

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

FORM 20-F

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

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2016

OR

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

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

OR

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**

Common Shares, without par value

American Depositary Shares, evidenced by American Depositary Receipts, each representing one Common Share

**Name of each exchange on which registered**

New York Stock Exchange

New York Stock Exchange

Not for trading purposes, but only in connection with the registration of American Depositary Shares pursuant to the requirements of the Securities and Exchange Commission.

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

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

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

683,509,869 Shares of Common Stock

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

Yes  No

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

Yes  No

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

Yes  No

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

Yes  No

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Emerging Growth Company

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

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

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

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

Item 17  Item 18

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

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Yes  No

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

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## PRESENTATION OF FINANCIAL AND OTHER INFORMATION

### General

We maintain our books and records in *reais*. We prepare our financial statements in accordance with International Financial Reporting Standards, or “IFRS”, as issued by the International Accounting Standards Board, or the “IASB”. Our audited financial statements as of December 31, 2016 and 2015 and for each of the years in the three year period ended December 31, 2016 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, 2016 were partially affected by the lowest stream flow measurements in over 80 years due to the serious drought in 2014 and 2015. With the return of the rainfall to its historical average for the rainy season that began in October 2015 and ended in March 2016, the level of water in the reservoirs that provide water to the population of the São Paulo metropolitan region returned to normal and the measures taken during the water crisis to continue to services consumers were gradually discontinued. However, heightened public awareness of the need to conserve water during the crisis resulted in our customers adopting lower water consumption practices during the water crisis and these practices have been partially integrated into our consumers’ daily habits. Another probable factor of the reduction of consumption during 2016 is the contraction of the Brazilian economy, which may have resulted in lower consumption of water by industry and other businesses. As a result despite our reservoirs having a higher volume of water available for treatment, the total volume of water billed to our clients did not return to the volume of water billed in 2013, before the water crisis. As of December 31, 2016, the reservoirs in the São Paulo metropolitan region, where our largest market is located, contained 1.2 trillion liters of bulk water storage for treatment, compared to 703 billion liters available for treatment as of December 31, 2015, including the technical reserve. Average monthly water production in 2016 for the São Paulo metropolitan region was 58.5 m<sup>3</sup>/s, compared to 52.0 m<sup>3</sup>/s in 2015, 62.2 m<sup>3</sup>/s in 2014 and 69.1 m<sup>3</sup>/s in 2013, the year before the water crisis started. For more information, see “Item 3.D. Risk Factors—Risks Relating to Our Business—“The measures we took to mitigate the effects of the drought that occurred in 2014 and 2015 resulted in a significant decrease in the volume of water billed and revenues from services we provide and, despite the discontinuation in May 2016 of the measures that were used to face the drought, new consumption habits were incorporated and the volume of water billed and revenues from services we provide continue to be impacted by those measures.” and “Item 4.B. Business Overview—The Recent Water Crisis”.

### Convenience Translations

We have translated some of the *real* amounts contained in this annual report into U.S. dollars. The rate used to translate such amounts in respect of the year ended December 31, 2016 was R\$3.2591 to US\$1.00, which was the commercial rate for the purchase of U.S. dollars in effect on December 31, 2016, as reported by the Central Bank. The U.S. dollar equivalent information presented in this annual report is provided solely for the convenience of the reader and should not be construed as implying that the *real* amounts represent, or could have been or could be converted into, U.S. dollars at the above rate. See “Item 3.A. Selected Financial Data—Exchange Rates” for more detailed information regarding the Brazilian foreign exchange system and historical data on the exchange rate of the *real* against the U.S. dollar.

### Rounding

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

### Other Information

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

In addition, references to:

- “ARSESP” are to the São Paulo State Sanitation and Energy Regulatory Agency (*Agência Reguladora de Saneamento e Energia do Estado de São Paulo*);
- “ADR” or “ADRs” are to American Depositary Receipt or American Depositary Receipts, respectively;
- “ADS” or “ADSS” are to American Depositary Share or American Depositary Shares, respectively;
- “Brazil” are to the Federative Republic of Brazil;
- “Central Bank” are to the Central Bank of Brazil;
- “Coverage” indicators are to (a) the number of homes that are actually connected to the water network or sewage collection network, plus the number of homes for which the water and sewage networks are available for connection but which are not connected to those networks (referred to as “feasible” or “connectable” homes), as a portion of (b) the total number of homes within the urbanized service area covered by our contract with the municipality (i.e., the “serviceable area”);
- “CVM” are to the *Comissão de Valores Mobiliários*, the Brazilian regulator of securities;
- “federal government” and “Brazilian government” are to the federal government of the Federative Republic of Brazil and “state government” are to the state government of the State of São Paulo;
- “real,” “reais” or “R\$” are to the Brazilian real, the official currency of Brazil;
- “Regional Systems” are to the area where the regional systems’ executive office operates, comprising 328 municipalities in the interior and coastline regions of the state of São Paulo;
- “São Paulo metropolitan region,” with respect to our operations, are to the area where the metropolitan executive office operates, comprising 38 municipalities, including the city of São Paulo;
- “Service” indicators are to (a) the number of homes that are actually connected to the water network or sewage collection network, as a portion of (b) the total number of homes within a given serviceable area;
- “Sewage Treatment Coverage” indicators are to the amount of consumer units connected to the sewage treatment system;
- “State” are to the State of São Paulo, which is also our controlling shareholder;
- “U.S. dollars” or “US\$” are to the United States dollar, the official currency of the United States;
- “water crisis” are to the drought we have experienced from late 2013 and throughout most of 2015. This drought, was the most serious that our service region has experienced in 85 years, primarily affected the Cantareira System, our largest water production system.

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

### **Market Information**

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

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

***Our contracts and the Municipalities We Serve***

Throughout this document, we refer to the 366 municipalities we serve and to our 369 water contracts. This difference results from the fact that we have two partial water contracts with the municipality of Mogi das Cruzes. However, as the majority of the municipality is serviced on a wholesale basis, Mogi das Cruzes has not been included in the total number of municipalities we serve. Most of our contracts with the municipalities we serve are concession agreements which have a term of 30 years. In November 2016, we signed a water supply contract with the municipality of Santa Branca, which became effective in February 2017. Therefore, we do not include Santa Branca among the 366 municipalities we serviced in 2016.

## CAUTIONARY STATEMENTS ABOUT FORWARD-LOOKING STATEMENTS

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

- general economic, political, demographical and other conditions in Brazil and in other emerging market countries;
- changes in applicable laws and regulations, as well as the enactment of new laws and regulations, including those relating to environmental, tax and employment matters in Brazil;
- availability of the water supply;
- the impact on our business of lower water consumption practices adopted by our customers during the water crisis, which may remain in place despite the termination of the measures adopted to serve the São Paulo metropolitan region during the water crisis;
- 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;
- 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 identify forward-looking statements. In light of these risks and uncertainties, the forward-looking events and circumstances discussed in this annual report might not occur. Our actual results could differ substantially from those anticipated in our forward-looking statements. Forward-looking statements speak only as of the date they were made and we do not undertake any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law. Any such forward-looking statements are not an indication of future performance and involve risks.

## PART I

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

Not applicable.

### ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

### ITEM 3. KEY INFORMATION

#### A. Selected Financial Data

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

The selected financial data as of December 31, 2016 and 2015 and for the years ended December 31, 2016, 2015 and 2014 have been derived from our audited financial statements, presented in accordance with IFRS, and included in this annual report. The selected financial data as of December 31, 2014, 2013 and 2012 and for the years ended December 31, 2013 and 2012 have been derived from our audited financial statements, presented in accordance with IFRS, which is not included in this annual report.

We have included information with respect to the dividends and/or interest attributable to shareholders’ equity paid to holders of our common shares since January 1, 2012 in *reais* and in U.S. dollars translated from *reais* at the commercial market selling rate in effect as of the payment date under the caption “Item 8.A. Financial Statements and Other Financial Information—Dividends and Dividend Policy—Payment of Dividends”.

	For the year ended December 31,					
	2016 <sup>(1)</sup>	2016	2015	2014	2013	2012 <sup>(2)</sup>
	US\$	RS	RS	RS	RS	RS
	<i>(in millions, except per share and per ADS<sup>(3)</sup> data)</i>					
<b>Selected Income Statement Data:</b>						
Net operating revenue	4,325.8	14,098.2	11,711.6	11,213.2	11,315.6	10,737.6
Cost of services	(2,765.5)	(9,013.1)	(8,260.8)	(7,635.6)	(6,816.3)	(6,449.9)
Gross profit	1,560.3	5,085.1	3,450.8	3,577.6	4,499.3	4,287.7
Selling expenses	(224.0)	(730.0)	(598.1)	(736.6)	(637.1)	(697.3)
Administrative income (expenses)	(286.9)	(934.9)	45.0	(924.4)	(729.1)	(717.4)
Operating profit	1,052.3	3,429.6	3,044.0	1,910.7	3,138.8	2,843.3
Financial income (expenses), net	214.6	699.4	(2,456.5)	(635.9)	(483.2)	(295.7)
Profit for the year	904.3	2,947.1	536.3	903.0	1,923.6	1,911.9
Earnings per share – basic and diluted <sup>(4)</sup>	1.32	4.31	0.78	1.32	2.81	2.80
Earnings per ADS – basic and diluted <sup>(4)</sup>	1.32	4.31	0.78	1.32	2.81	2.80
Dividends and interest on shareholders’ equity per share <sup>(4)</sup>	0.31	1.02	0.19	0.32	0.67	0.66
Dividends and interest on shareholders’ equity per ADS <sup>(4)</sup>	0.31	1.02	0.19	0.32	0.67	0.66
Weighted average number of common shares outstanding <sup>(4)</sup>	683,509,869	683,509,869	683,509,869	683,509,869	683,509,869	683,509,869

(1) Translated at the commercial selling rate at closing for the purchase of U.S. dollars, as reported by the Central Bank, as of December 31, 2016 of R\$3.2591 to US\$1.00.

(2) Data for 2012 has 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.

(3) ADS-American Depositary Share.

(4) 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.

## Selected Statement of Financial Position Data

	As of December 31,					
	2016 <sup>(1)</sup>	2016	2015	2014	2013	2012 <sup>(2)</sup>
	US\$	RS	RS	RS	RS	RS
	<i>(in millions, except per share and per ADS<sup>(3)</sup> data)</i>					
Property, plant and equipment	92.8	302.4	325.1	304.8	199.5	196.7
Intangible assets	9,587.6	31,246.8	28,513.6	25,979.5	23,846.2	21,967.5
Total assets	11,274.6	36,745.0	33,706.6	30,355.4	28,274.3	26,476.1
Current portion of long-term loans and financing	382.5	1,246.6	1,526.3	1,207.1	640.9	1,342.6
Long-term loans and financing	3,288.5	10,717.6	11,595.3	9,578.6	8,809.1	7,532.7
Interest on capital	214.8	700.0	127.4	214.5	457.0	414.4
Total liabilities	6,543.5	21,325.8	19,990.0	17,051.0	15,343.5	15,219.4
Equity	4,731.1	15,419.2	13,716.6	13,304.4	12,930.8	11,256.8
Capital stock	3,068.3	10,000.0	10,000.0	10,000.0	6,203.7	6,203.7
<b>Selected Statements of Cash Flows Data:</b>						
Net cash generated from operating activities	921.6	3,003.6	2,641.4	2,480.3	2,777.2	2,343.2
Net cash used in investing activities	(653.8)	(2,130.7)	(2,459.5)	(2,757.7)	(2,281.5)	(1,996.7)
Net cash provided by (used in) financing activities	(192.0)	(625.9)	(265.7)	218.5	(629.7)	(572.7)
Purchases of intangible assets and property, plant and equipment as presented in our statement of cash flow	(655.3)	(2,135.8)	(2,452.1)	(2,748.3)	(2,335.8)	(2,026.1)

- (1) Translated at the commercial selling rate at closing for the purchase of U.S. dollars, as reported by the Central Bank, as of December 31, 2016 of R\$3.2591 to US\$1.00.
- (2) Data for 2012 has 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.
- (3) ADS-American Depositary Share.

## Operating Data

In 2016, we updated our objectives for the forthcoming five years. As part of this process, we also made a number of changes to the operational indicators we use in managing our business, in order to better reflect the areas we attend:

- Our previous indicator for treatment of collected sewage, which was based on the volume of sewage treated as a percentage of the total volume collected, has now been replaced by an indicator known as the “Index of Consumer Units Connected to Sewage Treatment”, which represents the amount of consumer units connected to the sewage treatment system.
- We adopted new indicators regarding coverage and service provision based on our service concession areas or “serviceable areas.” The “serviceable area” is equal to the urbanized service area (urban areas and rural areas with urban characteristics), as defined for purposes of our contract with the respective municipality for purposes of our provision of services. The “coverage” indicator represents the area in which the water and sewage networks are made available for connection, while the “service” indicator represents the households that are connected to these networks:
  - The “coverage” indicator is equal to (a) the number of homes that are actually connected to the water network or sewage collection network, plus the number of homes for which the water and sewage networks are available for connection but which are not connected to those networks (referred to as “feasible” or “connectable” homes), as a portion of (b) the total number of homes within the urbanized service area covered by our contract with the municipality (i.e., the “serviceable area”).
  - The “service” indicator is equal to (a) the number of homes that are actually connected to the water network or sewage collection network, as a portion of (b) the total number of homes within a given serviceable area.

The main differences between these indicators and the indicators that we previously used are as follows:

- We now use the “serviceable area,” as defined above (i.e., the total number of homes within the urbanized service area covered by our contract with the municipality), as the denominator for purposes of these indicators, while previously we used the overall urban area defined by the relevant municipality.
- We now base our indicators on the most recent population and homes projection prepared by SEADE entitled “Projections of Population and Residences for the Municipalities of the State of São Paulo: 2010-2050” (*Projeção da População e dos Domicílios para os Municípios do Estado de São Paulo: 2010-2050*).

Accordingly, certain of the operating data presented in this Annual Report are not comparable with the data presented in previous Annual Reports.

The following table presents our operating data using the new methodology as of and for each of the years indicated:

Indicator (new methodology)	As of and for the year ended December 31,		
	2016	2015	2014
Number of water connections (in thousands)	8,654	8,420	8,210
Number of sewage connections (in thousands)	7,091	6,861	6,660
Percentage of population with water connections (“service” indicator) (in percent) <sup>(1)</sup>	95	96	96
Percentage of population with sewer connections (“service” indicator) (in percent) <sup>(1)</sup>	82	83	83
Percentage of population covered by water network (“coverage” indicator) (in percent) <sup>(2)</sup>	98	99	99
Percentage of population covered by sewage network (“coverage” indicator) (in percent) <sup>(2)</sup>	89	90	89
Percentage of consumer units connected to the sewage treatment system (“sewage treatment coverage” indicator) (in percent)	74	72	71
Volume of water billed during period (in millions of cubic meters)	1,990	1,914	2,069
Water Billed Loss Index during period (average) (in percent) <sup>(3)</sup>	20.8	16.4	21.3
Water Metered Loss Index during period (average) (in percent) <sup>(3)</sup>	31.8	28.5	29.8
Water loss per connection per day (average) <sup>(5)</sup>	308	258	319
Number of employees	14,137	14,223 <sup>(6)</sup>	14,753

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

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

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

- (4) Includes both physical and non-physical water loss. The Water Metered Loss Index represents the quotient of (i) the difference between (a) the total volume of water produced minus (b) the total volume of water measured minus (c) the volume of water that we exclude from our calculation of water loss, divided by (ii) the total volume of water produced. For more information, see “Item 4.B. Business Overview—Description of Our Activities—Water Operations—Water Loss”. We exclude the following from our calculation of water loss: (i) water discharged for periodic maintenance of water transmission lines and water storage tanks; (ii) water supplied for municipal uses such as firefighting; (iii) water we consume in our facilities; and (iv) estimated water loss related to the supply of water to shantytowns (*favelas*).
- (5) Measured in liters/connection per day, this amount is calculated by dividing (i) the average annual water loss by (ii) the average number of active water connections multiplied by the number of days of the year. This calculation method is based on worldwide market practice within the sector. See “Item 4.B. Business Overview—Description of Our Activities—Water Operations—Water Loss”. We exclude the following from our calculation of water loss: (i) water discharged for periodic maintenance of water transmission lines and water storage tanks; (ii) water supplied for municipal uses such as firefighting; (iii) water we consume in our facilities; and (iv) estimated water loss related to the supply of water to shantytowns (*favelas*).
- (6) In 2015, this figure included 370 employees who retired due to disability. This number was excluded from the 2016 figure.

For informational purposes, we present in the following table our operating data using our previous methodology as of and for each of the years indicated:

Indicator (previous methodology)	As of and for the year ended December 31,				
	2016	2015	2014	2013	2012
Number of water connections (in thousands)	8,654	8,420	8,210	7,888	7,679
Number of sewage connections (in thousands)	7,091	6,861	6,660	6,340	6,128
Percentage of population with water connections (in percent) <sup>(1)</sup>	99	99	99	99	99
Percentage of population with sewer connections (in percent) <sup>(2)</sup>	87	86	85	84	83
Percentage of treated sewage <sup>(3)</sup> (in percent)	79	78	77	78	77
Volume of water billed during period (in millions of cubic meters)	1,990	1,914	2,069	2,134	2,094
Water Billed Loss Index during period (average) (in percent) <sup>(4)</sup>	20.8	16.4	21.3	24.4	25.7
Water Metered Loss Index during period (average) (in percent) <sup>(5)</sup>	31.8	28.5	29.8	31.2	32.1
Water loss per connection per day (average) <sup>(6)</sup>	308	258	319	372	392
Number of employees	14,137	14,223 <sup>(7)</sup>	14,753	15,015	15,019

- (1) Number of residences connected to the water supply network as a percentage of the number of urban residences in a certain area.
- (2) Number of residences connected to the sewage collection network as a percentage of the number of urban residences in a certain area.
- (3) Treated sewage as a percentage of collected sewage.
- (4) 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*).
- (5) 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*).
- (6) 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*).
- (7) In 2015, this figure included 370 employees who retired due to disability. This number was excluded from the 2016 figure.

## Exchange Rates

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

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

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

Since 1999, following Brazil’s implementation of a floating rate regime, the Central Bank has not directly intervened in the exchange market. However, the Central Bank, using financial instruments at its disposal, may buy and sell foreign currency in the market in order to influence the exchange rate and decrease volatility with respect to the Brazilian *real*, and did so at various points during 2016. 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 <sup>(1)</sup>	Low	High
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
2016	3.2591	3.4833	4.1558	3.1193

  

Month ended	Period end	R\$ per US\$1.00		
		Average	Low	High
October 31, 2016	3.1811	3.1858	3.2359	3.1193
November 30, 2016	3.3967	3.3420	3.4446	3.2024
December 31, 2016	3.2591	3.3523	3.4650	3.2591
January 31, 2017	3.1270	3.1966	3.2729	3.1270
February 28, 2017	3.0993	3.1042	3.1479	3.0510
March 31, 2017	3.1684	3.1279	3.1735	3.0765
April 30, 2017	3.1984	3.1362	3.1984	3.0923

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,	RS per ¥1.00			
	Year end	Average <sup>(1)</sup>	Low	High
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
2016	0.0279	0.0289	0.0305	0.0278

Month ended	RS per ¥1.00			
	Period end	Average	Low	High
October 31, 2016	0.0303	0.0307	0.0318	0.0298
November 30, 2016	0.0299	0.0307	0.0323	0.0299
December 31, 2016	0.0279	0.0289	0.0305	0.0278
January 31, 2017	0.0279	0.0278	0.0284	0.0274
February 28, 2017	0.0276	0.0275	0.0280	0.0269
March 31, 2017	0.0284	0.0277	0.0284	0.0272
April 30, 2017	0.0287	0.0285	0.0288	0.0278

Source: Central Bank

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

## B. Capitalization and Indebtedness

Not applicable.

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

Not applicable.

## D. Risk Factors

### Risks Relating to Brazil

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

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

- the regulatory environment related to our business operations and concession agreements;
- interest rates;
- exchange rates and exchange controls and restrictions on remittances abroad;
- currency fluctuations;
- inflation;
- liquidity of the Brazilian capital and lending markets;

- tax and regulatory policies and laws;
- economic and social instability; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

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

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

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

Current political conditions in Brazil may affect the confidence of investors and the public in general as well as the development of the economy. Following the impeachment of former President Dilma Rousseff on August 31, 2016, uncertainty remains 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, which may 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.

Currently, Brazilian markets are experiencing heightened volatility due to the uncertainties derived from the ongoing *Lava Jato* investigation, being conducted by the Federal Prosecutor's Office, and its impact on the Brazilian economy and political environment. Members of the Brazilian federal government and of the legislative branch, as well as senior officers of large state-owned and private companies, are facing allegations of political corruption, involving alleged bribes by means of kickbacks on contracts granted by the government to several infrastructure, oil and gas and construction companies. 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. 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, in addition to alleged personal enrichment of the recipients of the bribes. As a result, a number of senior politicians, including congressmen and officers of the major state-owned and private companies in Brazil, have resigned and/or have been arrested, and certain senior elected officials and other public officials are being investigated for allegations of unethical and illegal conduct identified during the *Lava Jato* investigation.

