) Estimated interest payments on loans and financing were determined considering the interest rates as of December 31, 2015. However, our loans and financing are subject to variable interest indexation and foreign exchange fluctuations, and these estimated interest payments may differ significantly from payments actually made. The debt agreements have cross-default clauses.

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

We believe that we can meet the maturity schedule through a combination of funds generated by operations, the net proceeds of new issuances of debt securities in the Brazilian and international capital markets and additional borrowings from domestic and foreign lenders. Our borrowings are not affected by seasonality. For information concerning the interest rates on our indebtedness outstanding as of December 31, 2015, see Note 16 to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014, 2013 included elsewhere in this annual report.

105

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. Directors and Senior Management

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

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

Board of Directors

Our bylaws provide for a minimum of five and a maximum of 15 directors. The members of our board of directors are elected at a general shareholders’ meeting to serve a renewable two year term. Pursuant to our bylaws, our employees have the option to elect one member of our board of directors. Currently, our employees have not elected a director. In addition, pursuant to Law No. 6,404/1976 of December 15, 1976, as amended (“Brazilian Corporate Law”), at least one member of the board of directors of mixed capital companies, such as us, must be appointed by the minority shareholders. Finally, according to the *Novo Mercado* rules, at least 20.0% of the board of directors must be comprised of independent members.

Seven of the current members of our board of directors, Claudia Polto da Cunha, Alberto Goldman, Walter Tesch, Jerônimo Antunes, Reinaldo Guerreiro, Francisco Vidal Luna and Luis Eduardo de Assis were elected at the annual shareholders’ meeting held on April 30, 2014. Sidnei Franco da Rocha was elected at the extraordinary shareholders’ meeting held on October 13, 2014, Benedito Pinto Ferreira Braga Junior was elected at the extraordinary shareholders’ meeting held on January 29, 2015 and Jerson Kelman was elected at the extraordinary shareholders’ meeting held on February 13, 2015. Board members Alberto Goldman, Claudia Polto da Cunha, Sidnei Franco da Rocha and Walter Tesch were not re-elected by the shareholders at the general meeting held on April 29, 2016 and will therefore leave the board on May 12, 2016. The tenure of all the remaining directors will end upon the election of members for the new term at the annual shareholders’ meeting to be held in April, 2018. Currently, we have four members considered independent under the *Novo Mercado* rules.

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

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

Director	Age	Position	Date Elected
Benedito Pinto Ferreira Braga Junior	68	Chairman	January 29, 2015
Alberto Goldman ⁽¹⁾	78	Member	April 30, 2014
Jerson Kelman	68	Member	February 13, 2015
Claudia Polto da Cunha ⁽¹⁾	48	Member	April 30, 2014
Sidnei Franco da Rocha ⁽¹⁾	72	Member	October 13, 2014
Walter Tesch ⁽¹⁾	72	Member	April 30, 2014
Jerônimo Antunes	60	Independent Member*	April 30, 2014
Reinaldo Guerreiro	63	Independent Member*	April 30, 2014
Francisco Vidal Luna	69	Independent Member*	April 30, 2014
Luis Eduardo de Assis	59	Independent Member*	April 30, 2014

⁽¹⁾ Board members not re-elected by the shareholders at the general meeting held on April 29, 2016 and will therefore leave the board on May 12 2016.

* These members comply with the independence requirements established by the *Novo Mercado* rules.

Benedito Pinto Ferreira Braga Junior. Mr. Braga has been our chairman since January 2015. He has also been the State Secretary of Sanitation and Water Resources since January 2015. He holds a degree in Civil Engineering from the São Carlos School of Engineering at the University of São Paulo (*Universidade de São Paulo - USP*), with a Master's degree in Hydrology from Stanford University, and in Hydraulics from the Polytechnic School at USP and also a Ph.D in Hydrological Resources from Stanford University. He is a professor of Civil and Environmental Engineering at the Polytechnic School at USP and conducts technical and scientific studies in the field of water resource planning and management, with an emphasis on conflict resolution with multiple goals. He is also president of the World Water Council (WWC), responsible for the World Water Forums at The Hague, Kyoto, Mexico and Istanbul, and he is President of the International Forum Committee. Mr. Braga was President of the Intergovernmental Council of UNESCO International Hydrological Program from 2009 to 2010, President of the International Water Resources Association (IWRA) from 1998 to 2000 and a member of the board of the directors of the Brazilian National Water Agency (ANA) from its inception in 1999 to 2009.

Alberto Goldman. Mr. Goldman has been a member of our board of directors since April 2011. Mr. Goldman holds a degree in Civil Engineering from the Polytechnic School at the University of São Paulo (*Universidade de São Paulo - USP*). Mr. Goldman was Vice Governor of São Paulo from January 2007 to March 2010 and Governor of São Paulo from April 2010 to December 2010. He was a member of our board of directors from April 2009 to March 2010. He was also the State Secretary of Development (currently, the Development, Science and Technology State Department) from January 2007 to February 2009 and the State Deputy for two terms and Federal Deputy for six terms. Mr. Goldman was the president of the Budget Mixed Committee in 2000 and *rapporteur* of the General Telecommunications Law. He was the Special Secretary of State of the Program Coordination in 1987 and of the Administration Coordination between 1988 and 1990. Mr. Goldman was the Minister of Transportation from 1992 to 1994.

Jerson Kelman. Mr. Kelman has been a member of our board of directors since February 2015 and our CEO since January 2015. He holds a degree in Civil Engineering with a specialization in Hydraulics from the School of Engineering at the Federal University of Rio de Janeiro (*Universidade Federal do Rio de Janeiro - UFRJ*), a Master's degree in Civil Engineering from the Alberto Luiz Coimbra Institute of Graduate Studies and Research in Engineering at UFRJ and holds a Ph.D in Hydrology and Water Resources from Colorado State University. Mr. Kelman has also worked as a Water Resources Professor at COPPE-UFRJ since 1974 and served as President of the Brazilian National Water Agency, General Director of the Brazilian National Energy Agency, CEO of The Light Group between 2010 and 2012, Intervener at Enersul, and a member of the Brazilian National Council for Energy Policy and Environment and Water Resources, as well as various boards, both in Brazil and abroad.