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.

Developments in these proceedings and investigations 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 13.65%, 14.15% and 11.65% at the end of 2016, 2015 and 2014, 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 6.29%, 10.67% and 6.41%, during 2016, 2015 and 2014, respectively. If Brazil experiences increases in inflation, our costs and expenses may rise, we may be unable to increase our tariffs at the same rate to counter the effects of inflation, and our overall financial performance may be adversely affected. In addition, a substantial increase in inflation may weaken investors' confidence in Brazil, causing a decrease in the market price of our common shares or ADSs.

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

The Brazilian currency experienced frequent and substantial devaluations in relation to the U.S. dollar and other foreign currencies during the decades leading up to the mid-1990s. Throughout this period, the Brazilian government implemented various economic plans and exchange rate policies, including sudden devaluations, periodic mini-devaluations (during which the frequency of adjustments ranged from daily to monthly), floating exchange rate systems, exchange controls and dual exchange rate markets. From time to time since that period, there have continued to be significant fluctuations in the exchange rate between the Brazilian *real* and the U.S. dollar and other currencies. For example, the *real* appreciated 13.8%, 9.5% and 20.7% against the U.S. dollar in 2005, 2006 and 2007, respectively, reaching R\$1.634 in August 2008, although it depreciated by 32.0% against the U.S. dollar during full year 2008, closing the year at R\$2.337 per US\$1.00. The *real* strengthened again by 25.5% in 2009 and 4.3% in 2010, but depreciated against the U.S. dollar by 12.6% in 2011, 8.94% in 2012, 14.63% in 2013, 13.39% in 2014 and 47.01% in 2015, falling to R\$3.9048 against the U.S. dollar at December 31, 2015. The *real* fell further during the first months of 2016, reaching a low of R\$4.1558 against the U.S. dollar on January 21 2016, but then regained some value, reaching R\$3.2591 per US\$1.00 at December 31, 2016. There can be no assurance that the *real* will not depreciate further against the U.S. dollar. As of April 30, 2017, the commercial selling rate as reported by the Central Bank was R\$3.1984 per US\$1.00.

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

In the event of a significant devaluation of the *real* in relation to the U.S. dollar or other currencies, our ability to meet our foreign currency denominated obligations could be adversely affected because our tariff revenue and other sources of income are denominated solely in *reais*. In addition, because we have debt denominated in foreign currencies, any significant devaluation of the *real* will increase our financial expenses as a result of foreign exchange losses that we must record. We had total foreign currency denominated debt of R\$5,660.4 million as of December 31, 2016 and we anticipate that we may incur additional amounts of foreign currency denominated debt in the future. In 2016, our results of operations were positively affected by the 16.5% appreciation of the *real* against the U.S. dollar, and the appreciation of the *real* against the yen by 13.8%, which together led to a R\$1,090.5 million positive impact on our foreign exchange result, net. We do not currently have any derivative instruments in place to protect us against a devaluation of the *real* in relation to any foreign currency. A devaluation of the *real* may adversely affect us and the market price of our common shares or ADSs. For more information, see Note 5(a) to our 2016 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, 2017, 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".

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. On April 29, 2016, he was reelected for another term, ending in April 2018. 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, 2016, the State owed us R\$77.4 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\$937.0 million as of December 31, 2016. 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, 2016, we had a provision for an actuarial liability in the amount of R\$2,512.1 million with respect to future supplemental pension payments for which the State does not accept responsibility. On March 18, 2015, we, the State and DAEE, with the intervention of the Department of Sanitation and Water Resources, executed an agreement providing for payment of

R\$1,012.3 million, of which R\$696.3 million refers to principal and R\$316.0 million refers to monetary adjustment of the principal through February 2015. For a detailed discussion of this agreement, see “Item 7.B. Related Party Transactions—Agreements with the State of São Paulo” and Note 10 of our 2016 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 2016 financial statements.

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

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

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

We draw water for use in the São Paulo metropolitan area from the Guarapiranga and Billings reservoirs. Empresa Metropolitana de Águas e Energia S.A., or EMAE, a company that is also controlled by the State of São Paulo, has a concession to produce hydroelectric energy using water from the same reservoirs. EMAE commenced various lawsuits against us in the past seeking compensation for the water we draw from these reservoirs. Those lawsuits have now been settled in principle, by way of an agreement between EMAE and our company (which is summarized under “Item 7. Major Shareholders and Related Party Transactions”). That settlement agreement cannot take effect, however, until it has been approved by our company, EMAE and ANEEL. It has already been approved by our company, and was approved by ANEEL on December 30, 2016; but it must still be approved by EMAE’s shareholders in a shareholders’ meeting.

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

If the settlement agreement is not approved in the EMAE shareholders’ meeting, or if the ongoing lawsuit by the minority shareholders of EMAE requires the State to make a different decision regarding water use, our ability to draw water from the Guarapiranga and Billings reservoirs may be compromised. If we were no longer able to draw water from these reservoirs, we would have to transport water from locations farther away, which would increase our water transportation costs and may affect our ability to provide adequate service in the region.

## **Risks Relating to Our Business**

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

We experience decreases in our water availability from time to time due to droughts. The southeastern region of Brazil, particularly the southern region of Minas Gerais State and the Piracicaba, Capivari and Jundiá river basin, or “PCJ River Basin” (from which we extract most of the water used in the Cantareira System), and the northern area of the São Paulo metropolitan region experienced below average rainfall from 2012 to October 2015. In the October 2013 – March 2014 rainy season, rain levels and water inflow into the reservoirs reached the lowest stream flow measurements

in over 80 years, a scenario that continued in the October 2014 – March 2015 rainy season. During the October 2015 – March 2016 and during the October 2016 – March 2017 rainy seasons, the level of rainfall in the region returned to the normal levels expected for the period. Improved rainfall during the rainy season of October 2015 – March 2016 and of October 2016 – March 2017, the collaborative efforts between us and the population we serve and emergency construction conducted by us since 2014 in order to reduce the impact of the water crisis, resulted in a restoration of the water levels of the Cantareira system.

The depletion of water storage was 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 the solicitations we make to extract water based on this information, and inform us of the amount we are permitted to extract through periodical notices. In February 2016, as a result of the return of average rainfall levels to the region, we received authorization to extract 23 cubic meters per second, or m<sup>3</sup>/s, from the Cantareira System, an increase compared to the 13.5 m<sup>3</sup>/s we were authorized to extract for the majority of 2015, still significantly below the water volume we were allowed to extract in the period prior to February 2014, when we were allowed to extract up to a total of 33 m<sup>3</sup>/s. From September to November 2016 we received authorization to extract 25 m<sup>3</sup>/s, and from December 2016 to May 2017, we received authorization to extract 31 m<sup>3</sup>/s. In order to balance supply and demand despite the restricted water availability, we adopted a series of measures from 2014 to April 2016, including: (i) using treated water from other production systems to serve consumers originally supplied by the Cantareira system; (ii) offering discounts (bonus) to consumers that would use below average amounts of water, compared to average consumption; (iii) reducing pressure in the water distribution lines in order to decrease leakage; (iv) adjusting the volume of treated water sold to municipalities that operate their own distribution network; and (v) using pumps in order to extract water located below the intakes of the Cantareira system, from the so-called “technical reserve”, which had never before been used to serve the population. See “Item 4.B. Business Overview—The Recent Water Crisis”.

With the return of the rainfall to its historical average for the rainy season that began in October 2015 and ended in March 2016, the volume of water available to the population of the São Paulo metropolitan region returned to a normal level and the measures taken during the water crisis to continue to service consumers were gradually discontinued. However, heightened public awareness of the need to conserve water during the crisis resulted in our customers adopting lower water consumption practices during the water crisis and these practices were partially integrated in our consumers’ daily habits. As a result of this new behavior, despite us having a higher volume of water available for treatment, the volume of water billed to our clients did not return to the volume of water billed before the water crisis, in 2013. The Cantareira system’s maximum storage capacity, including the technical reserve, is 1,269.5 million m<sup>3</sup>. Excluding the technical reserve, which is 287.5 million m<sup>3</sup>, the Cantareira’s maximum storage capacity is 982.0 million m<sup>3</sup>. The volume of water in the Cantareira system recovered throughout the October 2015 – March 2016 rainy season and was 641.9 million m<sup>3</sup> as of March 2016, which represents 50.6% of its maximum storage capacity, including the technical reserve. The volume of water in the Cantareira system was 932 million m<sup>3</sup> as of March 31, 2017, which represents 73.4% of its maximum storage capacity, including the technical reserve. In December 2016, 7.6 million inhabitants were serviced by this system, compared to 5.4 million in December 2015. For more information about the water crisis, see “Item 4.B. Business Overview—The Recent Water Crisis”.

The drought prompted a continuous reduction in the volume of water billed and thus a reduction in revenue. In 2014, the water volume billed decreased 3.1% and the gross operational revenue fell by 6.7% compared to 2013. In 2015, the water volume billed decreased 8.0% and our gross operational revenue increased slightly by 0.5% compared to 2014. In 2016, the volume of water billed increased 4%, and the gross operational revenue increased by 24.3% compared to 2015. We cannot assure you that our consumers will revert to their pre-crisis consumption habits or, if at all, when this will occur. If consumers do not revert to their pre-crisis consumption habits, our financial condition could 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 the Agência Nacional de Águas, or ANA and the Departamento de Águas e Energia Elétrica do Estado de São Paulo ( the São Paulo State Department of Water and Energy), or DAEE, in order to extract water from the Cantareira System. The water right was renewed in 2004 and was due to expire in August 2014. However, due to prevailing climate conditions, particularly the severe drought, the water right was extended until October 31, 2015 and later extended again until May 2017. On February 20, 2017, ANA and DAEE released the base document for the negotiation of the water right that will last for the next 10 years. This proposal was the subject of consultations and public hearings in March 2017. The terms of this water right will define the volume of water that we will be authorized to extract from the Cantareira System to service the São Paulo metropolitan region. The drought that occurred in 2014 and for most of 2015 brought about the necessity of control mechanisms of the volume of water drawn from the Cantareira system that take into consideration the volume of water stocked. The current proposal establishes five tranches that regulate the amount of water we can draw based on the volume of water available in the reservoirs: (i) if the volume of water available is higher than 60% of the reservoirs' capacity, we can draw up to 33m<sup>3</sup>/s; (ii) if the volume of water available is between 40% and 60% of the reservoirs' capacity, we can draw up to 31m<sup>3</sup>/s; (iii) if the volume of water available is between 30% and 40% of the reservoirs' capacity, we can draw up to 27m<sup>3</sup>/s; (iv) if the volume of water available is between 20% and 30% of the reservoirs' capacity, we can draw up to 23m<sup>3</sup>/s; and (v) if the volume of water available is lower than 20% of the reservoirs' capacity, we can draw up to 15.5m<sup>3</sup>/s. We received authorization to extract 25m<sup>3</sup>/s from September to November 2016 and 31m<sup>3</sup>/s from December 2016 to May 2017. The renewal of the water right is expected to occur in May 2017.
- 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 2017, there is no forecast of any shortages or rationing of energy. See "Item 4.B. Business Overview—Energy Consumption".
- We are exposed to various weather-related risks, since our financial performance is closely linked to climate patterns. The possible increase in the frequency of extreme weather conditions in the future may adversely affect the water available for abstraction, treatment, and supply. Droughts could adversely affect the water supply systems, resulting in a decrease in the volume of water distributed and billed as well as in the revenue derived from water supply services. An increase in heavy rainfall could impact the regular operation of water sources, including abstraction of water from our reservoirs due to increased soil erosion, silting, and runoff of pollutants that affect the aquatic ecosystems. See "Item 4.B. Business Overview—Environmental Matters—Climate Change 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 4.B. Business Overview—Tariffs—Second Ordinary Tariff Revision" and "Item 5.A. Operating and Financial Review and Prospects—Factors Affecting Our Results of Operations—Effects of Tariff Increases".
- The state and federal government agencies that manage water resources could impose substantial charges for the abstraction of water from bodies of water and the discharge of sewage. We may not be able to pass these charges on to our customers. See "Item 4.B. Business Overview—Government Regulation—Water Usage".

- Our water pipes are susceptible to degradation caused by factors such as age, intense traffic, population density and commercial and industrial development, which may provoke accidents in the networks and affect the regular provision of our services, impacting society and the environment. See “Item 4.B. Business Overview—Description of Our Activities—Water Distribution” and “Item 4.B. Business Overview—Description of Our Activities—Sewage Operations—Sewage System”.

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

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

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

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

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

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

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

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 69.7% of our gross operating revenue from services in 2016 (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”.

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

The provision of water and sewage services in the city of São Paulo accounted for 50.1% of our gross operating revenues (excluding revenues relating to the construction of concession infrastructure) in the year ended December 31, 2016.

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*.

Since 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 Sewage and Water Supply Service Contracts, this charge must be included in the calculation of the tariff.

In April 2013, ARSESP issued Resolution No. 413/2013, which suspended Resolution No. 407/2013 until the first 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.

As of December 31, 2016, we have transferred approximately R\$2.2 billion to the São Paulo Municipal Fund for Environmental Sanitation and Infrastructure since 2010. We cannot assure you when and how we will recover this amount. In December 2016, we concluded the first four-year revision of our contract with the city of São Paulo, which altered our service quality, investment and investment tracking targets. However, the issue of the 7.5% charge was not discussed.

We cannot assure you that this 7.5% 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".



***We currently lack formal agreements or concessions with 54 of the municipalities to which we provide service, and 34 of our existing concession agreements will expire between 2017 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, 2016, we held formal 30-year agreements with 281 municipalities (including the city of São Paulo) of the 366 municipalities we serve. We entered into 3 of these agreements during 2016. The 281 municipalities with which we had formal agreements at year-end accounted for 80.3% of our total revenues for the year ended December 31, 2016, and 70.2% of our intangible assets as of December 31, 2016. Of the 54 served municipalities for which we lacked formal agreements at year-end, we were in the process of actively renegotiating with all municipalities. Together, these 54 municipalities accounted for 12.2% of our total revenues for the year ended December 31, 2016 and 21.1% of our intangible assets as of that same date. Between 2017 and 2030, 34 of our existing concession agreements will expire. These 34 concession agreements accounted for 6.7% of our total revenues for the year ended December 31, 2016 and 6.3% 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 54 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, 2016, 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 take possession of our water and sewage systems in Santos. We adopted the necessary judicial measures to contest this and we commenced legal proceedings against the municipality of Santos, after which the appellate court issued a decision in our favor. The legal proceedings have ended and we continue to have 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 regulates and supervises the provision of water and basic sanitation services in Santos, while we continue 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 indemnify us 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 its agreement 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, 2016, our total accounts receivable was R\$5,225.5 million. Of this amount, certain municipalities to which we provide water on a wholesale basis owed us R\$2,419.5 million, and certain municipal government entities owed us R\$800.4 million. Of the total amount owed by municipalities, R\$291.9 million was overdue by between 30 and 360 days and R\$2,092.3 million was overdue by over 360 days.

The Brazilian courts are entitled to obligate us to continue to supply water to these municipalities, even when we have not received payments due to us. We have no way of ensuring that negotiations with these municipalities or legal action taken against the municipalities will result in payments being made. For example, the municipalities of Santo André, Guarulhos and Mauá owe us significant sums in respect of water that we have been providing to them on a wholesale basis. Although we have intensified the process of collecting these sums and other amounts, and we executed Protocols of Intentions with Santo André, Guarulhos and Mauá in late 2015 and early 2016 seeking to resolve the outstanding amounts and restore normal commercial relations with them, the negotiations with Mauá and Santo André broke down in June 2016, while the negotiations with the municipality of Guarulhos broke down in August 2016. In those three cases, the Protocol of Intentions was terminated. For more information on wholesale operations, see “Item 4.B. Business Overview—Our Operations—Description of Our Activities—Wholesale Operations”. In addition, some entities associated with municipal governments for which we provide services also do not make regular payments. We cannot guarantee if or when these entities will make payments on a regular basis or pay the amounts they owe us. If these municipalities and related entities do not pay the amounts they owe us, we may suffer further material harm to our financial position.

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

Our capital expenditure program will require resources of approximately R\$13.9 billion in the period from 2017 through 2021. In 2016 we recorded R\$3.9 billion in capital expenditures.

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

domestic and international multilateral agencies and development banks in the future, we may not be able to meet our obligations or finance our capital expenditure program, which could have a material adverse effect on our business and financial condition.

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

Our debt includes financial covenants that impose indebtedness limits on us. Our failure to comply with these covenants could seriously impair our ability to finance our capital expenditure program, which could have a material adverse effect on us. For further information on these covenants, see "Item 5.B. Liquidity and Capital Resources—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, among others, to the release of untreated sewage into waterways or the disposal of sludge generated by treatment plants. More recently, we are involved in proceedings challenging the extraction of water resources in the face of the recent water crisis. Any unfavorable judgment in relation to these proceedings, or any material environmental liabilities, may have a material adverse effect on us. For further information on these proceedings, see "Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings". For further information on investments in environmental programs, see "Item 4.A. History and Development of the Company—Main Projects of our Capital Expenditure Program", "Item 4.B. Business Overview—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 Recent Water Crisis".

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

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

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

- investing in seeking new water sources located further from major consumer centers;
- investing in new technologies;

- improvement of water conservation practices and demand management alternatives such as economic mechanisms or educational programs; and
- increasing the capacity of our water reserves.

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

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

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

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

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

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

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

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

We are party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among others, civil, tax, labor, corporate and environmental issues. As of December 31, 2016, the total value of all outstanding claims against us was R\$54,038.8 million (net of R\$434.2 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 recognized provisions totalling R\$1,173.1 million (net of escrow deposits) as of December 31, 2016. For more information, see note 19 to our financial statements included in this annual report. These provisions do not cover all legal proceedings involving monetary claims filed against us and it may be insufficient to cover the ultimate resolution of these claims. Any unfavorable judgment in relation to these proceedings may have a material adverse effect on us. For more information, see “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”.

#### **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 55% of the aggregate market capitalization of the BM&FBOVESPA as of December 31, 2016.

***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 pursuing remedies under the U.S. securities laws in the U.S. courts. However, a court in the United States could allow claims predicated upon the U.S. securities laws brought by holders who purchased ADSs on the NYSE to be submitted to U.S. courts.

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

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

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

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

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

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

###### **Overview**

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

We believe we are one of the largest water and sewage service providers in the world (based on the number of customers in 2014, according to the inDepth Water Yearbook 2014-2015). We operate water and sewage systems in the state of São Paulo, which includes the city of São Paulo, Brazil's largest city. According to the IBGE, the state of São Paulo is Brazil's most populous state and the state with the highest gross domestic product, or GDP, in Brazil. For the year ended December 31, 2016, we generated net revenue of R\$14,098.2 million and net income of R\$2,947.1 million. Our total assets amounted to R\$36,745.0 million and our total shareholders' equity amounted to R\$15,419.2 million as of December 31, 2016.

As of December 31, 2016, we provided water and sewage services to a broad range of residential, commercial, industrial and governmental customers in 366 of the 645 municipalities in the state of São Paulo, including the city of São Paulo. Substantially all of our concessions or program agreements have 30-year terms. As of December 31, 2016, we lacked formal agreements for 54 of the municipalities we serve, each of which we are currently in the process of renegotiation. From January 1, 2017 through 2030, 34 further concessions will expire, and we will seek to replace them with program agreements. In addition to the 366 municipalities we served, we also provided water service to the municipality of Mogi das Cruzes, pursuant to two partial water contracts under which we service only certain neighborhoods of that municipality. See “Presentation of Financial and Other Information—Other Information—Our Contracts and the Municipalities We Serve”.

We also supply water on a wholesale basis to five municipalities in the São Paulo metropolitan region in which we do not operate water distribution systems (together covering a total estimated urban population of approximately three million residents). Four of these municipalities also utilize our sewage treatment services. For the year ended December 31, 2016, the São Paulo metropolitan region (including the municipalities to which we provide water on a wholesale basis) accounted for 69.7% of our gross operating revenue (excluding revenues relating to the construction of concession infrastructure), while the Regional Systems accounted for 30.3%.

As of December 31, 2016, we provided water services through 8.7 million water connections to approximately 24.7 million people, representing approximately 57% of the total population of the state of São Paulo, and had a water coverage ratio of 98% with respect to all regions. As of that date, we provided sewage services through 7.1 million sewage connections to approximately 21.2 million people and had an effective sewage service ratio of 82%. As of December 31, 2016, we operated using 73,015 kilometers of water pipes and water transmission lines and 50,097 kilometers of sewer lines.

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

The State of São Paulo, our controlling shareholder, is required by State Law No. 11,454/2003 to own at least 50% plus one of our common shares. As of April 30, 2017, the State owned 50.3% of our outstanding common shares. As a mixed capital company, we are an integral part of the State governmental structure. Our strategy and major policy decisions are formulated in conjunction with the State Secretariat for Sanitation and Water Resources as part of the State’s overall strategic planning. The majority of the members of our board of directors and our board of executive officers are nominated by the State government.

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

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

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

## Our Strengths

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

***Well-established business with significant size, scale and know-how to operate in complex urban settings.*** We believe we are one of the largest water and sewage service providers in the world. We provide water services directly to approximately 24.7 million people and supply water on a wholesale basis to an additional urban population of approximately 3.0 million people. As of December 31, 2016, we had an effective water coverage ratio of 98% in respect of all regions in which we operate. We also provide sewage services directly to approximately 21.2 million people, achieving an effective sewage service ratio of 82% in respect of all regions in which we operate as of December 31, 2016. Our significant size and scale have required us to operate in complex urban settings such as shantytowns (*favelas*) and environments without urban planning, thereby enabling us to develop well-trained personnel, skills for operating in adverse conditions that we believe our competitors lack.

***Operations in Brazil's most populous and wealthy state.*** The state of São Paulo, which is located in the most developed and economically active region of Brazil, is the most populous state in Brazil, with an estimated total population of 43.5 million as of December 31, 2016. The city of São Paulo had an estimated total population of 11.7 million as of the same date, while the São Paulo metropolitan region had a total population of 20.6 million. Based on its GDP, the state of São Paulo is the wealthiest state and largest economy in Brazil. The GDP of the state of São Paulo was approximately R\$1.7 trillion in 2015, representing approximately 26.3% of Brazil's total GDP, according to the most recent data collected by the IBGE. The state of São Paulo generates more revenue from water and sewage services than any other Brazilian state.

***Strong Base of Contracted Business.*** Between January 1, 2007 and December 31, 2016, we executed 30-year agreements with 281 of the 366 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, 2016, income from these 30-year agreements accounted for 80.3% 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 2007 until December 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 and 2017.

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



## Our Strategy

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

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

**Ensure the quality and availability of our services in our existing service area through excellence in service provision and improving our operating efficiency.** Our goal is to maintain the water coverage ratio, coupled with a high standard of quality and availability of our services, and meet the expected growth in our operating basis. We also intend to increase our sewage coverage by adding 1.1 million sewage connections by 2021. In addition, we seek to reduce both physical and non-physical water loss. See “— Capital Expenditure Program”.

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

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

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

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

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

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

**Maintain and expand our operating base.** We intend to maintain and expand our operating base by executing new agreements. To this end, we are actively seeking to develop closer relationships with the municipal governments that we currently serve in order to increase customer loyalty and thereby renew all or substantially all our concession agreements as they expire. We also regularly explore the possibility of executing agreements for the provision of water and sewage services in municipalities in the state of São Paulo in which we currently have no operations or to which we currently supply water and provide sewage treatment solely on a wholesale basis, which together represent a total population of approximately 16.4 million. We evaluate possible expansion opportunities in terms of proximity to our existing service areas to maximize return on investment and improve our financial performance. In June 2010, we entered into a 30-year agreement with the State and city of São Paulo for the provision of water and sewage services in the city of São Paulo, which in the year ended December 31, 2016 accounted for 50.1% of our gross operating revenues (excluding revenues relating to the construction of concession infrastructure). Between January 1, 2007 and December 31, 2016, we entered into agreements with 281 municipalities (including our services agreement with the city of São Paulo), of which 3 were entered into in 2016. These 281 municipalities accounted for 80.3% of our total revenues for the year ended December 31, 2016 and 70.2% of our intangible assets as of the same date. As of December 31, 2016, 54 of our concessions had expired and are currently being renegotiated. These 54 municipalities accounted for 12.2% of our total revenues for the year ended December 31, 2016 and 21.1% of our intangible assets as of the same date. From January 1, 2017 through 2030, 34 concession agreements, accounting for 6.7% of our revenues for the year ended December 31, 2016 and 6.3% of our intangible assets as of the same date, will expire.

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

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

**Expand our sewage treatment coverage.** Our goal is to progress in the implementation of sewage collection and treatment structures in an economically and technologically viable way. We had an effective sewage coverage ratio of 89% as of December 31, 2016 and plan to increase this ratio to 93% by 2021 by adding over 1.1 million sewage connections and the indicator of consumer units connected to the sewage treatment system from 74% to 83% by 2021. These investments are necessary to restore the quality of the rivers and lakes, providing new sources for water supply. In addition, there are municipalities in the state of São Paulo representing a total population of approximately 16.4 million to which we currently do not provide water or sewage services, or to which we currently supply water solely on a wholesale basis. Our strong presence in the State and experience in providing water and sewage services places us in a privileged position to expand our sewage services to these additional municipalities in the state of São Paulo as well as to other Brazilian states and abroad. For more information, see “Item 4.B. Business Overview—Description of our Activities—Sewage Operation” and “Item 4.B. Business Overview—Competition” and “Item 4.B. Business Overview—Tariffs”.

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

In 2016 we invested R\$3.9 billion and between 2017 and 2021 we plan to invest an additional R\$13.9 billion to improve and expand our water and sewage systems, increase water security, and meet the growing demand for water and sewage services in the state of São Paulo, thereby encouraging these customers to continue using our services.

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

### **State of São Paulo**

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

The state of São Paulo occupies approximately 3.0% of Brazil's land mass and encompasses an area amounting to approximately 96,000 square miles. According to the SEADE, the state of São Paulo had an estimated total population of 43.5 million as of December 31, 2016. The city of São Paulo, capital of the state of São Paulo, had an estimated total population of 11.7 million, with a total population of 20.6 million inhabitants in the São Paulo metropolitan region, as of December 31, 2016. The São Paulo metropolitan region encompasses 39 municipalities and is the largest metropolitan region in the Americas and the fifth largest metropolitan region in the world, according to the United Nations' Data Booklet "The World's Cities in 2016", with approximately 47% of the total population of the state of São Paulo as of December 31, 2016. According to the most recent data collected by the IBGE, the GDP of the state of São Paulo was approximately R\$1.7 trillion in 2015, representing approximately 26.3% of Brazil's total GDP, and making it the largest economy of any state in Brazil based on GDP. According to the IBGE, the state of São Paulo is also the leading Brazilian state in terms of manufacturing and industrial activity, with a strong position in car manufacturing, pharmaceuticals, computer manufacturing, steel making and plastics, among other activities, as well as a leading position in the banking and financial services industries. The state of São Paulo is the leading export state in Brazil, according to the Brazilian Ministry of Development, Industry and Foreign Trade (*Ministério do Desenvolvimento, Indústria e Comércio Exterior*).

### **History**

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

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

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

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

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

We provide water and sewage services directly to a large number of residential, commercial and industrial private consumers, as well as to a variety of public entities, in 366 of the 645 municipalities in the State, including in the city of São Paulo. We also supply water on a wholesale basis to five municipalities in the São Paulo metropolitan region in which we do not operate water distribution systems, and four of these municipalities also utilize our sewage treatment services. According to the inDepth Water Yearbook 2014-2015, we are the fourth largest water and sewage service company in the world in terms of number of clients.

In 1994, we were registered with the CVM as a publicly-held company and are therefore subject to the CVM’s rules, including those relating to the periodic disclosure of extraordinary facts or relevant events. Our common shares have been listed on the 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.

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

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

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

### **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 Officer and Investor Relations Officer, who is responsible for financial planning, costs and tariffs, raising capital and allocating financial resources to divisions of our company, conducting capital markets and other debt incurrence transactions and managing debt levels, controller, accounting, corporate governance and investor relations, 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 increase water security and meet demand growth for treated water;
- (II) to expand the percentage of households connected to our sewage system;

- (III). to increase the treatment of sewage collected; and
- (IV). to increase operating efficiency and reduce water loss.

We have budgeted investments in the total amount of R\$13.9 billion from 2017 through 2021. We invested R\$3.9 billion, R\$3.5 billion and R\$3.2 billion in 2016, 2015 and 2014, respectively.

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

	Planned Capital Expenditures					
	2017	2018	2019	2020	2021	Total
	<i>(in millions of reais)</i>					
Water	1,553	1,617	1,327	1,192	1,409	7,098
Sewage Collection	642	989	1,152	1,395	1,245	5,423
Sewage Treatment	136	248	330	362	282	1,358
<b>Total</b>	<b>2,331</b>	<b>2,854</b>	<b>2,809</b>	<b>2,949</b>	<b>2,936</b>	<b>13,879</b>

Our capital expenditure program from 2017 through 2021 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 366 municipalities we served as of December 31, 2016 and in the municipality of Santa Branca, with which we signed a contract that became effective in 2017. The recent drought has prompted a reduction in the volume of water billed, particularly in 2014 and 2015, and thus a reduction in revenue. Due to the drought and the need to prioritize construction to mitigate the effects of the water crisis and increase water security in the Metropolitan Region of São Paulo, we were required to adjust our investment programs commencing in 2014. These adjustments are expected to continue in 2017 and 2018 due to the priority given since 2014 to emergency investments in water.

### Main Projects of Our Capital Expenditure Program

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

**Investments in Water** – We have a series of ongoing and scheduled projects involving water production and distribution. For the period from 2017 through 2021, we plan to spend R\$7.1 billion in water-related investments. The main programs are:

#### *Metropolitan Water Program*

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

Since 2000, the Metropolitan Water Program has increased the production capacity in 8.1 m<sup>3</sup>/s, 5 m<sup>3</sup>/s of which can be attributed to the Public Private Partnership, or “PPP”, conducted in the Alto do Tietê concluded in 2011, and 2.1 m<sup>3</sup>/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 6.4 m<sup>3</sup>/s by the end of the first half of 2018 through the construction of the São Lourenço System. 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, adding 5.13 m<sup>3</sup>/s of water availability.

In 2016, we invested approximately R\$410 million in the Metropolitan Water Program.

## Interconnection of Jaguari and Atibainha Reservoirs

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 contracted investments of R\$555 million, this construction will allow the transfer of an average 5.13 m<sup>3</sup>/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 by the end of 2017. For more information, see “—Business Overview—The Recent 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 m<sup>3</sup>/s and should be able to benefit a population of almost 1.5 million people. The PPP contract was executed in August 2013 and construction began in April 2014. The project 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 during the first six months of 2018. For more information on Public Private Partnerships, see “—Business Overview—Public Private Partnerships”.

As of December 31, 2016, the estimated amount of the PPP contract was R\$6.0 billion (including R\$2.2 billion in construction and maintenance and operation of the system). After monetary adjustment, the contract amounts to approximately R\$7.9 billion and has a 25-year term, four years of which 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.

### 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\$3.2 billion (current value) in this project so far, including R\$505 million invested in 2016, and we anticipate total investments of approximately R\$6.3 billion (current value) throughout the term of the program. Funding for the program will come from our own resources as well as from credit facilities provided by JICA and BNDES.

The program aims to reduce the rate of water loss from 436 liters per connection per day in December 2008 to 280 liters per connection per day by 2020, which is equivalent to reducing the Water Billed Loss Index from 27.6% in December 2008 to 16.9% in 2020 and to reducing the Water Metered Loss Index (based on measured consumption) from 34.1% in December 2008 to 29.9% in 2020. In 2016, our water loss measured 308 liters per connection per day. In 2016, our Water Billed Loss Index was 20.8% and our Water Metered Loss Index averaged 31.8%.

It is worth noting that the reduction in the water loss indicators in 2014 and 2015 was due to the extension of pressure reduction management in the supply systems, an operational practice designed to manage the recent water shortage, and which impacts the supply of water and losses. This operational practice was adopted to cope with the temporary and atypical situation. In 2016, with the beginning of the normalization of the water supply, greater availability of water to customers and the consequent increase in pressures in the distribution network, there was an increase in the indicators of water losses. For more information on the measure we have adopted to confront the water crisis, see “—Business Overview—The Recent 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 supported by the federal government, the state of São Paulo, the municipality of São Paulo, the World Bank, and us. In 2016, R\$39 million was invested in the Water Source Program.

## Coastal Water Program

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

During the first phase of this program, we have focused mainly on increasing water production in order to satisfy demand and improve water quality in the Baixada Santista metropolitan region. In order to reach this goal, we built two water treatment stations, which started operations in 2013: Mambu/Branco, with water treatment capacity of 1.6 m<sup>3</sup>/s, and Jurubatuba, with water treatment capacity of 2 m<sup>3</sup>/s.

In 2016, the integrated system of the Baixada Santista metropolitan region was reinforced with the commencement of operations at the Melvi Treated Water Reserve Center, located in Praia Grande. The Center's reserves went from 20 million to 45 million liters. The infrastructure is part of the Mambu-Branco production center (inaugurated in 2013 in Itanhaém) and will serve residents and tourists in nine municipalities of the Baixada Santista region. In 2016, we invested R\$25 million in the Coastal Water Program.

**Investments in Sewage**—We have a series of ongoing and scheduled projects involving the collection, removal and treatment of sewage. For the period from 2017 through 2021, we plan to invest R\$6.8 billion in sewage. The main programs are:

### Tietê Project

The Tietê river crosses the São Paulo metropolitan region and receives most of the region's 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 contribute to the progressive revitalization of the Tietê river by installing sewage collection lines along the banks of the Tietê river and its tributaries. These lines collect raw sewage and deliver it to our sewage treatment facilities.

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

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

The first and second phases of the Tietê Project contributed to an increase from 70.0% to 84.0% in the sewage collection rate and an increase from 24.0% to 70.0% in the treatment of sewage collected in the São Paulo metropolitan region. As a result, the sewage collection system covered a total of 15.8 million people (5.1 million more than the number of people served when the Tietê Project was initiated), and the sewage treatment system covered 11.1 million people (8.5 million more than the number of people served when the Tietê Project was initiated). The 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 treatment system will serve an additional 5 million people.

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

We continued to work on items from the third phase and began in 2014 to implement measures related to the fourth phase. In 2016, we invested approximately R\$342 million in this project.

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

#### Clean Stream Program

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

Since 2007, 149 urban streams have been decontaminated, benefiting approximately 2.2 million people. In 2016, we had invested R\$4.8 million in the Clean Stream Program. The program is supported by funds from the *Caixa Econômica Federal* as well as our own funds. Part of the investment related to the Tietê Project benefits the Clean Stream Program.

Despite our constant monitoring of pollution levels, the municipality of São Paulo's difficulties in moving low-income families who live in risky areas led to a slowdown in progress under the program in 2016. We have renewed the partnership with the municipality and are currently defining objectives for 2017 and 2018.

#### Clean Wave Program

The main goals of the Clean Wave Program (*Programa Onda Limpa*) are to improve and expand the sewage systems in the municipalities comprising the Baixada Santista metropolitan region on the southern coast of the state, increasing the sewage collection rate to 90% and treating 100% of this collected sewage, thereby improving the bathing water quality at 82 beaches in the region by the end of the decade. This project is being carried out in 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 2018. The funds will come from our own resources as well as from loan agreements entered into with JICA and from BNDES.

In 2016, we invested R\$102 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 75% in 2016. 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, 2016, we had completed approximately 102 thousand sewage connections. By 2018, we will complete an additional 15 thousand sewage connections.

Under the program's first phase, we plan to execute 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 2022. The second phase of the Clean Wave Program is in planning for the period between 2022 and 2030. 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.

### 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, thereby improving the health and well-being of the population and stimulating economic development through an increase in tourism. Due to the adjustments in our investment plans in recent years, a significant portion of this program remains to be completed in the future.

### ***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. We carried out actions on three fronts as part of this project: (i) we installed drains to collect residue from rivers in the Guarapiranga basin; (ii) we developed diagnosis and control services for the removal of plants that obstruct water extraction; and (iii) we removed and disposed of waste that had accumulated at the bottom of the dam in the river basin. Two vessels were built specifically for this purpose. Additionally, we now use ecobarriers at the bottom of the reservoir's main affluents.

#### *Pró-Conexão*

In 2012, the State of São Paulo approved a project to subsidize connections to the sewage system for low-income families. Initially intended to last eight years, the project involves capital expenditures of up to R\$349.5 million of which 80% will be provided by the State government and 20% by us. In this period we expect that this program will create 192 thousand new sewage connections benefiting approximately 800 thousand people. As of December 2015, we completed approximately 23 thousand sewage connections under the *Pró-Conexão* program. Due to adjustments in our investment plan, this program did not progress in 2016. However, we expect to start works again in 2017.

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 expected to cover 81 communities in 30 municipalities, benefiting approximately 15,000 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. Due to the adjustments in our investment plans in the recent years, a significant portion of this program remains to be completed.

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

## **B. Business Overview**

### **Our Operations**

As of December 31, 2016, we provided water and sewage services to 366 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 2 other municipalities (Cajobi e Macatuba). For more information, see “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”. Between January 1, 2007 and December 31, 2016, we entered into agreements with 281 municipalities (including our services agreement with the city of São Paulo) in accordance with the Basic Sanitation Law, of which 3 were entered into in 2016. As of December 31, 2016, these 281 municipalities accounted for 80.3% 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, 2016, 54 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, 2017 through 2030, 34 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, 2016.

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

We set forth below a description of our activities.

#### ***Wholesale Operations***

##### ***Wholesale Water Services***

We provide water services on a wholesale basis to five municipalities located in the São Paulo metropolitan region (Guarulhos, Mauá, Mogi das Cruzes, Santo André and São Caetano do Sul). Agreements to provide water services on a wholesale basis must comply with the Basic Sanitation Law, which designates these services as “interdependent activities” and regulates each stage of the service. The law requires that the service be supervised by an independent agency, stipulates registration of the cost of the service, and requires assurance of payment among the several service providers in order to continue the provision of the services, in accordance with the rules to be published by ARSESP. Our agreements currently comply with the provisions of the Basic Sanitation Law. In 2016, the revenues from wholesale water services were R\$90.9 million.

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

#### *Wholesale Sewage Services*

Currently, we provide sewage services on a wholesale basis to the municipalities of Mauá, Mogi das Cruzes, Santo André and São Caetano do Sul. 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 2016 we treated approximately 35.6 million cubic meters of sewage from these municipalities. We believe this illustrates our commitment to social and environmental responsibility. In 2016, our revenues from wholesale sewage services were R\$36.2 million.

In December 2008, we entered into a five-year agreement for the collection and treatment of 20% of the sewage generated by the city of Guarulhos. We have not yet started to provide these services, and they will only be able to commence when the works on linking the Guarulhos sewage to our sewage system are finalized. These works are the responsibility of the Guarulhos sanitation company, which as of December 31, 2016 had not yet carried out the necessary works.

#### *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 2016, we produced approximately 2,696.2 million of cubic meters of water. The São Paulo metropolitan region (including the municipalities to which we supply water on a wholesale basis) currently is, and has historically been, our core market, accounting for approximately 69% of water invoiced by volume in 2016.

In the rainy season from October 2015 to March 2016 rainfall returned to historical averages and water levels in the reservoirs that provide water to the São Paulo metropolitan region, our largest market, increased. 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 that occurred in 2014 and 2015 resulted in a significant decrease in the volume of water billed and revenues from services we provide and, despite the discontinuation in May 2016 of the measures that were used to face the drought, new consumption habits were incorporated and the volume of water billed and revenues from services we provide continued to be impacted by those measures. “ and “—The Water Crisis”. The following table sets forth the volume of water that we produced and invoiced for the periods indicated:

	<b>Year ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
	<i>(in millions of cubic meters)</i>		
Produced:			
São Paulo metropolitan region	1,888.8	1,679.4	2,001.1
Regional Systems	807.4	787.2	839.3
<b>Total</b>	<b>2,696.2</b>	<b>2,466.6</b>	<b>2,840.4</b>
Invoiced:			
São Paulo metropolitan region	1,136.7	1,084.3	1,172.4
Wholesale	227.4	215.5	256.8
Regional Systems	626.2	613.9	639.4
<b>Total</b>	<b>1,990.3</b>	<b>1,913.7</b>	<b>2,068.6</b>

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

- water discharged for periodic maintenance of water transmission lines and water storage tanks;
- water supplied for municipal uses such as firefighting;
- water consumed in our own facilities; and
- estimated water loss associated with water we supply to shantytowns (*favelas*).

#### *Seasonality*

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

#### *Water Resources*

We can 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 224 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 m<sup>3</sup>/s, not including an additional 6.5 m<sup>3</sup>/s resulting from the emergency construction work conducted by us in 2014 and 2015. Total current installed capacity is 75.8 m<sup>3</sup>/s and can be distributed to the São Paulo metropolitan region. Average verified production for the interconnected water system of the São Paulo metropolitan region was 58.5 m<sup>3</sup>/s during 2016. The Cantareira, Guarapiranga and Alto Tietê systems produce 81.4% of the water we distributed in the São Paulo metropolitan region in 2016.