Claudia Polto da Cunha. Ms. Cunha has been a member of our board of directors since April 2013. She holds a degree in Law and a Master's degree in Public Law from the Law School at the University of São Paulo (*Universidade de São Paulo - USP*). She has been a State Attorney for the State of São Paulo since 2001, acting as the Corporate Matters Officer for the Paulista Partnership Company (*Companhia Paulista de Parcerias*) and the Executive Secretary at the State Council for Capital Protection (*Conselho de Defesa dos Capitais do Estado*), since 2006. Ms. Cunha is a member of the board of directors at the Metropolitan Company for Urban Transport (*Empresa Metropolitana de Transportes Urbanos*). She was a member of the fiscal committee at the Company for Urban and Housing Development (*Companhia de Desenvolvimento Habitacional e Urbano*), a member of the board of directors at the São Paulo Metropolitan Company (*Companhia do Metropolitano de São Paulo*), a member of the fiscal committee at *Rede Ferroviária Federal*, as well as a member of the board of trustees at the Foundation for Consumer Protection (*Fundação de Proteção e Defesa do Consumidor*).

Sidnei Franco da Rocha. Mr. Rocha has been a member of our board of directors since October 2014. He holds a degree in Law from Franca School of Law and is a graduate of Faculdade Francana with a degree in Philosophy, Sciences and Letters. He worked as a reporter and was Press Secretary in Franca City Hall, the Councilor's Office and

the Mayor's Office for three terms. He also was President of São Paulo Aviation S.A. (*Viação Aérea São Paulo S/A - VASP*) and General Director of Rádio Hertz, where he is currently the President-Director.

107

Walter Tesch. Mr. Tesch has been a member of our board of directors since April 2011. He holds a degree in Sociology from the University of Uruguay and a Master's degree in Social Sciences from the Pontifical Catholic University of Peru. He was Coordinator of CRHi (Water Resources Coordination) for the State of São Paulo from January 2011 to January 2015. Mr. Tesch has worked in Peru, Venezuela and several Latin American countries. Between 2005 and 2009, Mr. Tesch was the Head of the Administrative District of Parelheiros, which is equivalent to a quarter of the size of the São Paulo municipality and a water source region in the city of São Paulo. He was the Deputy Executive Secretary from 2009 to 2010 of the Water Defense Operation (*Defesa das Águas*), an agreement between the São Paulo municipal and state governments. Mr. Tesch has also authored articles and books on cooperatives and water sources.

Jerônimo Antunes. Mr. Antunes has been an independent member of our board of directors and Coordinator of the Audit Committee since April 2008. He holds a Bachelor's degree in Business Administration and Accounting and both a Masters' degrees and a doctorate in Controllershship and Accounting from the Business, Economics and Accounting School at the University of São Paulo (*Universidade de São Paulo - USP*). He has been a certified independent accountant and consultant in accountability and corporate finance since 1977. He has been a professor of several MBA courses at USP since 1999, at the Foundation Institute of Accounting, Actuary and Financial Research (*Fundação Instituto de Pesquisas Contábeis, Atuariais e Financeiras - FIPECAFI*) since 2000 and at the Foundation Institute of Administration (*Fundação Instituto de Administração - FIA*) since 2006, among other institutions. Mr. Antunes has acted as an independent auditor since 1977, an expert and specialist in accounting examinations since 2005, and President of the Audit Committee of Develop São Paulo (*Desenvolve SP*) since May 2013. Since July 2015, he is the alternate independent member of the Board of Directors of Petróleo Brasileiro S.A., the independent member of the Board of Directors of Petrobras Distribuidora S.A. and a member of the Audit Committee and Compensation and Succession Committee of Petróleo Brasileiro S.A. He is a member of IBGC and was an executive officer of the Institute of Accounting, Actuary and Financial Research (*Instituto de Pesquisas Contábeis, Atuariais e Financeiras - IPECAFI*), the Brazilian Institute of Independent Auditors (*Instituto Brasileiro de Auditores Independentes – IBRACON*) and the National Association of Executives in Finance, Administration and Accounting (*Associação Nacional de Executivos de Finanças, Administração e Contabilidade – ANEFAC*).

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

Francisco Vidal Luna. Mr. Luna has been an independent member of our board of directors since April 2013. He has a doctorate in Economics from the Business, Economics and Accounting School at the University of São Paulo (*Universidade de São Paulo - USP*) and is a retired professor of the same university. In the public sector, he has served as the Secretary of Planning for the state and city of São Paulo. He has also worked at the Treasury Department for the State of São Paulo and the Federal Planning Bureau, among other roles. Within the private sector, Mr. Luna was Chairman and President of Banco Inter American Express S.A. At the governmental level, he served as a member of the advisory board of the Superintendency for the Development of the Northeast (*Superintendência de Desenvolvimento do Nordeste – Sudene*), a member of the board of directors of BNDES; superintendent of the Planning Institute of the Federal Planning Bureau, Special Secretary for Economic Affairs of the Federal Planning Bureau. At the state level, Mr. Luna has also been the Chairman of the Advisory Board for the division of Economic

Affairs of the Secretariat of Finance of the State of São Paulo and Executive Secretary of the Board of Financial Coordination of São Paulo. Currently, Mr. Luna is a member of the board of directors and the audit committee of Develop São Paulo (*Desenvolve SP*), a member of the board of directors and the audit committee of *Gafisa S.A.*, a member of the board of directors of *Tenda S.A.*, Chairman of the board of directors of IDBRASIL and the Afro-Brazilian Museum, a member of the board of trustees of the Father Anchieta Foundation (*Fundação Padre Anchieta*) and an advisory board member of the Foundation of Medical Faculty (*Fundação Faculdade de Medicina – FFM*).