In 2016, the Cantareira system accounted for 37.6% 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 69.7% of our gross operating revenues (excluding revenues relating to the construction of concession infrastructure) for the year. For more information, see “Item 3.D. Risk Factors—Risks Relating to Our Business—We are exposed to risks associated with the provision of water and sewage services”.

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

	<b>Production Rate<sup>(1)</sup></b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
	<i>(in cubic meters per second)</i>		
<b>Water production system:</b>			
Cantareira	22.0	14.1	23.7
Guarapiranga	13.9	14.9	14.2
Alto Tietê	11.7	12.1	13.8
Rio Claro	3.8	3.9	3.9
Rio Grande (Billings reservoir)	4.9	5.0	4.8
Alto Cotia	1.2	0.9	0.9
Baixo Cotia	0.9	1.0	0.8
Ribeirão da Estiva	0.1	0.1	0.1
<b>Total</b>	<b>58.5</b>	<b>52.0</b>	<b>62.2</b>

(1) Average of the twelve months ended December 31, 2016, 2015 and 2014.

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

Statewide, we estimate that we are able to supply nearly all of the demand for water in all of the areas where we operate, subject to droughts and extraordinary climate events. We installed 200.2, 226.0 and 231.5 thousand new water connections in 2016, 2015 and 2014, respectively. The interconnected water system of the São Paulo metropolitan region serves 30 municipalities, of which 25 are operated directly by us under this system. Through this system, we serve the other five municipalities on a wholesale basis, whereas distribution is the responsibility of other companies or departments related to each municipality.

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

To ensure the continuous provision of regular water supply in the São Paulo metropolitan region, we intend to invest R\$13.9 billion from 2017 to 2021 to increase our water production and distribution capacities as well as to improve the water supply systems. In 2016, our total investment in water supply systems amounted to R\$2.6 billion, of which R\$2.4 billion were invested in the São Paulo metropolitan region.

#### *Water Treatment*

We treat all water at our water treatment facilities prior to dispatching it to our water distribution network. We operate 237 treatment facilities, of which eight are a part of the Metropolitan Production System—located in the São Paulo metropolitan region and account for approximately 70% of all water we produced in 2016. The type of treatment used depends on the nature of the source and quality of the untreated water. For example, water abstracted from rivers requires more treatment than water drawn from groundwater sources requires. All of the water we treat receives fluoridation treatment.

## Water Distribution

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

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

	As of December 31,		
	2016	2015	2014
Water distribution pipes and water transmission lines (in kilometers)	73,015	71,705	70,800
Number of connections (in thousands)	8,654	8,420	8,210

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, 2016, our water distribution pipes and water transmission lines included: (i) 37,760 kilometers in the São Paulo metropolitan region; and (ii) 35,255 kilometers in the Regional Systems.

As of that date, we had 408 storage tanks in the São Paulo metropolitan region with a total capacity of 2.2 million cubic meters, and 1,998 storage tanks in the Regional Systems. Furthermore, we had 462 treated water pumping stations in the São Paulo metropolitan region aqueduct system, including stations at treatment facilities, intermediate trunk transfer pumping stations and small booster stations serving local areas.

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

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

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

	in thousands					
	2017	2018	2019	2020	2021	2017 – 2021
São Paulo metropolitan region	120	107	102	97	88	514
Regional Systems	65	61	62	58	55	301
<b>Total</b>	<b>185</b>	<b>168</b>	<b>164</b>	<b>155</b>	<b>143</b>	<b>815</b>

## Water Loss

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

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

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

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

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

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

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

These indicators are calculated by applying the following formulas:

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

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

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

Where:

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

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

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

**V<sub>used</sub>**: corresponds to the volume of water used for operational, public, private and social needs (supply shantytown areas) at a given period; and

**N<sub>connections</sub>**: corresponds to the average number of active water connections.



Using this calculation method, as of December 31, 2016, we experienced 359 liter/connection per day of water loss in the São Paulo metropolitan region and 230 liter/connection per day in the Regional Systems, averaging 308 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 280 liters/connection per day, Water Billed Loss Index to 16.9% and the Water Metered Loss Index to 29.9% 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 21% in December 2016. This reduction is not only the result of initiatives to combat water loss including, for example, strengthening our supply systems' "pressure management", but it can also be attributed to atypical and temporary operations.

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

Our strategy to reduce water loss has two approaches:

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

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

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

## *Water Quality*

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

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

Water quality is monitored at all stages of the distribution process, including at the water sources, water treatment facilities and in the distribution network. We have 15 regional laboratories, one central laboratory, and laboratories located in all water treatment facilities that monitor water quality, as required by our standards and those set by law. Our laboratories analyze an average of 64 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, 2016, we collected approximately 81% and 84% 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 2016, we collected approximately 82% of all the sewage produced in the municipalities in which we operated in the state of São Paulo. We installed 236.6 thousand, 226.1 thousand and 244.3 thousand new sewage connections in 2016, 2015 and 2014, 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, 2016, we were responsible for the operation and maintenance of 50,097 kilometers of sewage lines, of which approximately 26,182 kilometers are located in the São Paulo metropolitan region and 23,915 kilometers are located in the Regional Systems, respectively.

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

	As of December 31,		
	2016	2015	2014
Sewage lines (in kilometers)	50,097	48,774	47,992
Sewage connections (in thousands)	7,091	6,861	6,660

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

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

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

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

Unlike the São Paulo metropolitan region, the interior region of São Paulo State does not generally suffer obstructions caused by sewage system overload. The coastal region, however, experiences obstructions in its sewage lines primarily due to infiltration of sand, especially during the rainy season in the summer months. In addition, the sewage coverage ratio in the coastal region is lower than in the other regions served by us, at approximately 76% as of December 31, 2016.

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:

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2017–2021</u>
	<i>in thousands</i>					
São Paulo metropolitan region	114	142	148	156	156	716
Regional Systems	86	84	87	84	78	419
<b>Total</b>	<b>200</b>	<b>226</b>	<b>235</b>	<b>240</b>	<b>234</b>	<b>1,135</b>

#### *Sewage Treatment and Disposal*

In 2016, approximately 61% and 98% of the consumer units of the sewage services used our sewage treatment system in the São Paulo metropolitan region and the Regional Systems, respectively, or 74% of the consumer units of our sewage services in the state of São Paulo, was connected at our treatment facilities and afterwards discharged into receiving water bodies such as rivers and the Atlantic Ocean, in accordance with applicable legislation. Though we have not yet reached full coverage of sewage collection and treatment services in the regions where we operate, we are making efforts to reach this goal.

We currently operate nine ocean outfalls and 539 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 435 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 80 sewage treatment facilities in the coastal region.

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

#### *Sludge Disposal*

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

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

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

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

Part of the R\$11.9 million invested in research and development in 2016 was used for approached to the disposal and beneficial use of sludge, in order to meet the Principles for Cleaner Production. Our agreement with the São Paulo State Foundation for Research Support (*Fundação de Amparo à Pesquisa do Estado de São Paulo*), or “FAPESP”, enables us to develop projects that make beneficial use of sludge to help recover degraded areas, cover landfills and yield sand for construction works.

Additionally, using financing from the *Financiadora de Estudos e Projetos* (“FINEP”), we are also developing two other innovating projects aiming to reduce the disposal of sludge in landfills. The first project uses a gasification system that uses specialist technology to transform sludge from treatment stations into a solid product, weighing 5% of its initial weight, which can be re-used in construction work. The second project consists of a waste dryer that uses highly mechanized and automated processes, drawing on solar energy, to reduce up to 70% of waste volume.

### Principal Markets in Which We Operate

As of December 31, 2016, we operated water and sewage systems in 366 of the 645 municipalities in the state of São Paulo. In addition, we currently supply water on a wholesale basis to five municipalities located in the São Paulo metropolitan region with a total population of approximately 3.0 million people.

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

	Year ended December 31,		
	2016	2015	2014
	<i>(in millions of R\$)</i>		
São Paulo metropolitan region	7,749.7	6,021.9	6,235.3
Regional Systems	3,372.5	2,924.9	2,670.1
<b>Total</b>	<b>11,122.2</b>	<b>8,946.8</b>	<b>8,905.4</b>

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

	Year ended December 31,		
	2016	2015	2014
	<i>(in millions of R\$)</i>		
Water supply	6,090.7	5,045.5	4,896.7
Sewage services	5,031.5	3,901.3	4,008.7
<b>Total</b>	<b>11,122.2</b>	<b>8,946.8</b>	<b>8,905.4</b>

### Competition

In the state of São Paulo, there are 279 municipalities that operate their own water and sewage systems and that collectively have a total population of approximately 16.4 million, or approximately 38% of the population of the state of São Paulo.

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

In recent years, we have also experienced an increasing level of competition in the market of water supply to industrial customers. Several large industrial customers located in municipalities we serve use their own wells to meet their water needs. In addition, competition for the disposal of non-residential, commercial and industrial sludge in the São Paulo metropolitan region has increased in recent years as private companies offer stand-alone water treatment solutions inside the facilities of their customers. We have also established new tariff schedules for commercial and industrial customers in order to assist us in retaining these customers. Since these fixed demand agreements (take-or-pay contracts) with certain of our industrial customers were not covered by our bonus program, until April 2016, we suspended the fixed demand requirement in order to encourage lower water consumption. In May 2016, we reinitiated the fixed demand requirement, and the volumes of those contracts were revised according to clients' new consumption profiles. We started 2016 with 528 formal contracts and, after revision of the charge and volume, ended the year with 466 contracts. 62 contracts were terminated because they did not meet the minimal amount required. Of the remaining 466 contracts, 10 were entered into in 2016. For more information about the water crisis, see “—The Recent Water Crisis”. For more information on Take-or-pay Contracts see “—Tariff Structure—Fixed Demand Agreements (Take-or Pay)”.

### **Billing Procedures**

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

The majority of the bills for water and sewage services are delivered to our customers in person, mainly through independent contractors who are also responsible for reading water meters, although a proportion of clients got, for convenience purposes, to receive their bill through regular mail. Water and sewage bills can be paid at some banks and other locations in the state of São Paulo. These funds are paid over to us after deducting average banking fees ranging from R\$0.29 to R\$1.27 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 2016, 2015 and 2014, we received payment of 93.0%, 90.4% and 94.6%, respectively, of the amount billed to our retail customers, and 93.0%, 90.2% and 94.3%, respectively, of the amount billed to those customers other than State entities, within 30 days after the due date. In 2016, 2015 and 2014, we received 97.2%, 96.2% and 101.1%, 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 2016, 2015 and 2014, we received payment of 74.1% 43.8% and 32.8%, 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 and ARSESP. The guidelines also establish procedural steps and the terms for the annual adjustments. The adjustments have to be announced 30 days prior to the effective date of the new tariffs, which previously would take effect in September. Pursuant to the most recent tariff revision, both the base date and future adjustments took place in April. In addition, on January 19, 2017 ARSESP released Deliberation n° 706, which divided the Second Ordinary Tariff Revision process into two parts. The first part is expected to end in June 2017, and the second part is expected to end in April 2018.

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 by 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 Jundiá rivers created a consortium known as ARES/PCJ to regulate and supervise our activities in those areas, and for similar purposes, in November 2013 the Regulatory Agency of São Bernardo do Campo (AR/SBC) was created. As a result of the creation of the ARES/PCJ, we are currently involved in legal proceedings in which ARES/PCJ is claiming that it has jurisdiction over the regulation and supervision of our activities in four municipalities (Piracaia, Mombuca, Santa Maria da Serra and Aguas de São Pedro). In 2016 we obtained a definitive favorable decision in the Piracaia proceeding. However, as the debate continues in other processes, 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.

#### *First Ordinary Tariff Revision*

On November 1, 2013, ARSESP issued Resolution No. 435/2013 which authorized 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 reposition 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) established that, as of May 11, 2014, a tariff repositioning index of 5.4408% in relation to our tariffs at the time 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) allowed us to apply the repositioning index arising from the tariff revision at a more opportune future date, when we proceeded 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) established that the next annual tariff adjustments would occur on the following dates: on April 11, 2015 and April 11, 2016, with the next tariff revision on April 11, 2017; and (iv) ratified 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 tariff structure was in place with respect to our services until the new structure was approved by ARSESP and implemented. Considering what was 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, authorized us to implement a final tariff revision as of December 27, 2014 with a repositioning index of 6.4952%. This percentage corresponds to the index of the 5.4408% tariff revision increase already granted as a result of the conclusion of the tariff revision, approved by ARSESP Resolution No. 484/2014 of April 10, 2014, and an additional 1% index, accrued to the index for partial compensation regarding the postponement of the tariff revision application. This additional 1% index may be revised or supplemented after ARSESP analyzes data related to our loss in revenue on account of the application postponement.

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

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

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

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

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

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

- 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 was set at 78% of the prior reference consumption value. The updated reference consumption value began to be applied to our customers' bills as of February 1, 2016. The bonus ranges of 10%, 20% and 30%, were maintained, following the rules of our discount (bonus) program which established that if a client consumes 10% less water during a certain period compared to his reference consumption value, he will obtain a discount of 20% in his water bill, and if the client consumes 20% less water, he obtains a discount of 30%.



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

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

*Extraordinary Tariff Revision*

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

- I. Resolution No. 560/2015, published May 4, 2015, authorized a readjustment of 7.7875% on existing tariffs, which constituted of: (i) an annual tariff readjustment for the year of 2015 of 7.1899%, calculated based on the 8.1285% variation in the IPCA in the period between March 2014 and March 2015, minus the efficiency factor of 0.9386%; and (ii) the additional adjustment of 0.5575% due to the postponement of the application of the Ordinary Tariff Review (the tariff review that adjusts tariffs according to inflation), authorized in May 2014 but only applied in December 2014, when it was partially compensated; and
- II. Resolution No. 561/2015, also published May 4, 2015, established the 6.9154% index of the Extraordinary Tariff Revision (the tariff revision we requested due to the decline in the volume of water billed due to the water crisis and the unpredicted increase in electricity tariffs) 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 apply on June 5, 2015.

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

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

- I. Resolution No. 640/2016, authorizing the cancellation of the Contingency Tariff, which was applied to water meter readings as of May 1, 2016; and
- II. Resolution No. 641/2016 authorizing the cancellation of the Water Consumption Reduction Incentive Program, which granted discounts to water and sewage bills. This cancellation was applied to water meter readings as of May 1, 2016.

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

Due to delays in retaining a consulting company to advise ARSESP on the tariff revision and to the fact that it is impossible to predict when this consulting will be retained, ARSESP released Resolution No. 706/2017 on January 19, 2017. This deliberation divided the Second Ordinary Tariff Revision process into two parts, with the aim of ensuring that the tariff revision will take place in a timely manner. Before the adjustments described below, the first part was initially expected to conclude in June 2017. The second part is expected to conclude in April 2018.

This Resolution also set out the timeline for the conclusion of the first part of the revision, expected on June 10, 2017. Resolution No. 706/2017 was subsequently amended on April 26, 2017 by Resolution No. 720/2017 and the pending steps of the provisional timeline were pushed back to a later date. On May 10, 2017, we asked ARSESP to delay the ongoing tariff revision by 30 days in order for ARSESP to consider the proposals made in our technical report and for us to clarify our Business Plan as per ARSESP's request. ARSESP accepted our request on May 11, 2017 in Resolution No. 722/2017, and announced it would release the updated timeline by May 19, 2017. The timeline below outlines the following steps for 2017 as a result of the later Resolution:

- (i) Submission of a Business Plan by us (submitted on January 31, 2017);
- (ii) Receipt by ARSESP of our historical data (submitted on March 1, 2017)
- (iii) Analysis of our Business Plan by ARSESP (submitted on March 31, 2017);
- (iv) Delivery of the Appraisal Report of the Regulatory Asset Base or RAB by us (submitted on March 31, 2017);
- (v) Validation of the RAB by ARSESP (deadline to be set by ARSESP by May 19, 2017);
- (vi) Development by ARSESP of the initial technical note with Preliminary Tariff P0 and Weighted Average Cost of Capital – WACC (deadline to be set by ARSESP by May 19, 2017);
- (vii) Opening of Public Consultation and Public Hearing – Preliminary Tariff P0 and WACC (deadline to be set by ARSESP by May 19, 2017);
- (viii) Analysis by ARSESP of the contributions received, development of the final Technical Note and Detailed Report – Preliminary Tariff P0 and WACC (deadline to be set by ARSESP by May 19, 2017); and
- (ix) Approval of the Final Technical Note, Detailed Report and Publication of the Resolution with the Preliminary Tariff P0 (deadline to be set by ARSESP by May 19, 2017).

The average maximum tariff (Final P0) will be disclosed and authorized by April 10, 2018. The difference between the income generated with the tariff revision resulting from the first part of the revision (Preliminary Tariff P0) and the income that would have been generated with the final Tariff P0 implemented on April 10, 2018 will be compensated by April 10, 2018, when the definitive tariff is set.

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

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

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

- In May 2014, ARSESP issued Resolution No. 488/2014, which maintained the suspension of ARSESP Resolution No. 407/2013 until the outcome of the revision of the contract signed between us, the city of São Paulo and the State of the São Paulo is known, thereby delaying the authorization to pass on to our consumers' service bill the charge for the Municipal Fund for Environmental Sanitation and Infrastructure. We cannot be certain when the contract will be revised or when we will be able to pass the 7.5% charge on to consumers through the service bill.
- In December 2016, we concluded the first four-year revision of our contract with the city of São Paulo, which altered our service quality, investment and investment tracking targets. However, the issue of the 7.5% charge was not discussed.

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.

Despite not having a concrete date for the implementation of the new tariff structure, we are conducting a series of studies on a new structure that will be delivered to ARSESP. Considering the various alterations that this new structure could bring about for the consumer, we plan to implement it over one or more tariff cycles. To date, we cannot predict when we will be able to send our proposal to ARSESP or when implementation may start.

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

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

We established a new tariff schedule, effective May 2002, for commercial and industrial customers that consume at least 5,000 cubic meters of water per month and that enter into fixed demand agreements (take-or-pay) with us for at least one-year terms, with the aim of retaining these industrial and commercial customers. In October 2007, the minimum volume for entering into these agreements was reduced from 5.0 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 May 2016, we reinitiated the fixed demand requirement, and the volumes of those contracts were revised according to clients' new consumption profiles. We started 2016 with 528 formal contracts and, after revision of the charge and volume, ended the year with 466 contracts. 62 contracts were terminated because they did not meet the minimal amount required. Of the remaining 466 contracts, 10 were entered into in 2016. For more information about the water crisis, see "—The Recent 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 are equal to the water tariffs. In the majority of the municipalities of the interior region of the State of São Paulo, sewage tariffs are approximately 20.0% lower than water tariffs. Wholesale water rates are the same for all municipalities served. We also make available sewage treatment services to those municipalities in line with the applicable contracts and tariffs. In addition, various industrial customers pay an additional sewage charge, depending on the characteristics of the sewage they produce. Each category and class of customer pays tariffs according to the volume of water consumed. The tariff paid by a certain category and class of customer increases progressively according to the increase in the volume of water consumed. The first category (0-10) corresponds to the minimum fee that is charged to our customers for the consumption of water. The following table sets forth the water and sewage services tariffs by (i) customer category and class; and (ii) volume of water consumed, charged in cubic meters during the years and period stated in the São Paulo metropolitan region:

<b>Customer Category Consumption</b>	<b>As of May 12, 2016</b>	<b>As of June 4, 2015</b>	<b>As of December 27, 2014</b>
Residential		(reais per m <sup>3</sup> )	
Standard Residential:			
0–10 <sup>(1)</sup>	2,24	2.06	1.79
11–20	3,50	3.23	2.80
21–50	8,75	8.07	7.00
Above 50	9,64	8.89	7.71
Social:			
0–10 <sup>(1)</sup>	0,76	0.70	0.61
11–20	1,31	1.21	1.05
21–30	4,64	4.28	3.71
31–50	6,62	6.10	5.29
Above 50	7,31	6.74	5.85
Shantytown ( <i>favela</i> ):			
0–10 <sup>(1)</sup>	0,58	0.53	0.46
11–20	0,66	0.61	0.53
21–30	2,19	2.02	1.75
31–50	6,62	6.10	5.29
Above 50	7,31	6.74	5.85
Non-Residential			
Commercial/Industrial/Governmental:	4,50		
0–10 <sup>(1)</sup>	8,75	4.15	3.60
11–20	16,76	8.07	7.00
21–50	17,46	15.45	13.41
Above 50		16.10	13.97
Social Welfare Entities:			
0–10 <sup>(1)</sup>	2,25	2.07	1.80
11–20	4,37	4.03	3.50
21–50	8,42	7.76	6.73
Above 50	8,74	8.06	6.99
Government entities that employ the Rational Use of Water Program ( <i>Programa de Uso Racional da Água – PURA</i> ), with reduction agreement:			
0–10 <sup>(1)</sup>	3,37	3.11	2.70
11–20	6,55	6.04	5.24
21–50	12,61	11.63	10.09
Above 50	13,10	12.08	10.48

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

In 2016, 2015 and 2014, 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***

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, Law no. 13,312/2016 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;
- when a regulated service is to be provided by different service providers, those providers must execute an agreement regulating their respective activities; and
- the obligation to adopt environmental criteria that include, among other measures, individual management of water consumption per habitation unit.

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 No. 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.

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.

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).

### ***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.

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.

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.

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

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

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

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

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

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

For its services, ARSESP charges 0.50% of the annual total invoice from 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. 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.

### ***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. However, this discount rate could change with the ongoing second tariff revision. See “—Tariffs”.

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

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

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

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

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

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

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

As of December 31, 2016, we provided water and sewage services to 366 municipalities. The majority of these concessions have 30-year terms. Due to court orders, we temporarily suspended our services in two other municipalities (Macatuba and Cajobi). For more information, see "Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings". Between January 1, 2007 and December 31, 2016, we entered into agreements with 281 municipalities (including our services agreement with the city of São Paulo) in accordance with the Basic Sanitation Law, of which 3 were entered into in 2016. As of December 31, 2016, these 281 municipalities accounted for 80.3% 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, 2016, 54 of our agreements or concessions had expired but we continued to provide water and sewage services to these municipalities and were in negotiations to execute program agreements to substitute the expired concessions. From January 1, 2017 through 2030, 34 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, 2016. Despite these developments, we currently supply water on a wholesale basis to Mauá. In January 2016, the municipality of Mauá executed a Protocol of Intentions with us for the preparation of studies and evaluations aiming to resolve commercial relations and existing debts between the municipality and us. However, the negotiations with Mauá ended June 2016. 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 Jundiá (LCE No. 1,146/2011).

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 February 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 69.7% of our gross operating revenue in 2016 (excluding revenues relating to the construction of concession infrastructure) and including the formal agreement with the municipality of São Paulo. We cannot predict how the shared management of these operations will be carried out in the São Paulo metropolitan region and other metropolitan regions we operate in or what effect it may have on our business, financial condition or results of operations. See “Item 3.D. Risk Factors—Risks Relating to Our Business—Current regulatory uncertainty, especially with regard to implementation and interpretation of the Brazilian Basic Sanitation Law, may have an adverse effect on our business”.

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

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

On December 16, 1996, the Governor of the State of São Paulo issued a decree which approved the existing tariff system and allowed us to continue to set our own tariffs. 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
- 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 four municipalities (Piracaia, Mombuca, Santa Maria da Serra and Aguas de São Pedro). 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 Recent Water Crisis**

Prior to 2014, we planned our supply of water to the São Paulo metropolitan region based on the water supply during the driest period on record, which was from 1953 to 1954. However, water inflow to the Cantareira reservoirs throughout 2014 and most of 2015 was less than half the inflow recorded in 1953, the previous most critical year. Consequently, the volume of water stored in the reservoirs in 2014 and 2015 declined significantly until September 2015, when the reservoirs once again held more water than 12 months previously for the first time since the beginning of the water crisis. In the rainy season from October 2015 to March 2016 rainfall returned to historical averages and water levels in the reservoirs that provide water to the São Paulo metropolitan region, our largest market, increased. At December 31, 2016, the reservoirs in the São Paulo metropolitan region contained 1.2 trillion liters of bulk water storage for treatment, compared to 703 billion liters as of December 31, 2015, including the technical reserve. The average monthly water production in 2016 for the São Paulo metropolitan region was 58.5 cubic meters per second, or  $m^3/s$ , compared to 52.0  $m^3/s$  in 2015, 62.2  $m^3/s$  in 2014 and 69.1  $m^3/s$  in 2013, the year before the water crisis started.

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

Under normal conditions, this system supplies water to approximately 8.9 million people, with an average extraction of up to 33  $m^3/s$  to serve the São Paulo metropolitan region. An additional 5  $m^3/s$  may be released to serve the metropolitan region of Campinas and Jundiá, which 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 stream flow measurements in over 80 years. This drought persisted in the rainy season between October 2014 and March 2015. During the October 2015 – March 2016 and during the October 2016 – March 2017 rainy season, the level of rainfall in the region returned to the normal levels expected for the period and water inflow levels consequently improved.

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

	For the month of											
	Oct.	Nov.	Dec.	Jan.	Feb.	March	April	May	June	July	Aug.	Sep.
<b>Water Inflow</b>	<i>(in m<sup>3</sup>/s)</i>											
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	25.0	62.9	19.4	19.3	14.9
2016/17	24.2	29.5	30.2	76.0	36.4	36.9	24.3					

As a result of the drought and low water volume in the Cantareira System, DAEE and ANA have regulated the volume of water we are permitted to extract from this system since March 2014. The DAEE and ANA determine this amount based on levels of rainfall, water inflow, level of water in our reservoirs and the requests we make to extract water. Based on this information, the DAEE and ANA inform us from time to time of the amount we are permitted to extract. In February 2016, after average rainfall levels had returned, we received an authorization to extract 23 m<sup>3</sup>/s from the Cantareira System, which was an increase compared to the 13.5 m<sup>3</sup>/s we were authorized to extract for the majority of 2015, although still significantly less than the 33 m<sup>3</sup>/s in effect prior to February 2014. Subsequently, we were authorized to extract 25 m<sup>3</sup>/s from September to November 2016, and 31 m<sup>3</sup>/s from December 2016 to May 2017.

The following table shows the volume of water stored in the systems that serve the São Paulo metropolitan region as of December 2014, March 2015, December 2015, March 2016, December 2016 and March 2017 at the end of the rainy season:

	For the month						Total Storage Capacity
	March 2017	December 2016	March 2016	December 2015	March 2015	December 2014	
	<i>(in millions of m<sup>3</sup>)</i>						
Cantareira	931.96	740.06	641.90	290.69	186.74	71.18	1,269.5*
Guarapiranga	135.40	123.62	150.01	147.12	145.81	69.57	171.19
Rio Grande	98.95	99.31	108.41	106.18	109.34	80.94	112.18
Rio Claro	13.98	11.30	14.02	9.71	5.96	4.51	13.67
Alto Tietê	314.60	248.08	247.94	135.55	130.91	69.63	573.81
Cotia	16.39	16.20	16.53	14.20	10.75	5.20	16.50

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

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

- use of treated water from other production systems to serve consumers originally supplied by the Cantareira system;
- implementation of a bonus program and contingency tariff;
- reduction of pressure in pipes in order to decrease leakage;



- adjustment to the volume of treated water sold to municipalities that operate their own distribution network, due to the reduced availability of water; and
- extraction of water from the technical reserve.

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

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

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

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

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

The Guarapiranga System, with a storage capacity of 171 billion liters, maintained favorable levels of water availability for the duration of the drought and was the system that supplied most water during the water crisis, serving an additional 1.4 million people in the south and southeast regions of the city of São Paulo who had previously been served by the Cantareira System. As a result, the number of people served by the Guarapiranga System increased from 3.8 million before the water crisis to 5.2 million during the crisis. As of December 31, 2016, the Guarapiranga System served a population of 4.0 million people.

Throughout 2014 and 2015, with the adoption of these measures, almost three million people who used to be served by the Cantareira System began to be served by other systems. As of December 31, 2016, the Cantareira System served 7.6 million people, compared to 8.9 million people before the drought.

#### Bonus Program

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

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

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

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

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

On March 24, 2016, with the return of historical average rainfall and increased predictability of reservoir levels, we applied to ARSESP for cancellation our Water Consumption Reduction Incentive Program. ARSESP approved this request on March 31, 2016, with effect on water meter readings recorded as of May 1, 2016. There have been no further updates since that date.

#### Contingency tariff

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

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

On March 24, 2016, with the return of historical average rainfall and increased predictability of reservoir levels, we applied to ARSESP for cancellation of the Contingency Tariff. ARSESP approved this request on March 31, 2016, with effect on water meter readings recorded as of May 1, 2016. There have been no further updates since that date.

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

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

Due to the severity of the recent 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, mitigating any effects on water supply.

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

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

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

### Extracting Water from the Technical Reserve

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

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

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

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

By the end of the decade, our production of treated water is expected to expand by 8.6 m<sup>3</sup>/s with the completion of the São Lourenço Project. In addition, we expect an additional 13 m<sup>3</sup>/s to be available to our reservoirs through interconnections to other reservoirs in the state of São Paulo, which will be available to us if reservoirs levels once again become low. Completion of these projects will result in improved water security for the SIM.

The main projects include:

- Alto Tietê System – transfer of an additional 1 m<sup>3</sup>/s from the Guaió River to the Taiacupeva reservoir, in order to recover the reserve volume of the Alto Tietê System. This project was concluded in June 2015.
- Alto Tietê System – transfer of additional up to 4.0 m<sup>3</sup>/s from Rio Grande - Billings reservoirs to the Alto Tietê System. This project was concluded in September 2015.
- Guarapiranga System – transfer of an additional 1 m<sup>3</sup>/s of which results from the expansion of the transfer capacity of the Billings reservoir to the Guarapiranga reservoir. This project was concluded in December 2015.
- Interconnection of the Jaguari (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 increase water availability in the Cantareira System by 5.13 m<sup>3</sup>/s (annual average) to 8.5 m<sup>3</sup>/s (maximum) by transferring water from the Jaguari reservoir to the Atibainha reservoir. Construction of the interconnection began in February 2016 and is expected to be completed in 2017. For more information, see “—History and Development of the Company—Capital Expenditures Program”.
- Alto Tietê System – transfer of an additional average 1.9 m<sup>3</sup>/s and up to 2.5 m<sup>3</sup>/s from the Itapanhaú river to the Biritiba reservoir, providing more volume to the Alto Tietê System. This project is currently under development and is expected to be concluded in 2018.
- Guarapiranga System – transfer of an additional 1 m<sup>3</sup>/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.
- Implementation of the São Lourenço Production System – this project was commenced in April 2014 and is expected to enter operations in 2018. This system will have an average water treatment capacity of 6.4 m<sup>3</sup>/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, 2016, we were the concessionaire for the provision of water supply and collection, treatment and disposal of sewage services directly to end consumers for 366 municipalities in 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, 2016, we used approximately 1.73% 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 2016, we purchased approximately 49% of our total energy consumption in the "free market," where we can more efficiently negotiate the supply of energy; and the remainder of our energy consumption comes from the Regulated Market. Most of the energy produced in Brazil comes from hydroelectric power plants.

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

### **Insurance**

We maintain insurance covering, among other things, fire or other damage to our property and office buildings and third-party liability. We also maintain insurance coverage for directors' and officers' liability (D&O insurance). We currently obtain our insurance policies by means of public bids involving major Brazilian and international insurance companies that operate in Brazil. As of December 31, 2016, we had paid a total aggregate amount of R\$5.2million in premiums. In addition, we paid R\$1.6million for a D&O insurance policy, covering R\$4.1billion 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 (“Sabesp”) at the Brazilian Institute of Industrial Property (*Instituto Nacional da Propriedade Industrial*), or INPI. In addition, we have registered with the INPI several other trademarks, such as: “Sabesp Soluções Ambientais”, “Projeto Tietê”, “Programa Córrego Limpo”, “Programa Onda Limpa”, “Prol – Programa de Reciclagem do Óleo de Fritura”, “Revista DAE”, “Ligação Sabesp”, “Agente da Gente – Sabesp na Comunidade”, “PURA – Programa de Uso Racional da Água”, “Sabesp Inteligência Ambiental”, “Reúso de Água”, “Uso Racional da Água”, “Parque da Integração”, “Sabesp Semana do Meio Ambiente”, “Água Sabesp Aquífero Guarani”, “Água Sabesp Estação Cantareira”, “Contrato de Fidelização Sabesp”, “Esgoto não Domésticos Sabesp”, “PEA – Programa de Educação Ambiental – Sabesp”, “Sabesp Abraço Verde”, “Água de Reúso Sabesp”, “Eu Sou Guardião das Águas Sabesp Eu Não Desperdiço” and “Clubinho Sabesp”, which is a tool for environmental education directed to children through our website, and of its characters: “SuperH2O”, “Gota Borradeira”, “Gotucho”, “Ratantan”, “Dr. Gastão”, “Cauã”, “Denis”, “Gabi”, “Iara”, “Sayuri”, and “Cadu”.

We have also filed applications with the INPI for registration of the following trademarks: “Programa de Recuperação Ambiental”, “Signos Sistema de Informação Geográfica no Saneamento”, “Signos Net Sistema de Informação Geográfica no Saneamento”, “Scorpion”, “Ecoposto Sabesp”, “Calculadora de Sonhos”, “Acertando suas contas com a Sabesp”, “Parque Sabesp Mooca”, “Parque Sabesp Butantã”, “Parque Sabesp Cangaíba”, and “Sistema de Suporte a Decisões Sabesp”.

### Patents

We have a patent granted by the Instituto Nacional de Propriedade Industrial, or “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;
- rotary devices used to clean water reservoirs transported by trucks with high-pressure hydrojetting systems;
- a digital leakage detection system;
- a chemical composition sensor, its fabrication process and use to measure pH in microfluid systems; and
- a bubble removal system, autonomous microlaboratory and use of autonomous microlaboratory to monitor water quality.

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 de 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", "Painel de Bordo", "COP - Online Control of Water Losses", "Sistema de Gestão de Energia Elétrica – GEL", "CADGEO", "LIGGEO", "Sistema de Gestão de Propriedade Intelectual" and "SOE – Sistema de Organização Empresarial".

Among them, we highlight:

- 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.
- CADGEO and LIGGEO are computer programs used to locate the water and sewage infrastructure in times of installation, maintenance or expansion in real time via satellite.

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

## **Domain Names**

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

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

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

## Environmental Matters

Our environmental management, which is guided by the directives established in our environmental policy, is inherent to the provision of our services and the essence of our business. In order to consolidate our environmental culture, we 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 nine 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;
- 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 legislations 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;
- the progressive implementation and maintenance of the Environmental Management System (EMS) in our water and sewage treatment stations. The EMS is currently in place in 129 treatment stations, 35 of which are ISO 14001 certified. There are perspectives of implementing the EMS in all stations by 2024, whereby the scope of 14001 certification may be expanded according to the strategy of the Business Units, which scope is evaluated annually by means of external audits. Since 2015, we have been working on the EMS with a mixed model, whereby the ISO 14001 standard is applied to the certified scope, while the other stations adopt their own environmental management model (named SGA-SABESP); and
- in the development of our activities related to the execution of works and interventions, we go through a process of obtaining permits and environmental licenses, according to the current legislation. As a result of these processes, we undertake environmental compensation commitments. In order to meet our current and future obligations, we developed and are implementing a program that includes the planting and the maintenance of 1 million seedlings in the next ten years. The work has already started and is included within the context of the "Programa Nascentes" of the Government of the State of São Paulo. Currently, 213 thousand seedlings in the metropolitan region of São Paulo are being planted, with the prospect to hire immediately 100 thousand more seedlings in the interior region of the state of São Paulo. We also plan to plant further 300 thousand seedlings in the short and medium term also as part of the "Programa Nascentes".

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 2016, we invested R\$21.0 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 environmental initiatives with a local scope executed by our Business Units.

Other investments and expenses associated with environmental protection are included in the total value of operational expenses and investments mentioned in this annual report, due to the direct relationship of our environmental activities with our overall purpose. For example, we have made, among others, significant investment in sewage, effluent monitoring, payment for the use of water in federal and state water bodies, maintenance of reserves in protected areas, environmental education actions.

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

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

The São Paulo State Climate Change Policy (Law No. 13,798/2009), enacted on November 9, 2009, and regulated by Decree No. 55,947 of June 24, 2010, aims to reduce global emissions of carbon dioxide by 20.0% by 2020 compared with 2005 levels. Brazil's Climate Change Policy (Law No. 12,187/2009), enacted on December 29, 2009 and regulated by Decree No. 7.390/2010 establishes a voluntary national commitment to reduce Brazil's currently projected GHG emissions for 2020 by a percentage between 36.1% and 38.9%. Such targets have not been established for the sanitation sector yet. In this sense we 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 2016, we concluded the corporate inventory of greenhouse gases for 2015, thus totaling nine 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 85% of total greenhouse gas release. Electric energy represents approximately 12% and other activities represent approximately 3%.

We have projects in the research and development stages that entail using biogas generated in the treatment of sewage and recycling sewage sludge as a possible way to reduce the gases released in the treatment processes. 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 consumers. See “—Tariffs”.

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

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

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



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

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

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

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

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

### ***Public Bidding Procedures***

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

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

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

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

### *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.

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 2016, we paid approximately R\$43.0 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, Baixo Tietê, Médio Tietê and Baixada Santista basins. In 2014, charges were implemented for the use of water from the Alto Tietê River Basin, and in 2016, from the Tietê / Batalha, Tietê / Jacaré and Ribeira de Iguape River Basins. It is probable that the same will occur in 2017 and 2018 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; Complementary Law No. 140/2011 CONAMA Resolution No. 237/1997, which regulates (i) environmental licenses; (ii) federal, state and local jurisdiction over environmental issues; (iii) the list of activities subject to licensing; and (iv) environmental impact studies and reports; State Decree No. 47,400/2002 and related articles from State Law No. 9,509/1997 regarding environmental licensing; State Decree No. 8,468/1976, CONAMA Resolution No. 357/2005, which establish standards of quality for receiving bodies of water; State Decree No. 8,468/1976 and CONAMA Resolution No. 430/2011 which establish the standards for discharge of effluents; and DAEE Ordinance No. 717/1996, which regulates the concession of grants for the right to use water and rights to interfere in water resources.

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, sewage treatment stations and sewage pumping stations in order to comply with environmental regulations.

#### *Sewage Requirements*

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

The CETESB is authorized under State law to monitor discharges of effluents into the water bodies, among other things. The CETESB also issues the environmental licenses to the polluting sources, including sewage treatment 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 29, 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:

- 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, 2016, we operated through 73,015 kilometers of water pipes and water transmission lines and 50,097 kilometers of sewer lines. As of the same date, we operated 237 water treatment facilities and 548 sewage treatment facilities (including nine ocean outfalls), as well as 16 water quality control laboratories.

As of December 31, 2016, the total net book value of our property, plant and equipment and intangible assets (including concession assets) was R\$31,549.2 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, 2016, 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 366 municipalities, or 57% of all municipalities in the state. We also provided water services on a wholesale basis to five municipalities located in the São Paulo metropolitan region in which we did not operate water distribution systems.

The São Paulo metropolitan region, which includes the city of São Paulo, is our most important service region. With a total population of approximately 20.6 million, the São Paulo metropolitan region accounted for 69.7%, 67.3% and 70.0% of our gross operating revenue in 2016, 2015 and 2014 (excluding revenues relating to the construction of concession infrastructure), respectively. As of December 31, 2016, 63.1% 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.

In 2015, our business was significantly affected by the most severe drought recorded in our service area in over 80 years. During the rainy season that began in October 2015 and ended in March 2016, rainfall returned to its historical average, resulting in the level of water in the reservoirs that provide water to the population of the São Paulo metropolitan region returned to normal and the measures taken during the water crisis to continue to services consumers were gradually discontinued. However, heightened public awareness of the need to conserve water during the crisis resulted in our customers adopting lower water consumption practices during the water crisis and these practices have been partially integrated into our consumers' daily habits. Another probable factor of the reduction of consumption during 2016 is the contraction of the Brazilian economy, which may have resulted in lower consumption of water by industry and other businesses. As a result of this new behavior, despite our reservoirs having a higher volume of water available for treatment, the volume of water billed to our clients has not returned to the 2013 pre-water crisis levels.

### **Effects of Tariff Increases**

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

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

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

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

	Year ended December 31,		
	2016	2015	2014
Increase in average tariff <sup>(1)</sup>	8.45%	15.24%	6.50%
Inflation – IPC – FIPE	6.54%	11.07%	5.20%
Inflation – IPCA	6.29%	10.67%	6.41%
Inflation – IGP–M	7.17%	10.54%	3.69%

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

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

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

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

#### *General Economic Conditions*

In 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 was 6.8%, 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. The average unemployment rate in Brazil was 8.5%.

In 2016, Brazilian GDP decreased 3.6% in comparison with 2015. Brazil’s trade surplus in 2016 was US\$47.7 billion, the highest surplus recorded since the start of the historical series in 1989 and at year-end the country had US\$372.2 billion in currency reserves. The average unemployment rate in Brazil in 2016 was 11.5%, the highest rate in 13 years, 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 11.65% at December 31, 2014 and increased to 14.15% at December 31, 2015. The SELIC rate increased to 13.65% at December 31, 2016.