108

Luis Eduardo de Assis. Mr. Assis has been an independent member of our Board of Directors since April 2014. He holds a degree in Economics from the University of São Paulo (*Universidade de São Paulo - USP*), a Master's degree from the State University of Campinas (*Universidade Estadual de Campinas – UNICAMP*) and an MBA from *Scuola Superiore Enrico Mattei* in Milan, Italy. He was director of Monetary Policy of the Central Bank of Brazil and a professor in the Department of Economics at the Pontifical University of São Paulo (*Pontifícia Universidade Católica de São Paulo - PUC-SP*) and at the Getulio Vargas Foundation (*Fundação Getulio Vargas - FGV-SP*). He has developed his long career in the financial market, having held the positions of Chief Economist and Investment Director at Citibank, Chief Executive Officer at HSBC Investment Bank Brasil, Chief Operating Officer at HSBC Bank Brasil, Senior Strategic Planning Executive at the HSBC Group in London and Local Director for Latin America at HSBC. Currently, he serves as the President of Fator Seguradora and writes an opinion column for the newspaper *O Estado de São Paulo*.

Board of Executive Officers

Our board of executive officers is composed of six executive officers appointed by our board of directors for renewable two year terms. Our executive officers are responsible for all matters concerning our day to day management and operations. Members of our board of executive officers have individual responsibilities established by our board of directors and our bylaws.

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

Executive Officer	Age	Position	Date Elected
Jerson Kelman	68	Chief Executive Officer	June 22, 2015
Manuelito Pereira Magalhães Junior	48	Corporate Management Officer	June 22, 2015
Rui de Britto Álvares Affonso	58	Chief Financial Officer and Investor Relations Officer	June 22, 2015
Paulo Massato Yoshimoto	63	Metropolitan Region Officer	June 22, 2015
Luiz Paulo de Almeida Neto	59	Regional Systems Officer	June 22, 2015
Edison Airoidi	59	Technology, Enterprises and Environment Officer	June 22, 2015

Jerson Kelman. See above “—Board of Directors”.

Manuelito Pereira Magalhães Júnior. Mr. Magalhães has been our Corporate Management Officer since February 2011. He holds a degree in Economic Sciences from the State University of Campinas (*Universidade Estadual de Campinas – UNICAMP*). Mr. Magalhães was a member of our board of directors from January 2007 to February 2011. He was a parliamentary advisor in the Federal Senate. From 2009 to 2011 he was the Chief Executive Officer of *Empresa Paulista de Planejamento Metropolitano – EMPLASA*. From 2006 to 2009 he was the Secretary of Planning of the Municipality of São Paulo and from 2005 to 2006 he was the Deputy Secretary of the Planning Secretariat. From 2003 and 2004 he was Ombudsman of the National Supplementary Health Agency. From 1998 to 2002, he was the special advisor of the Ministry of Health.

Rui de Britto Álvares Affonso. Mr. Affonso has been our Chief Financial Officer and Investor Relations Officer since July 2003. Mr. Affonso holds a doctorate and a Master’s degree in Economics from the State University of Campinas (*Universidade Estadual de Campinas – UNICAMP*), and a degree in Economics from the University of São Paulo (*Universidade de São Paulo - USP*). He has been a professor at UNICAMP since 1986, a professor at the Business, Economics and Accounting School of USP from 1983 to 1989, and a Director of Public Economy at the Foundation of

Administrative Development (*Fundação do Desenvolvimento Administrativo*) from 1994 to 2003. He also represented Brazil on the board of the Forum of Federations, a non governmental entity located in Canada, from 2000 to 2006. Mr. Affonso has also held several positions in state government.

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

Luiz Paulo de Almeida Neto. Mr. Almeida Neto has been our Regional Systems officer since January 2011. He holds a degree in Civil Engineering from the Polytechnic School at the University of São Paulo (*Universidade de São Paulo - USP*), a degree in Business Administration from the Votuporanga Educational Foundation (*Fundação Educacional Votuporanga/SP*) and a post graduate degree in Sanitary Engineering from the School of Public Health at USP. Mr. Almeida joined us in 1979 and has worked with us as head of the Baixo Tietê Business Unit responsible for the management of areas located in the hydrographic basins of Baixo Tietê, Tietê Batalha, São José dos Dourados and Turvo Grande. Mr. Almeida Neto has authored several articles.

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

Compensation

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

In 2015, 2014 and 2013, the aggregate compensation, including benefits in kind granted that we paid to members of our board of directors, board of executive officers and fiscal committee for services in all capacities were R\$4.6 million, R\$4.3 million and R\$4.2 million, respectively.

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

	Year ended December 31,		
	2015	2014	2013
	<i>(in thousands of R\$, except where indicated otherwise)</i>		
Total compensation per administrative body			
Board of directors	1,139	1,051	1,026
Board of executive officers	3,135	2,899	2,929
Fiscal committee	324	303	258
Total amount of compensation	4,598	4,253	4,213
Number of members (in individuals)			
Board of directors	10	9	9
Board of executive officers	6	6	6
Fiscal committee	5	5	5
Fixed annual compensation			
Salary			
Board of directors	878	802	788
Board of executive officers	1,781	1,654	1,673
Fiscal committee	252	232	198
Direct and indirect benefits			
Board of directors	262	250	239
Board of executive officers	833	741	690
Fiscal committee	72	71	60
Variable compensation			
Bonus			
Board of directors	-	-	-
Board of executive officers	521	504	566
Fiscal committee	-	-	-
Maximum amount of compensation			

Board of directors	157	157	157
Board of executive officers	581	552	530
Fiscal committee	66	64	64
Minimum amount of compensation			
Board of directors	96	96	96
Board of executive officers	494	481	471
Fiscal committee	64	64	17
Average amount of compensation			
Board of directors	114	117	111
Board of executive officers	489	483	469
Fiscal committee	60	61	57

110

Profit Sharing and Pension Plans

We have established a pension and benefit fund (*Fundação SABESP de Seguridade Social*), or SABESPREV, to provide our employees with retirement and pension benefits. This pension plan provides benefit payments to former employees and their families. Both we and our employees make contributions to the pension plan under SABESPREV, which we called as plan G1. Our total contributions to the pension plan totaled R\$23.7 million, R\$23.0 million and R\$18.4 million in 2015, 2014 and 2013, respectively. In addition to the pension plan under SABESPREV, we are also required to pay supplemental pension payments relating to the employment contract of certain employees prior to the creation of SABESPREV, which we called as plan G0. Based on independent actuarial reports, as of December 31, 2015, our obligation under these both plans (G0 and G1) totaled R\$2,832.2 million. For further information on our pension plans see Note 20 to our financial statements as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014 and 2013 included elsewhere in this annual report.

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

We recorded profit sharing expenses of R\$76.6 million, R\$72.9 million and R\$68.5 million in 2015, 2014 and 2013, respectively. We do not have a stock option plan for our employees.

B. Board Practices

The members of our board of directors are elected at an annual shareholders' meeting to serve a renewable two year term. Our next annual shareholders' meeting will be held on April, 2017. Our board of directors ordinarily meets once a month or when called by a majority of the directors or the chairman. See "Item 6.A. Directors and Senior Management—Board of Directors".

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

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

Fiscal Committee (Conselho Fiscal)

Our fiscal committee, which is established on a permanent basis, consists of a minimum of three and a maximum of five members and generally meets once a month. Our fiscal committee currently consists of five members and five alternates. Furthermore, each member has its respective alternate. Eight of the current members of our fiscal committee (Humberto Macedo Puccinelli, Rui Brasil Assis, Massao Fabio Oya, Joaldir Reynaldo Machado, Tomás Bruginski de Paula, José Rubens Gozzo Pereira, Maria Elvira Lopes Gimenez and Enio Marrano Lopes) were elected in the shareholders' meeting held on April 30, 2015. Sandra Maria Giannella was elected in the Extraordinary shareholders' meeting held on November 10, 2015 and José Alexandre Pereira de Araújo was elected in the Extraordinary shareholders' meeting held on January 29, 2016. The ten members of the fiscal council had their tenure

renewed in the annual general shareholders' meeting held on April 29, 2016 until the next annual general shareholders' meeting to be held in April 2017. The primary responsibility of the fiscal committee, which is independent from management and from the external auditors appointed by our board of directors, is to review our financial statements and report on them to our shareholders.

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

Fiscal Committee Members	Age	Position	Date Elected
Humberto Macedo Puccinelli	58	Member	April 30, 2015
Joaldir Reynaldo Machado	67	Member	April 30, 2015
José Alexandre Pereira de Araújo	44	Member	January 29, 2016
Rui Brasil Assis	61	Member	April 30, 2015
Massao Fabio Oya	34	Member	April 30, 2015
Tomás Bruginski de Paula	55	Alternate	April 30, 2015
José Rubens Gozzo Pereira	68	Alternate	April 30, 2015
Enio Marrano Lopes	54	Alternate	April 30, 2015
Sandra Maria Giannella	59	Alternate	November 10, 2015
Maria Elvira Lopes Gimenez	45	Alternate	April 30, 2015

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

Joaldir Reynaldo Machado. Mr. Machado has been a member of our fiscal committee since April 2015. He holds a degree in Economics from the School of Economics, Administration and Accounting of the University of São Paulo (*Faculdade de Economia, Administração e Contabilidade da Universidade de São Paulo – FEA USP*). Currently, he is the Chief of Staff of the Sanitation and Water Resources Secretariat State of São Paulo. He worked as a Chief of Staff of the Economy and Planning Secretariat State of São Paulo (2007-2013), Chief of the Economy and Planning Secretariat State of São Paulo (2003), Coordinator of Planning and Evaluation of the Economy and Planning Secretariat State of São Paulo (1998-2003), Advisor of the EMPLASA Executive Board (1992-1994), executive of the Finance Department of our Company (1991-1992), Chief of Staff of Environment State Secretariat State of São Paulo (1987-1991) and has also worked for SEADE Foundation (1979-1987).

José Alexandre Pereira de Araújo. Mr. Pereira de Araújo has been a member of our fiscal committee since January 2016. He holds a business administration degree from the Pontifical University of Campinas (*Pontifícia Universidade Católica de Campinas - PUC-Campinas*) and specializations in Business Management and Public Management from the State University of Campinas (*Universidade Estadual de Campinas – UNICAMP*) and Foundation of Sociology and Politics (*Fundação Escola de Sociologia e Política – FESP*). He was the Government Manager of the State of São Paulo's Superintendence of the Banco do Brasil between 1998 and 2002, the Chief of Staff of the Center for Studies and Research of the Municipal Administration – CEPAM, between 2003 and 2005, the Chief of Staff of the Secretariat of City Management of the city of São Paulo between 2005 and 2007, the Executive Secretary of the Council of Real Estate Patrimony of the Mayor's Office of São Paulo between 2005 and 2007, the Chief of Staff of Public Management of the government of the state of São Paulo between 2007 and 2008, the Director of the *Poupatempo* between 2008 and 2010, and the Director of Business Management of the Official Press of the government of the state of São Paulo between 2011 and 2014. Currently, he is the Adjunct Secretary of the Planning and Management Secretariat of the government of the state of São Paulo. Besides SABESP, he has not served in any administrative position in any other publicly traded company.