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\$5,660.4 million as of December 31, 2016, of which R\$366.7 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 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. In 2016, the 16.54% appreciation of the *real* against the U.S. dollar and the 13.89% appreciation of the *real* against the yen led to a foreign exchange gain of R\$1,090.5 million. However, since most of our debt denominated in foreign currencies is long-term debt with a long amortization schedule, a devaluation of the *real* would principally impact cash flows regarding the current portion of our long-term debt.

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

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

	Year ended December 31,		
	2016	2015	2014
	<i>(in reais, except percentages)</i>		
Depreciation (appreciation) of the <i>real</i> versus U.S. dollar <sup>(1)</sup>	(16.54)%	47.0%	13.4%
Period-end exchange rate – US\$1.00	3.2591	3.9048	2.6562
Average exchange rate – US\$1.00 <sup>(2)</sup>	3.3523	3.3387	2.3547

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

(2) Represents the average for period indicated.

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

	Year ended December 31,		
	2016	2015	2014
	<i>(in reais, except percentages)</i>		
Depreciation (appreciation) of the <i>real</i> versus yen <sup>(1)</sup>	(13.89)%	46.0%	(0.45)%
Period-end exchange rate – ¥1.00	0.0279	0.0324	0.0222
Average exchange rate – ¥1.0 <sup>(2)</sup>	0.0289	0.0276	0.0222

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

(2) Represents the average for period indicated.



During the years ended December 31, 2016, 2015 and 2014 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 more than 80 years of recorded rainfall in the region, a scenario that continued in the October 2014 – March 2015 rainy season. During the October 2015 – March 2016 rainy season, the level of rainfall in the region returned to the normal levels expected for the period. Improved rainfall in the rainy season that began in October 2015, the collaborative efforts between us and the population we serve and emergency construction works conducted by us throughout 2014 and 2015 to combat the water crisis, resulted in a partial restoration of the water levels of the Cantareira system.

As of December 31, 2016, the reservoirs in the São Paulo metropolitan region, where our largest market is located, contained 1.2 trillion liters of bulk water storage for treatment, compared to 703 billion liters available for treatment as of December 31, 2015, including the technical reserve. In December 2016, this system served 7.6 million residents, compared to 8.9 million in February 2014, the last month before the water crisis started.

In order to balance supply and demand despite restricted water availability, we adopted from February 2014 until April 2016 a series of measures. With the return of the rainfall to its historical average for the rainy season that began in October 2015 and ended in March 2016, the level of water in the reservoirs that provide water to the population of the São Paulo metropolitan region returned to normal and the measures taken during the water crisis to continue to services consumers were gradually discontinued. See “Item 4.B. Business Overview—The Recent 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 establish an allowance for doubtful accounts in an amount that our management considers sufficient to cover expected losses, based on an analysis of customer accounts receivable, in accordance with the accounting policy stated in Note 3.4 to our financial statements as of December 31, 2016 and 2015 and for the years ended December 31, 2016, 2015 and 2014. Bad debt expense, net of recoveries, is included in selling expenses, and was R\$90.5 million, R\$2.4 million and R\$139.6 million for the years ended December 31, 2016, 2015 and 2014, respectively. Wholesale sales losses, amounting to R\$328.7 million, R\$273.0 million and R\$219.7 million million in 2016, 2015 and 2014, respectively, were also recorded as a reduction of revenue.

The methodology for determining the allowance for doubtful accounts requires significant estimates, considering a number of factors, including historical collection experience, current economic trends, estimates of forecast write-offs, the aging of the accounts receivable portfolio and other factors. Actual results could differ from those estimates.

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

As of December 31, 2016, we had intangible assets of R\$31,246.8 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 Revenue” to our financial statements.

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

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

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

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

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

We are a party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among other types, disputes with customers and suppliers and tax, labor, civil, environmental and other proceedings. For a more detailed discussion of these legal proceedings, see Note 19 to our financial statements included in this annual report. We recognize provisions for legal proceedings in which our company has a present obligation as a result of past events (either due to an explicit agreement or duty, known as a legal obligation; or due to our past actions, known as a constructive obligation), it is probable that an outflow of resources embodying economic benefits will be necessary to settle the obligation and the amount of obligation can be estimated reliably. Therefore, we are required to make judgments regarding future events for which we often seek the advice of legal counsel. As a result of the significant judgment required in assessing and estimating these provisions, actual losses realized in future periods could differ significantly from our estimates and could exceed the amounts which we have provisioned.

As of December 31, 2016, we were party to judicial and administrative proceedings, relating to civil, environmental and tax matters, amounting to R\$1,173.1 million (after deducting court escrow deposits in the amount of R\$368.5 million) with respect to which we recognized provisions based on the criteria described above, as shown in Note 3.15 to our financial statements included in this annual report. As of the same date, the proceedings with respect to which we have contingent liabilities (i.e., no provisions have been recognized) totaled R\$52,865.6 million, of which we believe R\$45,433.5 million of those have a remote probability of an outflow of resources embodying economic benefits exists.

## ***Pension Benefits***

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

We determine the appropriate discount rates at the end of each year, which is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. The discount rate was decreased from 7.25% in 2015 to 5.71% in 2016 under Plan G0 and from 7.23% in 2015 to 5.74% in 2016 under Plan G1 in order to follow the decrease in the rates applicable to the Brazilian Government NTN – B, long term notes, which term is similar to the duration of the pension benefits, as described in Notes 3.19 (a) and 20 (b) to our financial statements included in this annual report.

Other key assumptions for pension obligations are based in part on current market conditions. Additional information on the pension plans under Plan G0 and G1 is disclosed in Note 20 to our financial statements included in this annual report.

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

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

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

As of December 31, 2016 and 2015, we have recognized R\$186.3 million and R\$128.2 million, respectively, as deferred income tax assets, net of the deferred tax liabilities, as disclosed in Note 18 to our financial statements included in this annual report.

## **Certain Transactions with Controlling Shareholder**

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

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

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

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

As of December 31, 2016 and 2015, the amounts not recognized related to pension benefits paid by us on behalf of the State totaled R\$937.0 million and R\$855.1 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, 2016 and 2015, the pension benefit obligations of Plan G0 totaled R\$2,512.1 million and R\$2,167.0 million, respectively. For detailed information on the pension benefit obligations refer to Note 20 to our financial statements included in this annual report.

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

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

### *Use of Guarapiranga and Billings reservoirs*

We draw water for use in the São Paulo metropolitan area from the Guarapiranga and Billings reservoirs. Empresa Metropolitana de Águas e Energia S.A., or EMAE, a company that is also controlled by the State of São Paulo, has a concession to produce hydroelectric energy using water from the same reservoirs. EMAE commenced various lawsuits against us in the past seeking compensation for the water we draw from these reservoirs. Those lawsuits have now been settled in principle, by way of an agreement between EMAE and our company. That settlement agreement cannot take effect, however, until it has been approved by our company, EMAE and ANEEL. It has already been approved by our company, and was approved by ANEEL on December 30, 2016; but it must still be approved by EMAE’s shareholders in a shareholders’ meeting. The settlement agreement, if approved, will require us to make certain installment payments to EMAE in settlement of the claim for compensation for our capture and use of the water, as well as apportionment of the maintenance, operation and monitoring costs for the reservoirs. See “Item 7. Major Shareholders and Related Party Transactions” and See Note 10(c) to our financial statements included in this annual report.

### **Results of Operations**

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

	Year ended December 31,					
	2016		2015		2014	
	<i>(in millions of reais, except percentages)</i>					
Net operating revenue	14,098.2	100.0%	11,711.6	100.0%	11,213.2	100.0%
Cost of services	(9,013.1)	(63.9)%	(8,260.8)	(70.5)%	(7,635.6)	(68.1)%
Gross profit	5,085.1	36.1%	3,450.8	29.5%	3,577.6	31.9%
Selling expenses	(730.0)	(5.2)%	(598.1)	(5.1)%	(736.6)	(6.6)%
Administrative income (expenses)	(934.9)	(6.6)%	45.0	0.4%	(924.4)	(8.2)%
Other operating income (expenses), net and equity in results of investments in affiliates	9.5	0.1%	146.4	1.3%	(5.9)	(0.1)%
Profit from operations before finance income (expenses) and income tax and social contribution	3,429.7	24.3%	3,044.1	26.0%	1,910.7	17.0%
Financial income (expenses), net	699.4	5.0%	(2,456.5)	(21.0)%	(635.9)	(5.7)%
Profit before income tax and social contribution	4,129.1	29.3%	587.6	5.0%	1,274.8	11.4%
Income tax and social contribution	(1,182.0)	(8.4)%	(51.3)	(0.4)%	(371.9)	(3.3)%
Profit for the year	2,947.1	20.9%	536.3	4.6%	903.0	8.1%

### *Year Ended December 31, 2016 Compared to Year Ended December 31, 2015*

#### *Net operating revenue*

Net operating revenue increased by R\$2,386.6 million, or 20.4%, to R\$14,098.2 million in 2016 from R\$11,711.6 million in 2015. These variations were principally due to:

- an increase of 15.2% in tariffs since June 2015 (7.8% ordinary tariff adjustment and 6.9% extraordinary tariff revision);
- an increase of 8.4% in tariffs since May 2016;
- an increase of 4.4% in our total billed volume (4.0% in water and 4.8% in sewage); and
- a reduction in the bonus granted within the Water Consumption Reduction Incentive Program, concluded in April 2016, which amounted to R\$187.4 million in 2016 compared to the R\$926.1 million granted in 2015.

These increases were partially offset by the suspension of the Contingency Tariff in April 2016, in the amount of R\$224.7 million in 2016 compared to the R\$499.7 million in 2015.

Construction revenue increased by R\$396.2 million, or 11.9%, to R\$3,732.9 million in 2016 from R\$3,336.7 million in 2015. See Note 3.3(b) to our financial statements included in this annual report for a description of the accounting policies applicable to our construction services business.

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

Our cost of services increased by R\$752.3 million, or 9.1%, to R\$9,013.1 million in 2016 from R\$8,260.8 million in 2015. As a percentage of net operating revenue, cost of services decreased to 63.9% in 2016 from 70.5% in 2015.

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

- an increase of R\$387.6 million in construction costs due to higher investments in 2016;
- an increase of R\$117.3 million in the cost of the electricity, mainly due to an average increase of 15.4% in the free market tariffs, with an 2.3% increase in consumption; an average increase of 21.5% in the Tariff for the Use of Distribution System (TUSD), with a 5.0% increase in consumption; and an average increase of 1.5% in the regulated market tariffs, with consumption remaining stable;
- an increase in the provision for the Municipal Fund for Environmental Sanitation and Infrastructure, in the amount of R\$101.1 million, as a result of the increase in revenues generated from the municipality of São Paulo; and
- an increase of R\$72.0 million in depreciation and amortization, mainly due to the increase in operating intangible assets in 2016, arising principally from entry into operation of new assets.

### ***Gross Profit***

As a result of the factors discussed above, gross profit for the year ended December 31, 2016 increased by R\$1,634.3 million, or 47.4%, to R\$5,085.1 million in 2016 from R\$3,450.8 million in 2015. As a percentage of net operating revenue, gross profit margin increased to 36.1% in 2016 from 29.5% in 2015.

### ***Selling Expenses***

Selling expenses increased by R\$131.9 million, or 22.1%, to R\$730.0 in 2016 from R\$598.1 million in 2015. As a percentage of net operating revenue, selling expenses increased slightly to 5.2% in 2016 from 5.1% in 2015. The increase in selling expenses was primarily due to:

- an increase of R\$88.0 million, mainly resulting from (i) increase in default, causing a R\$165.4 million impact, and (ii) lower recovery of funds, in the amount of R\$34.5 million. This increase was partially offset by increased receipts of court-ordered debt payments, especially from the municipality of Guarulhos, amounting to R\$110.9 million;

- an increase of R\$30.9 million in services expenses, due to the increase in the scope of water meter readings and increased use of credit recovery services in 2016.

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

Administrative expenses increased by R\$979.9 million, to an expense of R\$934.9 million in 2016 from income of R\$45.0 million in 2015. As a percentage of net operating revenue, administrative expenses amounted to 6.6% in 2016.

The increase in administrative expenses was principally due to:

- a credit in the amount of R\$696.3 million received in 2015 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 included in this annual report and;
- an increase of R\$278.4 million in general expenses, mainly due to increased provisions for court proceedings in 2016 and provision reversals in 2015, resulting from judicial decisions.

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

Other operating income, net was R\$9.5 million in 2016 compared with R\$146.4 million operating expenses, net in 2015.

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

Our other operating income decreased by R\$128.3 million, mainly due to: (i) decrease in gain in sale of properties (R\$47.4 million); (ii) decrease in sales of the exceeding cost of electricity (R\$42.8 million); (iii) lower amounts received from the Hydrographic Basin Depollution Program (R\$22.6 million); and (iv) lower amounts received related to contractual fines on suppliers (R\$16.8 million).

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

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

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

Financial income (expenses), net increased by R\$3,155.9 million to financial income, net of R\$699.4 million in 2016 from financial expense, net of R\$2,456.5 million in 2015. As a percentage of net operating revenues, financial income amounted to 5.0% in 2016 compared with financial expenses amounting to 21.0% in 2015. The variation was due to:

- a positive variation of R\$3,082.9 million in the cost of currency variations on borrowings and financing, due to the strengthening of the *real* against the U.S. dollar and the Japanese Yen in 2016 (16.5% and 13.9%, respectively), when compared to the devaluation of the *real* in 2015 (47.0% and 45.9%, respectively); and

- an increase in the cost of other monetary variations by R\$65.2 million, principally due to higher provisioning for court proceedings in 2016.

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

As a result of the factors discussed above, profit before income tax and social contribution increased by R\$3,541.5 million, to R\$4,129.1 million in 2016 from R\$587.6 million in 2015. As a percentage of net operating revenue, our profit before income tax and social contribution increased to 29.3% in 2016 compared to 5.0% in 2015.

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

Income tax and social contribution expense increased by R\$1,130.7 million to R\$1,182.0 million in 2016 from R\$51.3 million in 2015. This increase was mainly due to the upturn in our operating revenues and our financial income, net, which was impacted by the exchange rate variation. These increases were partially offset by the increases in our operating costs and expenses. Additionally, the effective tax rate increased from 9% in 2015 to 29% in 2016, mainly due to the agreement entered into with the State of São Paulo on March 18, 2015, which was considered a non-taxable income (see reconciliation of the effective tax rate in Note 18(d) to our financial statements included in this annual report.

#### ***Profit for the year***

As a result of the factors discussed above, our profit for the year increased to R\$2,947.1 million in 2016 from R\$536.3 million in 2015. As a percentage of net operating revenue, our profit for the year increased to 20.9% in 2016 from 4.6% in 2015.

We assess the performance of our enterprise by analyzing the results of the sanitation services provided, our single reportable segment that includes all our operations results except for revenue and costs associated with the construction of concession services infrastructure, recognized in accordance with IFRIC 12 and as discussed in “Item 4.B. Business Overview—Our Operations—Description of Our Activities”. Consequently, management discussion and analysis of the performance of the sanitation services segment is substantially the same as our results discussed above.

#### ***Year Ended December 31, 2015 Compared to Year Ended December 31, 2014***

##### ***Net operating revenue***

Net operating revenue 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 revenue 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 revenue 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:

- 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, 2016 and 2015 and for the years ended December 31, 2016, 2015 and 2014 for a description of the accounting policies applicable to our construction services business.

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

The cost of 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 revenue, cost of services increased to 70.5% in 2015 from 68.1% in 2014.

The increase in costs of 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 revenue, gross profit margin 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 revenue, 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 4.B. Business Overview—Our Operations—Description of Our Activities—Wholesale Operations” and “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 Income (Expenses)***

Administrative expenses decreased by R\$969.4 million, or 104.9%, to income of R\$45.0 million in 2015 from an expense of R\$924.4 million in 2014. As a percentage of net operating revenue, 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 and Equity in Results of Investments in Affiliates***

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 revenue, 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 revenue, 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***

Income tax and social contribution expense 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.

### ***Profit for the year***

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

## **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, 2016, we had R\$1,886.2 million of cash and cash equivalents. The outstanding current portion of our long-term indebtedness was R\$1,246.6 million as of December 31, 2016, of which R\$366.7 million was denominated in foreign currency. Long-term indebtedness was R\$10,717.6 million as of December 31, 2016, of which R\$5,293.7 million consisted of foreign currency-denominated obligations.

As a result of the financial impacts of the 2014-2015 water shortage to date, we took 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 (suspended in April 2016), and requesting extraordinary tariff revision. For more information, see Note 1 of our 2016 financial statements.

Our management expects that the cash and cash equivalents available on December 31, 2016, the operating cash generation estimated for 2017 and the lines of credit available for investments are sufficient to meet our short-term liabilities, in light of our current financial position and our expected cash generated by operating activities. In our opinion, the working capital is sufficient for the company's present requirements.

## **Cash Flows**

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

Cash generated from operating activities is the single largest source of our liquidity and capital resources, and we expect that it will continue to be so in the future. Our net cash generated from operating activities was R\$3,003.6 million, R\$2,641.4 million and R\$2,480.3 million in 2016, 2015 and 2014, respectively. The main driver of our cash flow from operating activities relates to our cash collections from customers, which is due to the nature of our business and to the fact that we are expanding our infrastructure. The increase in net cash generated in 2016 is due principally to the end of the water crisis, which led to an increase of 4.4% in our total billed volume (4.0% in water and 4.8% in sewage). This increase was partially offset by the income tax and social contribution paid in 2016.

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

Net cash used in investing activities was R\$2,130.7 million, R\$2,459.5 million and R\$2,757.7 million in 2016, 2015 and 2014, respectively. The main driver of our net cash outflow for investing activities relates to purchases of intangible assets, as required under our concession and program contracts, which is due to the fact that we are expanding our infrastructure and service coverage. Although we invested approximately R\$1.3 billion (including capitalized interest) in the São Lourenço PPP, a construction project planned and initiated before the water crisis, this project did not impact our cash flow in 2016.

### ***Net Cash Generated By (Used in) Financing Activities***

Our net cash used in financing activities was R\$625.9 million in 2016 and R\$265.7 million in 2015, while our net cash generated by financing activities was R\$218.5 million in 2014. The main driver of our cash flows from financing activities relates to the proceeds and repayments of loans used to finance purchases of intangible assets related to our concession and program contracts, in order to support the expansion of our services and our payment of interest on shareholders' equity.

### ***Indebtedness Financing***

Our total financial indebtedness decreased by 8.8%, from R\$13,121.6 million as of December 31, 2015 to R\$11,964.1 million as of December 31, 2016. In addition, during the same period, our total indebtedness denominated in foreign currency decreased by 14.5%, from R\$6,617.8 million as of December 31, 2015 to R\$5,660.4 million as of December 31, 2016.

As of December 31, 2016, we had R\$10,717.6 million in long-term indebtedness outstanding (excluding the current portion of long-term indebtedness), of which R\$5,293.7 million consisted of foreign currency-denominated long-term debt. We had an outstanding current portion of long-term indebtedness of R\$1,246.6 million as of December 31, 2016. As of December 31, 2016, R\$366.7 million of this current portion of long-term indebtedness was denominated in foreign currency. As of December 31, 2016, our Standard & Poor's Rating Service domestic rating was brA+ and our S&P international rating was BB. Our Moody's America Latina Ltda. national rating was Aa2br and our Moody's global rating was Ba2 as of December 31, 2016, while our Fitch Ratings Brasil Ltda nacional rating was AA-(bra) and our Fitch internacional rating was BB, as of the same date.

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

Pursuant to these agreements, cash received from operations is required to pass through designated accounts. In the event of a default under the relevant agreement, such cash and future cash flows that are required to be deposited in such accounts become restricted and are subject to security interests in favor of the relevant creditor. As of December 31, 2016, 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\$3,690.2 million. See “—Indebtedness Financing—Financial Covenants—Local currency denominated indebtedness” and note 16 to our financial statements included in this annual report.