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

Massao Fabio Oya. Mr. Oya has been a member of our fiscal committee since April 2015. He holds a degree in Accounting from the Father Anchieta Foundation (*Fundação Padre Anchieta*) and a Master's degree in Financial Management and Controllershship from the Father Anchieta Institute. He is a partner of *Solução Governança*

Corporativa e Consultoria Ltda., a company which provides business advisory services in the corporate, accounting

112

and corporate governance areas. He is a sitting member of *Companhia Paranaense de Energia – COPEL*, *Pettenati Indústria Têxtil S.A.*, *Companhia Providência Ind. e Com. S.A.*, *Cristal Pigmentos do Brasil S.A.*, *WLM Indústria e Comércio S.A.* and *Bicicletas Monark S.A.* He was a sitting member of the Fiscal Councils of *Companhia de Saneamento do Parana – Sanepar*, between 2011 and 2012, *TIM Participações S.A.* between 2011 and 2012, *Banco do Estado do Rio Grande do Sul S.A. – Banrisul*, in 2011, *Wetzel S.A.*, between 2011 and 2012, *Bardella S.A. – Indústrias Mecânicas* between, 2013 and 2015, and *General Shopping S.A.*, between 2012 and 2013.

Tomás Bruginski de Paula. Mr. de Paula has been an alternate member of our fiscal committee since April 2006. He holds a Master's degree in Economics from the State University of Campinas (*Universidade Estadual de Campinas – UNICAMP*). He has been a professor at the Economics Department of *Pontifícia Universidade Católica – PUC* since 1986. He has been an executive officer at the São Paulo Company for Partnerships (*Companhia Paulista de Parcerias*) since 2004 and the São Paulo Securities Company (*Companhia Paulista de Securitização*) since 2009. Mr. de Paula has worked as a consultant for several entities, including the Economic Committee for Latin America (CEPAL), the United Nations Development Program (PNUD), the Brazilian Institute of Municipal Administration (IBAM), the Brazilian School of Public and Business Administration at the Getulio Vargas Foundation (EBAPE/FGV), the State System Data Analysis Foundation (SEADE), and the Brazilian Electricity Agency in the infrastructure and public policy financing areas. He is also a member of the fiscal committee of *Develop São Paulo (DesenvolveSP)* and a member of the board of directors of the São Paulo State Highway Company (*Desenvolvimento Rodoviária S.A. - DERSA*). Mr. de Paula was also a member of the fiscal committee of the São Paulo Company of Electric Power Transmission (*Companhia de Transmissão de Energia Elétrica Paulista – CTEEP*).

José Rubens Gozzo Pereira. Mr. Pereira has been an alternate member of our fiscal committee since April 2010. He holds a degree in Economics from Mackenzie University and a graduate degree from the Getulio Vargas Foundation and attended international studies extension programs at the Universities of London and Paris. He has been responsible for the Funding Department of the Finance Secretariat since 1989. Mr. Pereira held positions in the public sector in the DAEE, where he was responsible for the Budget and Financing Department. He was an executive officer at Traffic Engineering Company of São Paulo (*Companhia de Engenharia de Tráfego – CET*) and in the International Cooperation Department at the Energy Company of São Paulo (*Companhia Energética de São Paulo – CESP*).

Enio Marrano Lopes. Mr. Lopes has been an alternate member of our fiscal committee since April 2014. He holds a degree in Business Administration from Faculdades Oswaldo Cruz. Currently, Mr. Lopes is Budget Assistant Coordinator for the Secretariat of Planning and Management (*Secretaria de Planejamento e Gestão*) of the State of São Paulo and a member of the Fiscal Committee of the CDHU. He also served in various positions for the Secretariat of Planning and Management of the State of São Paulo and was a member of the Fiscal Committee of the São Paulo State Highway Company (*Desenvolvimento Rodoviária S.A. - DERSA*), the Metropolitan Train Authority of São Paulo (CPTM) and the Energy Company of São Paulo (*Companhia Energética de São Paulo – CESP*).

Sandra Maria Giannella. Ms. Gianella has been a member of our fiscal committee since November 2015. She holds a degree in Economics from the Armando Álvares Penteado Foundation (*Fundação Armando Álvares Penteado – FAAP*), in Business Administration from the Mackenzie Presbyterian University (*Universidade Presbiteriana Mackenzie*) and a specialization in Financial Management from the Getulio Vargas Foundation (*Fundação Getulio Vargas - FGV-SP*). She has been a public employee of the state of São Paulo since 1978 and has held several leadership positions throughout her career. Currently, she coordinates the Advisory of Business Management of the government of the state of São Paulo and is the Executive Secretary of the Management Committee of the State and City of São Paulo, the committee responsible for the management of the basic sanitation service provision contract between SABESP and the city of São Paulo. Since 1991, she has been the fiscal counselor of several controlled by the state of São Paulo, such as the *Companhia do Metropolitano de São Paulo – Metrô*, *Desenvolvimento Rodoviário S.A. –*

DERSA, Companhia Energética de São Paulo – CESP, Elektro, Companhia Paulista de Parcerias – CPP, and us.

Maria Elvira Lopes Gimenez. Mrs. Gimenez has been an alternate member of our fiscal committee since April 2015. She holds a degree in Economics from the Santana University of São Paulo (*Faculdade Santana São Paulo*) and currently holds the position of financial assistant of the Board of Executive Officers at *Solução Governança Corporativa e Consultoria Ltda.* She is also alternate member of the Fiscal Council at Companhia Providência Ind. e Com. S.A., WLM Indústria e Comércio S.A. and Cristal Pigmentos do Brasil S.A. Mrs. Gimenez was the financial assistant of the Board of Executive Officers at Guardyanet Serviços de Traduções Ltda.

Audit Committee

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

The audit committee is responsible for assisting and advising the board of directors in its responsibilities to ensure the quality, transparency and integrity of our published financial information. To this end, the audit committee supervises all matters relating to accounting, internal controls and the internal and independent audit functions. The audit committee and its members have no decision making powers or executive functions.

The minimum availability required from each member of the audit committee is thirty hours per month. Under our bylaws, the members shall exercise their roles for the same period as their corresponding term of office, or until otherwise resolved by the general shareholders' meeting or by resolution of the board of directors. All of our Audit Committee members are independent.

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

Director	Position	Date Elected
Jerônimo Antunes	Coordinator and Financial Expert	May 14, 2014
Reinaldo Guerreiro	Member	May 14, 2014
Francisco Vidal Luna	Member	May 14, 2014

Regulatory Affairs Committee

Our bylaws provide for a regulatory issues committee to be comprised of our Chief Executive Officer, Chief Financial Officer and Investor Relations Officer, Metropolitan Officer, and Regional System Officer. The regulatory affairs committee is responsible for defining our regulatory directives, strategies and guidelines and coordinating our regulatory affairs department, under the directives of our board of directors.

The Chief Executive Officer acts as chairman of our regulatory affairs committee and is responsible for proposing its internal regulations to be approved by the committee. Pursuant to our bylaws, the head of regulation shall be the executive secretary of the committee.

Under our bylaws, the resolutions of our regulatory affairs committee shall be binding and our executive board shall be entitled to implement them in the scope of its jurisdiction. Meetings of our regulatory affairs committee are held at least once a month, if ordinary, and when extraordinary can be called by any of our committee's members. In 2015, no meetings of the Regulatory Affairs Committee were conducted due to the redirectioning of efforts of our Board of Executive Officers and other members of our Company in the efforts to mitigate the effects of the water crisis.

C. Employees

As of December 31, 2015, we had 14,223 full time employees. In 2015, we had an average of 949 interns and 530 apprentices (*aprendizes*), as defined by Federal Law No. 10,097/2000, dated December 19, 2000, as amended.

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

	As of December 31,		
	2015	2014	2013
Number of employees by category of activity:			
Projects and operations	9,489	9,788	9,983
Administration	2,211	2,381	2,443
Finance	440	466	455
Marketing	2,083	2,118	2,134
Number of employees by corporate division:			
Head office	1,377	1,481	1,510
São Paulo metropolitan region	6,612	6,715	6,856
Regional Systems	6,234	6,557	6,649
Total number of employees	14,223	14,753	15,015

The average tenure of our employees is approximately 18 years. We also outsource certain services such as maintenance, delivery of water and sewage bills, meter reading, catering and security. We believe that our relations with our employees are generally satisfactory.

Approximately 75% of all our employees are members of unions. The five main unions that represent our employees are (i) the Union of Workers in Water, Sewage and Environment of the State of São Paulo – SINTAEMA, (ii) workers union of Santos Urban Industries, Baixada Santista region, South Coast and Vale Ribeira – SINTIUS, (iii) the Union of Engineers of the State of São Paulo – SEESP, (iv) the Union of Attorneys of the State of São Paulo – SASP and (v) the Union of Industrial Technicians of the State of São Paulo – SINTEC.

In 2013, the collective bargaining agreement resulted in: (i) a salary increase of 8% (which corresponds to the inflation adjustment for the period plus a real gain of 2.5%), (ii) the establishment of an employment guarantee for 98% of our employees, (iii) an increase of 13.6% in meal vouchers (*vale refeição*), and (iv) an increase of 21.5% in food allowance and an additional of 15% for employees who work on flexible work shifts, among other things.

The collective bargaining agreement signed in 2014 resulted in: (i) a salary increase of 5.2% (which corresponds to the inflation adjustment for the period); (ii) the establishment of an employment guarantee for 98% of our employees; (iii) an increase of 8% in meal vouchers; (iv) an increase of 5.2% in food allowance; and (v) the termination of Regional Salary for which Sabesp adopted separate pay scales for Region 1 – São Paulo metropolitan region, Vale do Paraíba, Baixada Santista, Capivari/Jundiaí and Litoral Norte – and Region 2 – other interior and coast cities. Region 2 employees received salaries at a ratio of 80% of the salaries of Region 1 employees. As a result of the collective agreement of 2014, equalization in salaries was conceded for the two regions in two stages: first, on May 1, 2014 with a salary increase from 80% to 90% and second, on May 1, 2015, from 90% to 100%.

The collective bargaining agreement signed in 2015 resulted in: (i) a salary increase of 8.29% (which corresponds to the inflation adjustment for the period plus a 1.01% real adjustment); (ii) the readjustment of 10% in the values of the meal vouchers and monthly food stipend; (iii) a readjustment of 8.29% for the remaining benefits; (iv) maintenance of the clause that guarantees the employment of 98% of our employees according to the 2014/2015 collective bargaining agreement; and (iv) maintenance, in an exceptional character, of the Christmas food stipend.

We experienced a two day strike in 2013, which did not interrupt the essential services that we provide. In 2015, 2014 and 2012 there were no strikes. Under Brazilian law, our non-administrative employees are considered “essential employees” and, therefore, are limited in their right to strike.

D. Share Ownership

As of April 30, 2016, none of our directors and executive officers owned any of our common shares. See “Item 7.A. Major Shareholder” for more information.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholder

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

115

The following table sets forth ownership information for each of our shareholders that beneficially owned 5.0% or more of our common shares and for our officers and directors, individually and as a group, as of April 30, 2016:

	Common shares	
	Shares	%
State of São Paulo	343,524,285	50.3%
Directors and executive officers of Sabesp	-	-
Others	339,985,584	49.7%
Total⁽¹⁾	683,509,869	100.0%

(1) As of April 30, 2016, 29.9% of our outstanding common shares were held by 4,211 registered shareholders in Brazil.

As of April 30, 2016, 19.8% of our outstanding common shares were held in the United States, in the form of ADSs. According to the ADS depository's records, which contain information regarding the ownership of our ADSs, there were, in March 2016, 34 record holders of ADSs in the United States.

B. Related Party Transactions

Transactions with the State of São Paulo

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

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

Rendering Services

We provide water and sewage services to the federal government, state and municipal governments and government entities in the ordinary course of our business. Gross revenue from sales to the State, including State entities, totaled R\$357.5 million in 2015, R\$412.0 million in 2014 and R\$449.1 million in 2013. Our accounts receivable from the State for water supply and sewage services totaled R\$66.3 million and R\$50.8 million, as of December 31, 2015 and 2014, respectively. In addition, as required by law, we invest our cash and cash equivalents with government financial institutions.