The following table sets forth information on our indebtedness outstanding as of December 31, 2016:

	December 31, 2016			Final Maturity*
	Current	Noncurrent	Total	
<b>Denominated in local currency:</b>				
10 <sup>th</sup> issue debentures	40,967	120,343	161,310	2020 TJLP + 1.92% (1 <sup>st</sup> & 3 <sup>rd</sup> series) & IPCA + 9.53% (2 <sup>nd</sup> series)
12 <sup>th</sup> issue debentures	45,450	340,165	385,615	2025 TR + 9.5%
14 <sup>th</sup> issue debentures	39,802	178,571	218,373	2022 TJLP + 1.92% (1 <sup>st</sup> & 3 <sup>rd</sup> series) & IPCA + 9.19% (2 <sup>nd</sup> series)
15 <sup>th</sup> issue debentures	97,692	672,657	770,349	2019 CDI + 0.99% (1 <sup>st</sup> series) & IPCA + 6.2% (2 <sup>nd</sup> series)
17 <sup>th</sup> issue debentures	140,144	904,094	1,044,238	2023 CDI + 0.75% (1 <sup>st</sup> series) & IPCA + 4.5% (2 <sup>nd</sup> series) & IPCA + 4.75% (3 <sup>rd</sup> series)
18 <sup>th</sup> issue debentures	32,436	223,840	256,276	2024 TJLP + 1.92% (1 <sup>st</sup> and 3 <sup>rd</sup> series) & IPCA + 8.25% (2 <sup>nd</sup> series)
19 <sup>th</sup> issue debentures	199,461	-	199,461	2017 CDI + 0.80% to 1.08%
20 <sup>th</sup> issue debentures	-	495,533	495,533	2019 CDI + 3.80%
<i>Caixa Econômica Federal</i>	59,199	1,088,160	1,147,359	2017/2038 TR + 5% to 9.5%
National Bank for Economic and Social Development (BNDES) Coastal region	16,603	33,207	49,810	2019 2.5% + TJLP
National Bank for Economic and Social Development (BNDES) PAC	10,987	60,293	71,280	2023 2.15% + TJLP
National Bank for Economic and Social Development (BNDES) PAC II 9751	4,288	27,007	31,295	2027 1.72% + TJLP
National Bank for Economic and Social Development (BNDES) PAC II 9752	2,341	21,659	24,000	2027 1.72% + TJLP
National Bank for Economic and Social Development (BNDES) Onda Limpa	23,219	168,083	191,302	2025 1.92% + TJLP
National Bank for Economic and Social Development (BNDES) Tietê III	30,054	307,862	337,916	2028 1.66% + TJLP
National Bank for Economic and Social Development (BNDES) 2015	-	233,967	233,967	2035 2.5% + TJLP
Financial leasing	14,914	537,602	552,516	2035 7.73% to 10.12% + IPC 2018/2025 TJLP + 1.66% (Fehidro) & TR + 12.00% (Presidente Prudente)
Other	746	10,829	11,575	
Interest and others charges	121,605	-	121,605	
<b>Total denominated in local currency</b>	<b>879,908</b>	<b>5,423,872</b>	<b>6,303,780</b>	
<b>Denominated in foreign currency:</b>				
Inter-American Development Bank (IADB) US\$555,671,000 (2015 - US\$560,826,000)	190,436	1,607,782	1,798,218	2017 to 2035 2.14% to 4.92%
International Bank for Reconstruction and Development (IBRD) US\$79,946,000 (2015 - US\$61,158,000)	-	260,224	260,224	2034 1.46%
Deutsche Bank - US\$150,000,000	-	480,244	480,244	2019 Libor + 4.50%
Eurobonds - US\$350,000,000 (2015 - US\$ 350,000,000)	-	1,137,395	1,137,395	2020 6.25%
JICA 15 - ¥ 14,981,590,000 (2015 - ¥ 16,134,020,000)	32,175	386,111	418,286	2029 1.8% & 2.5%
JICA 18 - ¥ 13,470,080,000 (2015- ¥ 14,506,240,000)	28,930	346,890	375,819	2029 1.8% & 2.5%
JICA 17 - ¥ 1,596,251,000 (2015 - ¥ 1,565,564,000)	1,205	42,675	43,880	2035 1.2% & 0.01%
JICA 19 - ¥ 27,569,009,000 (2015 - ¥ 21,701,103,000)	-	768,463	768,463	2037 1.7% & 0.01%

IADB 1983AB - US\$ 106,346,000 (2015 - US\$ 130,289,000)	78,030	263,921	341,951	2023 Libor + 1.88% to 2.38%
Interest and others charges	35,883	-	35,883	
<b>Total denominated in foreign currency</b>	<b>366,659</b>	<b>5,293,704</b>	<b>5,660,363</b>	
<b>Total loans and financing</b>	<b>1,246,567</b>	<b>10,717,576</b>	<b>11,964,143</b>	

\* TR was 0.1849% per month as of December 31, 2016; CDI stands for Interbank Deposit Rate (*Certificado de Depósitos Interbancários*), which was 13.63% per annum as of December 31, 2016; IGP-M was 7.17% per annum as of December 31, 2016; TJLP stands for Long-term Interest Rate (*Taxa de Juros a Longo Prazo*), published quarterly by the Central Bank, which was 7.5% per annum as of December 31, 2016.

The following table shows the maturity profile of our debt, as of December 31, 2016, for the period indicated:

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>After 2022</u>	<u>Total</u>
	<i>(in millions of reais)</i>						
Loans and financing	1,246.6	1,576.4	1,718.9	2,024.3	641.1	4,756.8	11,964.1

Referring to all of our foreign currency-denominated indebtedness, the amount of R\$4,018.0 million, net of transaction costs, as of December 31, 2016 was denominated in U.S. dollars and R\$1,606.4 million was denominated in Japanese Yen. This indebtedness consisted principally of:

- R\$1,798.2 million (US\$555.7 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, considering that one of the contracts was terminated in December 2016, as planned, 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 2017, December 2017 and July 2025. The principal amount accrues interest at USD LIBOR plus a rate varying from 1.14% to 3.00%, paid semiannually; (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 plus a variable spread, paid semiannually;

- R\$260.2million (US\$79.9 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 USD LIBOR plus a variable spread, paid semiannually;
- R\$342.0 million (US\$106.3 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 accrues interest at USD LIBOR plus a rate varying from 1.88% to 2.38%, paid semiannually. The proceeds were used to repay an outstanding series of debt securities in connection with the implementation of our investment plan;
- R\$1,137.4 million (US\$350.0 million) in U.S. dollar denominated Eurobonds issued in December 2010 with an interest rate of 6.25%. The bonds pay interest semi-annually and mature in 2020. The proceeds from the offering were used to repay financial commitments throughout 2007 and 2011. In November 2016, the US\$140.0 million 7.5% notes due to 2016 were completely amortized;
- R\$1,606.4 million (57,616.9 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 a rate that varies from 1.8% to 2.5% per year, paid semiannually; (ii) ¥6,208 million in denominated loans contracted in October 2010 for the financing of the environmental improvement program in the basin of the Billings dam. The loan matures in October 2035. Amortizations will be made in semiannual installments starting in October 2017 after a grace period of seven years. The principal amount accrues interest at a rate that varies from 0.01% to 1.2% per year, paid semiannually; (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 with final maturity in August 2029. The principal amount accrues interest at a rate that varies from 1.8% to 2.5% per year, paid semiannually; and (iv) ¥33,584 million denominated loan in February 2012 for the financing of the Corporate Program for Water Loss Reduction (*Programa Corporativo para Redução de Perdas*). The loan matures in February 2037. Amortizations will be made in semiannual installments starting in February 2019 after a grace period of seven years. The principal amount accrues interest at a rate that varies from 0.01% to 1.7% per year, paid semiannually; and
- R\$469.020 (US\$150.0 million), in U.S. dollar denominated loan contracted in October 2016, with Deutsche Bank AG, London Branch and Banco Bradesco S.A., New York Branch, with an interest rate of 3-month LIBOR plus 4.50% interest per year and with final maturity in October 2019. Interest under this loan is paid quarterly and the principal amount is amortized in semiannual installments after an 18 month grace period. The proceeds from the loan were used to repay the US\$140.0 million Eurobond issued in November 2006, which matured in November 2016, and other financial commitments throughout 2016. The loan agreement includes financial covenants requiring our debt service coverage ratio to be higher than 2.35:1.00; and our ratio of total adjusted debt to EBITDA, determined on a consolidated basis, to be lower or equal than 3.65:1.00.

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

Our outstanding domestic debt was R\$6,303.8 million as of December 31, 2016 and consisted primarily of *real*-denominated loans from federal and state-owned banks, in particular, *Caixa Econômica Federal* and BNDES, as well as debentures issued in November 2009, June 2010, February 2011, February 2012, November 2012, January 2013, October 2013, June 2014, December 2015, 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, 180 or 240 months in monthly installments commencing 30 days following the applicable grace period, which varies from 10 to 48 months from the date of signature of the line of credit agreement. The final maturity is 2038. The principal amount accrues interest from 5.0% to 8.0%. 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 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 is being made in up to 144 successive monthly installments with the final maturity in 2028. The principal amount accrues interest at the TJLP but is limited to 6.0% per year plus a yearly 1.66%. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. This financing agreement is collateralized with a portion of the revenues from the provision of water and sewage services;

- 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 the BNDES program, we issued three tranches of debentures in the aggregate amount of R\$826.1 million. In November 2009, we issued our tenth tranche of debentures in the aggregate principal amount of R\$275.4 million. The debentures are divided in three series: the first and third series will mature in November 2020 and the second in December 2020. The debentures of the first and third series, in the aggregate principal amount of R\$77.1 million and R\$115.7 million, respectively, bear interest at 1.92% per year, plus the TJLP. If the TJLP exceeds 6.0% per year, such excess will be added to the principal amount. The debentures of the second series, in the aggregate principal amount of R\$82.6 million, bear interest at the rate of the IPCA index plus 9.53% per year. This issuance was entirely subscribed by BNDES. 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 2017. 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 will mature in June 2025 and bear monthly interest based on the TR plus 9.5% per year. We used the proceeds from the twelfth issuance to fund a portion of our capital expenditure program in the water supply and sewage system.



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 March 2016, we made an extraordinary partial amortization of the 19<sup>th</sup> issuance of R\$300 million, leaving R\$200 million of the 19<sup>th</sup> outstanding until maturity.

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 and 1212 from the IADB require as follows:

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

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

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

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

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

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. This agreement has a cross-default clause. See Note 16 to our financial statements.

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

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

As of December 31, 2016 and 2015, 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 covenant 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\$1,504.2 million as of December 31, 2016. 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 included in this annual report.

In summary, the BNDES financings specify two bands for the ratios of Adjusted Net Debt / Adjusted EBITDA, Adjusted EBITDA / Adjusted Financial Expenses, and Other Onerous Debt / Adjusted EBITDA. The financings also specify a collateral mechanism by which we assign a portion of 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\$218.0 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%.

The current covenant clauses are:

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

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

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

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

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

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

As of December 31, 2016, the amount that must pass through the blocked collateral account is R\$218 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.

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 included in this annual report.

With respect to our outstanding debentures, the twelfth issuance requires us to maintain an Adjusted Current Ratio (current assets divided by current liabilities, excluding from current liabilities the current portion of noncurrent debts incurred by us that is recorded in current liabilities) higher than 1.0:1.0 and an EBITDA/Financial Expenses Ratio equal to or higher than 1.5:1.0. The twelfth debenture issuance has an early maturity clause, which is triggered if our credit ratings are downgraded two levels below the “brAA-” Brazil National Scale rating assigned to our debentures by the credit rating agency Standard & Poor’s at the time of their issuance. On February 19, 2016, our credit rating and the one assigned to the twelfth debenture issuance by Standard and Poor’s were both “brA+”. This issuance has a cross-default clause. See Note 16 to our financial statements included in this annual report.

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 included in this annual report.

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

The table below shows the more restrictive covenants ratios and our financial covenants ratios as of December 31, 2016.

	<b>Restrictive Ratios</b>	<b>Ratio as of December 31, 2016</b>
Adjusted EBITDA / Adjusted financial expenses	Equal to or higher than 2.80:1.00	5.35
Adjusted net debt / Adjusted EBITDA	Equal to or lower than 3.80:1.00	2.24
Adjusted total debt / Adjusted EBITDA	Lower than 3.65:1.00	2.58
Other onerous debt <sup>(1)</sup> / Adjusted EBITDA	Equal to or lower than 1.30:1.00	0.73
Adjusted current ratio	Higher than 1.0	1.19
EBITDA/Paid financial expenses	Equal to or higher than 1.50:1.00	6.18

(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, 2016 and 2015, 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 2016, we recorded R\$3.9 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\$13.9 billion from 2017 through 2021. 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\$823.5 million, R\$149.9 million and R\$252.3 million in 2016, 2015 and 2014, respectively. See “Item 7.B. Related Party Transactions – Dividends”.

### **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 2016, 2015 and 2014, we invested R\$11.9 million, R\$14.7 million and R\$10.7 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.

Some of nine projects concluded in the first round have led to several patents and software registrations requests, 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; and
- “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.

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 Spatial 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 eight 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;
- 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 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 2016, we received the imported equipment. In 2017, we expect to complete the construction and installation of equipment, and start testing the technology.

In 2016, we signed a technical cooperation agreement with Magni, a representative of the Danish company Liqtech, aiming to test cutting edge ceramic ultra-filtering membranes to treat residual water in our treatment stations. Tests are scheduled for 2017.

In 2016, we also formalized a Memorandum of Understanding with the Danish Water Forum (“DWF”), aiming to enhance technological cooperation to create pilot projects that seek to make our treatment stations more energy-efficient and to fight water loss through the creation of “Measure and Control Districts”, areas of the distribution network temporarily or permanently closed to measure the amount of water entering or leaving.

Seeking energy efficiency in our operations, we established a procedure to calculate the oxygen transfer rate in air diffusers dissolved in sewage treatment plants. The project also aims to find the best cleaning period and when these devices have to be replaced. This project remains under review.

We also have developed custom made biofilters to reduce the odor from sewage pumping stations and sewage treatment plants. Additionally, we have projects linked to the quality and treatment of water, including projects that focus on particularly hard to remove chemical components, and projects that focus on machinery used to control the water treatment process in our treatment stations.

In our waste collection and treatment areas, we have projects that seek to automatize operational processes and develop alternative technologies not used or rarely used in Brazil, such as the use of ultraviolet technology in the disinfection of water planned to be re-used and the use of activated charcoal to minimize odors generated by the waste collection process in cities.

#### **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;
- the effects that further changes in the Basic Sanitation Law and its interpretation may have on the basic sanitation industry in Brazil and on us;
- the effects of inflation in our results of operations;
- the effects of fluctuations in the value of the Brazilian real and in interest rates on our net interest income;
- the renewal of our concession agreements;
- the impact on our business of lower water consumption practices adopted by our customers during the water crisis, which may remain in place despite the termination of the measure we adopted to serve the São Paulo metropolitan region during the water crisis;
- 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; 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, 2016.

#### F. Tabular Disclosure of Contractual Obligations

Our debt obligations and other contractual obligations as of December 31, 2016 were as follows:

	<u>Less than 1 year</u>	<u>1–3 years</u>	<u>3–5 years</u>	<u>More than 5 years</u>	<u>Total</u>
	(in millions of reais)				
Loans and financing	1,246.6	3,295.4	2,665.4	4,756.8	11,964.2
Estimated interest payments <sup>(1)</sup>	533.1	1,146.1	621.1	1,027.8	3,328.1
Accounts payable to suppliers and contractors	312.0	-	-	-	312.0
Services payable	460.1	-	-	-	460.1
Program contract commitments	106.4	70.5	1.9	16.7	195.5
Purchase obligations <sup>(2)</sup>	2,686.6	3,881.3	1,424.3	7,605.0	15,597.2
<b>Total</b>	<b>5,344.8</b>	<b>8,393.3</b>	<b>4,712.7</b>	<b>13,406.3</b>	<b>31,857.1</b>

- (1) Estimated interest payments on loans and financing were determined considering the interest rates as of December 31, 2016. 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, 2016, see Note 16 to our financial statements as of December 31, 2016 and 2015 and for the years ended December 31, 2016, 2015, 2014 included elsewhere in this annual report.

## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

### A. Directors and Senior Management

Under our bylaws and Brazilian Corporate Law, we are managed by our board of directors (*Conselho de Administração*), which currently consists of seven 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 Mercadorules*, at least 20.0% of the board of directors must be comprised of independent members.



All the current members of our board of directors were elected at the annual shareholders' meeting held on April 29, 2016, except for Francisco Luiz Sibut Gomide, who was elected at the annual shareholder's meeting held on April 28, 2017. The tenure of all the 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 five 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 elected at the shareholders' meetings on April 29, 2016 and April 28, 2017:

Director	Age	Position	Date Elected
Benedito Pinto Ferreira Braga Junior	69	Chairman	April 29, 2016
Jerson Kelman	69	Member	April 29, 2016
Jerônimo Antunes	61	Independent Member *	April 29, 2016
Reinaldo Guerreiro	64	Independent Member *	April 29, 2016
Francisco Vidal Luna	70	Independent Member *	April 29, 2016
Luis Eduardo Alves de Assis	60	Independent Member *	April 29, 2016
Francisco Luiz Sibut Gomide	71	Independent Member *	April 28, 2017

\* 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.

*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.

*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 - FINEP/CAFI*) 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. Since October 2016, he is President of the Audit Committee of Petróleo Brasileiro S.A. – Petrobras and President of the Audit Committee of Petrobras Distribuidora S.A. Since October 2016, he is member of the Board of Paranapanema 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 and a member of our Audit Committee from January 2007 to May 2017. He holds a doctorate in Accounting and Controllershship, a Master's degree in Accounting and Controllershship and a Bachelor's degree in Accounting Sciences, all of them from the Business, Economics and Accounting School at the University of São Paulo (*Universidade de São Paulo - USP*). Currently, he is a professor and Deputy Head of the Accounting Department at the Business, Economics and Accounting School at USP. He 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 and a member of our Audit Committee from April 2013 to September 2016. He has a doctorate in Economics from the Business, Economics and Accounting School at the University of São Paulo (*Universidade de São Paulo - USP*) and is a retired professor of the same university. In the public sector, he has served as the Secretary of Planning for the state and city of São Paulo. He has also worked at the Treasury Department for the State of São Paulo and the Federal Planning Bureau, among other roles. 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*).

*Luis Eduardo Alves de Assis.* Mr. Assis has been an independent member of our Board of Directors since April 2014 and a member of our Audit Committee since September 30, 2016. He holds a degree in Economics from the University of São Paulo (*Universidade de São Paulo - USP*), a Master's degree from the State University of Campinas (*Universidade Estadual de Campinas – UNICAMP*) and an MBA from *Scuola Superiore Enrico Mattei* in Milan, Italy. He was director of Monetary Policy of the Central Bank of Brazil and a professor in the Department of Economics at the Pontifical University of São Paulo (*Pontifícia Universidade Católica de São Paulo - PUC-SP*) and at the Getulio Vargas Foundation (*Fundação Getulio Vargas - FGV-SP*). He has developed his long career in the financial market, having held the positions of Chief Economist and Investment Director at Citibank, Chief Executive Officer at HSBC Investment Bank Brasil, Chief 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.

*Francisco Luiz Sibut Gomide* Mr. Gomide has been an independent member of our board of directors since April 2017 and a member of our Audit Committee since May 2017. He holds a Bachelor's degree in Civil Engineering and Economic Sciences from the Federal University of Paraná (*Universidade Federal do Paraná*) and a PhD in Hydrology and Water Resource from the Colorado State University. He was Minister of Mining and Energy in 2002, President of ESCELSA – Espírito Santo Centrais Elétricas S.A. between 1995 and 2001, President of the Energy Company of Mato Grosso do Sul between 1997 and 2001, General manager of Itaipu Binacional between 1993 and 1995, President and Chief Financial Officer of the Energy Company of Paraná (*Companhia Paranaense de Energia – Copel*) between 1986 and 1993 and 1983 to 1985, respectively, and Hydraulic Engineer at the Energy Company of Paraná between 1969 and 1982.

### **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	69	Chief Executive Officer	June 22, 2015
Manuelito Pereira Magalhães Junior	49	Corporate Management Officer	June 22, 2015
Rui de Britto Álvares Affonso	59	Chief Financial Officer and Investor Relations Officer	June 22, 2015
Paulo Massato Yoshimoto	64	Metropolitan Region Officer	June 22, 2015
Luiz Paulo de Almeida Neto	60	Regional Systems Officer	June 22, 2015
Edison Airoidi	60	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 2016, 2015 and 2014, 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\$4.4 million, R\$4.6 million and R\$4.3 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,		
	2016	2015	2014
	<i>(in thousands of R\$, except where indicated otherwise)</i>		
<b>Total compensation per administrative body</b>			
Board of directors	923	1,139	1,051
Board of executive officers	3,184	3,135	2,899
Fiscal committee	299	324	303
<b>Total amount of compensation</b>	<b>4,406</b>	<b>4,598</b>	<b>4,253</b>
<b>Number of members (in individuals)</b>			
Board of directors	8	10	9
Board of executive officers	6	6	6
Fiscal committee	5	5	5
<b>Fixed annual compensation</b>			
Salary			
Board of directors	710	878	802
Board of executive officers	1,877	1,781	1,654
Fiscal committee	243	252	232
Direct and indirect benefits			
Board of directors	213	262	250
Board of executive officers	812	833	741
Fiscal committee	56	72	71
<b>Variable compensation</b>			
Bonus			
Board of directors	-	-	-
Board of executive officers	494	521	504
Fiscal committee	-	-	-
<b>Maximum amount of compensation</b>			
Board of directors	157	157	157
Board of executive officers	618	581	552
Fiscal committee	61	66	64
<b>Minimum amount of compensation</b>			
Board of directors	96	96	96
Board of executive officers	420	494	481
Fiscal committee	51	64	64
<b>Average amount of compensation</b>			
Board of directors	114	114	117
Board of executive officers	531	489	483
Fiscal committee	61	60	61

## 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\$24.3 million, R\$23.7 million and R\$23.0 million in 2016, 2015 and 2014, 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, 2016, our obligation under these both plans (G0 and G1) totaled R\$3,265.3 million. For further information on our pension plans see Note 20 to our financial statements included in this annual report.