Payment of Pensions

Pursuant to a law enacted by the State, certain former employees of some State owned companies that provided services to us in the past and later merged to form our Company acquired a legal right to receive supplemental pension benefit payments. These rights are referred to as "Plan G0". These amounts are paid by us, on behalf of the State, and are claimed by us as reimbursements from the State, as primary obligor. In 2015, 2014 and 2013, we made payments

to former employees of R\$158.9 million, R\$149.9 million and R\$140.1 million, respectively, in respect of Plan G0. The State made reimbursements in 2015, 2014 and 2013 in the amounts of R\$121.7 million, R\$112.5 million and R\$111.0 million, respectively.

Agreements with the State

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

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

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

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

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

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

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

The December 2001 agreement also provided that the legal advisors of the State would carry out specific analyses, which have commenced, to ensure agreement among the parties as to the methodology employed in determining the

amount of reimbursement for pension benefits owed to us by the State. The commencement of payments with respect to pension amounts owed to us by the State has been postponed until these analyses are completed, the appraisal report is approved and the credit assignments relating to the transfer of the reservoirs are formalized. As discussed above, the transfer of these reservoirs is currently being disputed and we are not certain whether the transfer will be legally permitted. Under the December 2001 agreement, the first payment was to be made in July 2002.

117

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

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

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

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

together with another independent consulting firm, a new evaluation of the reservoirs that might be transferred to us as amortization of the reimbursement payable by the State to us.

On November 17, 2008, we, the State and DAEE entered into a third amendment to the December 2001 agreement, pursuant to which the State recognized a debt balance payable to us totaling R\$915.3 million, hereinafter referred to as the "Undisputed Reimbursement Amount," as adjusted based on the IPCA. We accepted on a provisional basis the reservoirs as part of the payment of the Undisputed Reimbursement Amount and offered to the State a provisional settlement, recognizing a credit totaling R\$696.3 million, corresponding to the value of the reservoirs located in the Alto Tietê region. We and the State have agreed that the final offset will only be recorded when the effective transfer of the reservoirs is recorded at the Real Estate Registry. The outstanding balance of Undisputed Reimbursement Amount, amounting to R\$219.0 million, is being paid by the State in 114 consecutive monthly installments, as adjusted by the annual IPCA variation, plus interest accruing at the annual rate of 6.0%. The first installment was paid in November 2008.

118

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

The principal amount will be paid in 180 installments, as follows:

- The first 24 installments was settled by an immediate transfer of 2,221,000 preferred shares issued by the São Paulo Company of Electric Power Transmission (*Companhia de Transmissão de Energia Elétrica Paulista – CTEEP*), totaling R\$87.2 million, based on the share closing price as of March 17, 2015; and
- The amount of R\$609.1 million will be adjusted by the IPCA until the date when the payments start and will be paid in cash in 156 monthly installments beginning on April 5, 2017. When payments begin, installments will be adjusted by IPCA plus simple interest of 0.5% per month.

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

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

In addition to the Undisputed Reimbursement Amount, there is an outstanding balance relating to the Disputed Reimbursement Amount. As of December 31, 2015, the Disputed Reimbursement Amount, amounted to R\$855.1 million, but due to the uncertainty regarding the recovery of the amount our management decided not to recognize the reimbursements. See Note 10 to our financial statements as of December 31, 2015 and 2014 and for the year ended December 31, 2015, 2014 and 2013 regarding the Disputed Reimbursement Amount. We and the State have agreed that the dispute relating to the Disputed Reimbursement Amount will not prevent us from carrying out the commitments made in the December 2001 agreement.

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

Finally, the third amendment to the December 2001 agreement established that the Public Attorney's Office of the State of São Paulo, or the Public Attorney's Office, would issue a revised interpretation of the calculation and eligibility criteria applicable to the Disputed Reimbursement Amount. At that time, we believed that the Public Attorney's Office would issue a revised interpretation which would have helped us bring the negotiations with the State to a conclusion. However, contrary to our expectations, the Public Attorney's Office interpretation of the calculation and eligibility criteria applicable to the Disputed Reimbursement Amount refuted the reimbursement of the largest portion of this amount. As of December 31, 2015, we had made a provision of R\$2,166.9 million in our pension obligations accounts in respect of the pension benefit obligation of Plan G0.

Even though the negotiations with the State are still progressing, we cannot assure you that we will recover the receivables related to the Disputed Reimbursement Amount (amount not recorded in our financial statements since it is a contingent asset).

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

Agreement with the State and the city of São Paulo

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

- the State and the city of São Paulo would execute a separate agreement with us, granting us exclusive rights to provide water and sewage services in the city of São Paulo;
- ARSESP would regulate and oversee our activities regarding water and sewage services in the city of São Paulo, including tariffs;
- a management committee (*Comitê Gestor*), consisting of six members appointed for two-year terms, with the State and the city of São Paulo given the right to appoint three members each, would be responsible for planning water and sewage services for the city and for reviewing our investment plans; and
- we may participate in management committee meetings but may not vote.

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

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

- ARSESP will ensure that the tariffs will adequately compensate us for the services we provide and that tariffs may be adjusted in order to restore the original balance between each party's obligations and economic gain (*equilíbrio econômico financeiro*).

We currently have an investment plan in place that reflects our obligations under the *convênio* and addresses their compatibility with the sanitation plans of the State, the city of São Paulo and, if necessary, the São Paulo metropolitan region. The investment plan is not irrevocable and is reviewed every four years by our management committee. We draft a detailed work plan every two years, particularly with respect to the investments to be executed in the subsequent period.

Dividends

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

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

Government Guarantees of Financing

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

Furthermore, the federal government has guaranteed, and the State has provided a counter guarantee, in respect of the financial agreements we entered into with the IADB (i) in 1992 and 2000 for the total original aggregate amount of US\$650.0 million related to the financing of the first and second phases of the Tietê River recovery project to reduce pollution; and (ii) in 2010 for the aggregate amount of US\$600 million related to the financing of the third phase of the Tietê River project. The federal government has also guaranteed and the State of São Paulo has provided a counter guarantee, in respect of the financial agreement we entered with the IBRD in the amount of US\$100 million for the Water Source Program (*Programa Mananciais*).

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

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

Use of Reservoirs

We currently use the Guarapiranga and Billings reservoirs, which are also used by another company controlled by the São Paulo State Government, based on a grant issued by the DAEE. We do not pay any fees with respect to the use of these reservoirs. We are, however, responsible for maintaining them and funding their operating costs. The State incurs no operating costs on our behalf. If these facilities were not available for our use, we would have to obtain water from more distant sources, which would be more costly.

Agreements with Lower Tariffs

We have entered into agreements with public entities, including State entities and municipalities, which manage approximately 7,014 properties. Under these agreements, these public entities pay a different tariff which is approximately 25.0% lower than the tariff that applies for the public entities that have not entered into these agreements, provided such entities implement our Program for Rational Use of Water (*Programa de Uso Racional da Água – PURA*), which has a fixed target for reduction or maintenance of water consumption, according to technical evaluations carried out by us. These agreements are valid for a 12 month term with automatic renewal for equal periods. Pursuant to the terms of these agreements, if these entities fail to make any payment on a timely basis to us, we have the right to cancel the agreement, thereby revoking the 25.0% tariff reduction.

121

Personnel Assignment Agreement among Entities Related to the State Government

We have personnel assignment agreements with entities related to the State Government, under which the expenses are fully passed on and monetarily reimbursed. The expenses related to personnel assigned by us to other state government entities in 2015, 2014 and 2013 amounted to R\$10.5 million, R\$9.7 million and R\$12.9 million, respectively.

The expenses related to personnel assigned by other entities to us totaled R\$0.3 million in 2015, R\$0.5 million in 2014, and R\$1.0 million in 2013.

Services Obtained from State Government Entities

As of December 31, 2015 and 2014, we had an outstanding amount payable of R\$2.2 million and R\$1.6 million, respectively, for services rendered by São Paulo State government entities, including the supply of electric power by the Energy Company of São Paulo (*Companhia Energética de São Paulo –CESP*).

Non operating Assets

We lend land, free of charge, to DAEE. Such non operating assets totaled R\$1.0 million as of December 31, 2015 and 2014.

Transactions with SABESPREV Pension Fund

SABESPREV is a pension fund we established to provide our employees with retirement and pension benefits. The assets of SABESPREV are independently held, but we nominate 50.0% of SABESPREV's board of directors, including the chairman of the board, who has the deciding vote pursuant to the applicable legislation. Both we and our employees make contributions to SABESPREV pension plans. We contributed R\$9.5 million, R\$8.9 million and R\$8.4 million in 2015, 2014 and 2013, respectively, in the defined contribution plans and R\$23.7 million, R\$23.0 million and R\$18.3 million, respectively, in the defined benefit plans. On May 29, 2001, a federal law was enacted which, among other provisions, limits the amount mixed capital companies, like us, may contribute to their pension plans. Specifically, the ordinary contributions made by us to our pension plans may not exceed the contributions made by the beneficiaries of these plans.

Our original pension plan (the Defined Benefit Plan) has an actuarial deficit. We have commenced studies to manage this deficit and have also created a new, defined contribution plan, SABESPREV Mais. Our new plan was approved by Previc in June 2010, after which our old plan stopped accepting new members. Contributions to the new plan are also shared between plan members and Sabesp, and benefits are established based on the balance of the individual member's account when payment on his or her benefit begins. This balance consists of contributions and profitability obtained when applying resources. We intended to have members of the old plan migrate their reserves to the new plan. This migration was interrupted by a judicial order as a result of proceedings brought by representative entities for our employees and ex employees. In October 2010, the judge presiding over the case pronounced in an interim decision that people and reserves were not allowed to migrate between the plans until a further decision was made. This decision also prevents the plan from charging contributions to account for the deficit for those who remained covered by the original plan. In September 2012, the judge presiding over the case ordered a financial expert inspection and in early 2013 a financial expert was appointed to the case. The results of this inspection were unfavorable to the representative entities for our employees and ex employees and in 2015 the proceeding was dismissed, revoking the interim decision made in October 2010.

Compensation of Management

B. Related Party Transactions

The compensation paid by us to the members of our board of directors, board of executive officers and fiscal committee amounted to R\$4.1 million, R\$3.8 million and R\$3.4 million in 2015, 2014 and 2013, respectively, and it refers to salaries and other short term benefits management. An additional R\$0.5 million, R\$0.5 million and R\$0.6 million related to the bonus program was accrued to executive officers in 2015, 2014 and 2013.

122

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

Loan agreement through credit facility

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

We entered into a loan agreement through credit facility with the special purpose enterprises, or “SPEs”, Águas de Andradina S.A., Águas de Castilho S.A., Aquapolo Ambiental S.A. and Attend Ambiental S.A. to finance the operations of these companies, until the loans and financing required to banks are cleared.

The contracts signed with SPEs Águas de Andradina S.A. and Águas de Castilho S.A. were settled. Other agreements signed with Aquapolo Ambiental S.A. on March 30, 2012 and Attend Ambiental on May 9, 2014, remain with the same features, according to the table below:

Companies	Credit limit	Principal disbursed	Interest balance	Total	Interest rate	Maturity
Attend Ambiental	5,400	5,400	1,757	7,157	3.5% p.a. SELIC + CDI +	(i) 04/30/2016
Aquapolo Ambiental	5,629	5,629	4,710	10,339	1.2% p.a.	(ii)
Aquapolo Ambiental	19,000	19,000	8,793	27,793		