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

We recorded profit-sharing expenses of R\$83.7 million, R\$76.6 million and R\$72.9 million in 2016, 2015 and 2014, 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 28, 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 his or her respective alternate. All of the current members of our fiscal committee were elected in the shareholders' meeting held on April 28, 2017. Their tenure will end on April 2018. The primary responsibility of the fiscal committee, which is independent from management and from the external auditors appointed by our board of directors, is to review our financial statements and report on them to our shareholders.

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

<b>Fiscal Committee Members</b>	<b>Age</b>	<b>Position</b>	<b>Date Elected</b>
Humberto Macedo Puccinelli	59	Member	April 28, 2017
Joaldir Reynaldo Machado	68	Member	April 28, 2017
Pablo Andres Fernandez Uhart	44	Member	April 28, 2017
Rui Brasil Assis	63	Member	April 28, 2017
Alexandre Pedercini Issa	35	Member	April 28, 2017
Rogério Mário Pedace	55	Alternate	April 28, 2017
Geraldo José Sertório Collet Silva	66	Alternate	April 28, 2017
Kelly Lopes Lemes	41	Alternate	April 28, 2017
César Aparecido Martins Louvison	56	Alternate	April 28, 2017
Leticia Pedercini Issa Maia	37	Alternate	April 28, 2017

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

*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 from 2007 to 2013, Chief of the Economy and Planning Secretariat State of São Paulo in 2003, Coordinator of Planning and Evaluation of the Economy and Planning Secretariat State of São Paulo from 1998 to 2003, Advisor of the São Paulo Company of Metropolitan Planning (*Empresa Paulista de Planejamento Metropolitano – EMPLASA*) Executive Board from 1992 to 1994, executive of our Finance Department from 1991 to 1992, Chief of Staff of Environment State Secretariat State of São Paulo from 1987 to 1991 and has also worked for the SEADE Foundation from 1979 to 1987.

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

*Rui Brasil Assis.* Mr. Assis has been a member of our fiscal committee since April 2014. He holds a degree in Civil Engineering from Escola de Engenharia de Lins. In the public sector, he worked for Lins City Hall from 1980 to 1983, the Water and Electricity Department from 1983 to 1999, the Water Resources, Sanitation and Construction Secretariat from 1999 to 2003, the Energy, Water Resources and Sanitation Secretariat from 2003 to 2007, the Energy 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.

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

*Rogério Mário Pedace.* Mr. Pedace has been a member of our fiscal committee since April 2017. He holds a Bachelor's degree in Data Processing from the Mackenzie Presbyterian University (*Universidade Presbiteriana Mackenzie*) and also a Master's degree from the Armando Álvares Penteado Foundation (*Fundação Armando Álvares Penteado – FAAP/CENAP*). He is currently the Corporate Management Director of the Securitization Company of the State of São Paulo (*Companhia Paulista de Securitização – CPSEC*). Mr. Pedace has more than twenty years of experience in Human Resources, and worked at Hay Group (*Hay do Brasil Consultores Ltda*) from 1997 to 2016, as Business Manager and Consulting Director of key accounts, retail and public sectors.

*Geraldo José Sertório Collet Silva.* Mr. Silva has been a member of our fiscal committee since April 2017. He holds a Bachelor's degree in Public Administration from the Getulio Vargas Foundation (*Fundação Getúlio Vargas – FGV - SP*). Currently, he is the advisor of the Office of the Chief of Staff of the Sanitation and Water Resources Secretariat (*Secretaria de Saneamento e Recursos Hídricos*). He previously held the same position in the Office of the Chief of Staff of the Planning and Regional Development Secretariat (*Secretaria de Planejamento e Desenvolvimento Regional*) between 2012 and 2015 and of the Office of the Chief of Staff of the Sanitation and Energy Secretariat (*Secretaria de Saneamento e Energia*) in 2007. Between 2004 and 2007, he was a member of the fiscal committee of the Official Press of the State of São Paulo (*Imprensa Oficial do Estado de São Paulo*) and was a member of the fiscal committee of the Energy Company of São Paulo (*Cia Energética de São Paulo – CESP*) and an alternate member of the fiscal committee of the Metropolitan Water and Energy Company (*Empresa Metropolitana de Águas e Energia – EMAE*) between 2007 and 2011. Mr. Silva has acted as a member of the Corporate Management Advisory of the Sanitation and Energy Secretariat (*Secretaria de Saneamento e Energia*) from 2007 to 2012, Advisor and Assistant of the coordinating body of the Chief of Staff of the Economy and Planning Secretariat of the State of São Paulo (*Secretaria de Economia e Planejamento do Estado de São Paulo*) from 2003 to 2007 and as an administrative Officer of the technical information, documentation and environmental research of the Environment Secretariat of the State of São Paulo (*Secretaria do Meio Ambiente do Estado de São Paulo*) from 2001 to 2003. He was an Assistant of the area responsible for the Pomar Project and the working fronts of the Environment Secretariat of the State of São Paulo from 1999 to 2001, and worked as an Administrative Officer of the Environmental Resources Protection State Department (*Departamento Estadual de Proteção de Recursos Naturais – DEPRN*) of the Environment Secretariat of the State of São Paulo (*Secretaria do Meio Ambiente do Estado de São Paulo*) from 1995 to 1999.

*Kelly Lopes Lemes.* Ms. Lemes is a member of our fiscal committee since April 2017. She holds a Bachelor's degree in Law from the Western Paulista University (*Universidade do Oeste Paulista – UNOESTE*). Ms. Lemes is the coordinator of the central unit of Human Resources of the Management and Planning Secretariat (*Secretaria de Planejamento e Gestão*) since August 2016 and was previously technical director III at the same institution between March 2014 and March 2016. She was technical assistant of the coordination of the Public Management Secretariat (*Secretaria de Gestão Pública*) between November 2007 and March 2014. Ms. Lemes was a technical assistant of the Public Administration of the State Civil House (*Secretaria da Casa Civil*) between July and August of 2006, technical assistant of Planning and Control II at the same Secretariat from May, 2006 and July, 2007, technical assistant of the same Secretariat between September 2005 and May 2006, and technical assistant of Human Resources I of the Secretariat for Penitentiary Administration (*Secretaria da Administração Penitenciária*) between March 2004 and September 2005.

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

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

#### **Audit Committee**

Our bylaws provide for an audit committee to be comprised of three board members, who will cumulatively comply with the requirements of (i) independence, (ii) technical expertise, and (iii) identifying and complying with applicable exemptions in accordance with the United States Securities and Exchange Commission, or the SEC, and New York Stock Exchange, or NYSE, rules. Our Board of Directors determined that 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
Francisco Luiz Sibut Gomide	Member	May 12, 2017
Luis Eduardo Alves de Assis	Member	September 30, 2016

### 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. In May 2016, the Regulatory Affairs Committee met for the first time since the water crisis. In total, six meetings were held in 2016.

### C. Employees

As of December 31, 2016, we had 14,137 full-time employees. In 2016, we had an average of 886 interns and 472 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,		
	2016	2015	2014
<b>Number of employees by category of activity:</b>			
Projects and operations	9,456	9,489	9,788
Administration	2,220	2,211	2,381
Finance	424	440	466
Marketing	2,037	2,083	2,118
<b>Number of employees by corporate division:</b>			
Head office	1,389	1,377	1,481
São Paulo metropolitan region	6,634	6,612	6,715
Regional Systems	6,114	6,234	6,557
<b>Total number of employees</b>	<b>14,137</b>	<b>14,223</b>	<b>14,753</b>

The average tenure of our employees is approximately 19 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.



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.

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

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

#### D. Share Ownership

As of April 30, 2017, 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.

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, 2017:

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

(1) As of April 30, 2017, 49.7% of our outstanding common shares were held by 6,357 registered shareholders in Brazil.

As of April 30, 2017, 19.2% 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 April 2017, 32 record holders of ADSs in the United States.

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

(i) to proceed with studies aiming to provide alternatives to our current capitalization model;

(ii) our hiring of the International Finance Corporation, a member institution of the World Bank Group; and

(iii) the conclusion of an agreement between us and the São Paulo State Government, through the Secretariat of Sanitation and Water Resources and the Secretariat of Finance, to delineate the scope of the International Finance Corporation's hiring and to govern the relationship between the contracting parties, including the proportional reimbursement of expenses.

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

## **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\$445.7 million in 2016, R\$357.5 million in 2015 and R\$412.0 million in 2014. Our accounts receivable from the State for water supply and sewage services totaled R\$77.4 million and R\$66.3 million, as of December 31, 2016 and 2015, 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 2016, 2015 and 2014, we made payments to former employees of R\$178.7 million, R\$158.9 million and R\$149.9 million, respectively, in respect of Plan G0. The State made reimbursements in 2016, 2015 and 2014 in the amounts of R\$139.5 million, R\$121.7 million and R\$112.5 million, respectively.

### ***Agreements with the State***

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

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

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

The agreement provided that the DAEE would transfer to us ownership of the Taiaçupeba, 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 that it is not probable that we will ultimately prevail in our appeal, which would prohibit the transfer of the reservoirs in payment of the accounts receivable due from the State.

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

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

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

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

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

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

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 were settled by an immediate transfer of 2,221,000 preferred shares issued by the São Paulo Company of Electric Power Transmission (Companhia de Transmissão de Energia Elétrica Paulista - CTEEP), totaling R\$87.2 million, based on the share closing price as of March 17, 2015. As of April 20, 2016, the Company sold these shares for R\$111.1 million; and
- 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, 2016, the Disputed Reimbursement Amount amounted to R\$937.0 million, but due to the uncertainty regarding the recovery of the amount our management decided not to recognize the reimbursements. See Note 10 to our financial statements included in this annual report regarding the Disputed Reimbursement Amount. We and the State have agreed that the dispute relating to the Disputed Reimbursement Amount will not prevent us from carrying out the commitments made in the December 2001 agreement.

In addition, the third amendment to the December 2001 agreement provides for the regularization of the monthly flow of benefits. While we are liable for the monthly flow of benefits to the former employees of the state-owned companies that merged to form our Company, the State shall reimburse us based on criteria identical to those applied when determining the Undisputed Reimbursement Amount. Should there be no preventative 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, 2016, we had made a provision of R\$2,512.1 million in our pension obligations accounts in respect of the pension benefit obligation of Plan G0.

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

We will not waive the receivables from the State to which we consider ourselves to be legally entitled. Accordingly, we will take all possible actions to resolve the issue at all administrative and court levels. Should this conflict persist, we will take all the necessary actions to protect our interests. On March 24, 2010, we sent to the controlling shareholder the official letter approved by our executive committee, proposing that the matter be discussed at the BM&FBOVSPA 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. In December 2016, we concluded the first four-year revision of our contract with the city of São Paulo, which altered our service quality, investment and investment tracking targets. However, the issue of the 7.5% charge was not discussed.

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

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

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

## ***Use of Reservoirs***

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

Empresa Metropolitana de Águas e Energia S.A., or EMAE, a company that is also controlled by the State of São Paulo, has a concession to produce hydroelectric energy using water from the same reservoirs. EMAE commenced various lawsuits against us in the past seeking compensation for the water we draw from these reservoirs. That settlement agreement cannot take effect, however, until it has been approved by our company, EMAE and ANEEL. It has already been approved by our company, and was approved by ANEEL on December 30, 2016; but it must still be approved by EMAE’s shareholders in a shareholders’ meeting.

The agreement, if approved, will settle the compensation arrangements between EMAE and our company regarding compensation for our capture and use of the water in the one hand, as well as apportionment of the maintenance, operation and monitoring costs for the reservoirs on the other hand. It will require us to pay the following amounts to EMAE:

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

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

### ***Agreements with Lower Tariffs***

We have entered into agreements with public entities, including State entities and municipalities, which manage approximately 6,399 properties. Under these agreements, these public entities pay a different tariff which is approximately 25.0% lower than the tariff that applies for the public entities that have not entered into these agreements, provided such entities implement our Program for Rational Use of Water (*Programa de Uso Racional da Água – PURA*), which has a fixed target for reduction or maintenance of water consumption, according to technical evaluations carried out by us. These agreements are valid for a 12-month term with automatic renewal for equal periods. Pursuant to the terms of these agreements, if these entities fail to make any payment on a timely basis to us, we have the right to cancel the agreement, thereby revoking the 25.0% tariff reduction.

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

We have personnel assignment agreements with entities related to the State Government, under which the expenses are fully passed on and monetarily reimbursed. The expenses related to personnel assigned by us to other state government entities in 2016, 2015 and 2014 amounted to R\$10.4 million, R\$10.5 million and R\$9.7 million, respectively.

The expenses related to personnel assigned by other entities to us totaled R\$0.01 million in 2016, R\$0.3 million in 2015 and R\$0.5 million in 2014.

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

As of December 31, 2016 and 2015, we had an outstanding amount payable of R\$1.9 million and R\$2.2 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, 2016 and 2015.

### ***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\$10.8 million, R\$9.5 million and R\$8.9 million in 2016, 2015 and 2014, respectively. On May 29, 2001, a federal law was enacted which, among other provisions, limits the amount mixed capital companies, like us, may contribute to their pension plans. Specifically, the ordinary contributions made by us to our pension plans may not exceed the contributions made by the beneficiaries of these plans.

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



In 2016, participants were again offered the ability to migrate according to the rules established by the regulatory authority. In The Retiree and Pensioner Association filed a judicial proceeding questioning the amounts that were transferred from the benefits plan to the individual accounts of the participants who migrated to the defined contribution plan. We are awaiting a judicial decision with respect to this, although this has not delayed the implementation, starting in December 2016, of the exceptional charge to cover the deficit relating to the participants who continued participating in the defined contribution plan.

### **Compensation of Management**

The compensation paid by us to the members of our board of directors, board of executive officers and fiscal committee amounted to R\$3.9 million, R\$4.1 million and R\$3.8 million in 2016, 2015 and 2014, respectively, and it refers to salaries and other short-term benefits management. An additional R\$0.5 million, R\$0.5 million and R\$0.5 million related to the bonus program was accrued to executive officers in 2016, 2015 and 2014.

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

The table below summarizes the terms of those agreements at December 31, 2016:

<b>Companies</b>	<b>Principal disbursed</b>	<b>Interest balance</b>	<b>Total</b>	<b>Interest rate</b>	<b>Maturity</b>
Attend Ambiental S.A.	5,400	3,071	8,471	SELIC + 3.5% p.a.	(1)
Aquapolo Ambiental S.A.	5,629	6,090	11,719	CDI + 1.2% p.a.	04/30/2016 <sup>(2)</sup>
Aquapolo Ambiental S.A.	<u>19,000</u>	<u>13,217</u>	<u>32,217</u>	CDI + 1.2% p.a.	10/30/2015 <sup>(2)</sup>
<b>Total</b>	<b><u>30,029</u></b>	<b><u>22,378</u></b>	<b><u>52,407</u></b>	-	-

(1) The loan agreement with Attend Ambiental S.A. had a renewable term of 180 days, starting from the date the funds were made available to the borrower. The credit facility became overdue on May 11, 2015 and is subject to default interest, including monetary correction based on the General Market Price Index (*Índice Geral de Preços do Mercado*, or IGP-M), a 2% penalty fee and interest on arrears of 1% per month. This contract is currently being renegotiated among the parties.

(2) The loan agreement for R\$19 million originally matured on April 30, 2015 but was extended to October 30, 2015. We are currently renegotiating the payment and maturity terms of both loan agreements with Aquapolo Ambiental S.A.

As a result of the negotiations with these borrowers, we have reclassified the principal of R\$30.0 million and interest of R\$22.4 million from “Other receivables” in current assets to “Other receivables” in noncurrent assets until new payment terms are agreed upon. As of December 31, 2016, the total principal and interest due under these loan agreements is R\$52.4 million. The nonpayments reduced our financial income by R\$7.1 million in 2016.

### **Pró-Conexão**

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

As of December 2015 we had completed approximately 23,000 sewage connections under the *Pró-Conexão* program. Due to adjustments in our investment plan, no progress was made on this program in 2016. However, we expect to recommence construction work in 2017.

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

Not applicable.

## **ITEM 8. FINANCIAL INFORMATION**

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

See “Item 18. Financial Statements”.

### **Legal Proceedings**

We are currently subject to numerous legal proceedings relating to civil, tax, labor, corporate and environmental issues arising in the normal course of our business. Several individual disputes account for a significant part of the total amount of claims against us. Our material legal proceedings are described in Note 19 to our financial statements included in this annual report, and that description is incorporated by reference under this Item.

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

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

Although we are not able to predict the final outcome of these lawsuits, we believe that the outcome, if unfavorable to us, may have a material adverse effect on us. We recognize provisions for classify certain of these proceedings as defined in Note 3.15 to our financial statements included in this annual report. As of December 31, 2016 we have provisions totalling R\$149.1 million for the matters stated in Note 19 to our financial statements included in this annual report.

### **Other Legal Proceedings**

The Civil Entity Coordination Committee of Piracicaba on December 30, 2003 filed a civil public action against us, the National Water Agency and the State of São Paulo Treasury Department seeking, among other claims for relief: (i) the termination of use of 31 m<sup>3</sup>/s of water from one of the municipality’s reservoirs; (ii) the creation of a schedule to regulate water use and withdrawal from the Piracicaba river basin by the Cantareira system to eliminate possible damage to populations downstream; and (iii) the development of an environmental impact study on the Cantareira system evaluating the impact of water use and withdrawal on the various basins that constitute the system. In August 2012, this civil public action was decided favorably for us in two lower courts, and the plaintiff’s appeal to a higher court seeking special and extraordinary recourse was denied based on inadmissibility. We are currently awaiting a court decision on the action brought by the plaintiff against the decisions of inadmissibility cited. The amount involved in this proceeding as of December 31, 2016 is R\$24.4 billion. We have assessed that we do not have a current obligation as a result of a past event, and accordingly have not made any provisions.

The Public Prosecutor's Office of the State of São Paulo on November 30, 2012 filed a civil public action against us seeking: (i) the nullification of the contract we entered with the Municipality of São Paulo on June 23, 2010 regarding the service of water supply and sewage services; (ii) our exclusion from BM&FBovespa's Corporate Sustainability Index; and (iii) sewage treatment coverage of the entire Municipality of São Paulo by 2018. The plaintiff's request for an injunction was denied, and the courts maintained this decision after we presented our defense. On November 18, 2014, the case was dismissed in the first instance, and the plaintiff then appealed this dismissal. We are currently waiting the court's ruling on the appeal. The amount involved in these proceedings is R\$15.6 billion as of December 31, 2016. We have assessed that we do not have a current obligation as a result of a past event, and accordingly have not made any provisions.

## **Dividends and Dividend Policy**

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

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

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

We are required to maintain a legal reserve, to which we must allocate 5.0% of net profits for each fiscal year until the amount for such reserve equals 20.0% of our paid-in capital. However, we are not required to make any allocations to our legal reserve in respect of any fiscal year in which the aggregate amount of the legal reserve plus our other established capital reserves exceeds 30.0% of our capital. Net losses, if any, may be offset against the legal reserve. As of December 31, 2016, 2015 and 2014 the balance of our legal reserve was R\$923.3 million, R\$785.0 million and R\$758.1 million, respectively, which was equal to 9.3%, 7.8% and 12.2%, respectively, of our capital.

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

Under Brazilian Corporate Law, any company may authorize in its bylaws the creation of a discretionary reserve. Bylaws which authorize the allocation of a percentage of a company's net income to the discretionary reserve must also indicate the purpose, criteria for allocation and maximum amount of the reserve. We may also allocate a portion of our net profits for discretionary allocations for plan expansion and other capital investment projects, the amount of which would be based on a capital budget previously presented by management and approved by our shareholders. Under Law No. 10,303/2001 of October 31, 2001, as amended, capital budgets for more than one year must be revised at each annual shareholders' meeting. After completion of the relevant capital projects, we may retain the allocation until the shareholders vote to transfer all or a portion of the reserve to capital or retained earnings. As of December 31, 2016, 2015 and 2014 we had an investment reserve of R\$5,249.8 million, R\$3,273.6 million and R\$2,914.0 million, respectively.

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

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

### ***Mandatory Distribution***

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

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

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

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

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

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

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

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

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

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

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

Dividends and interest on shareholders' equity over the minimum established in a company's bylaws are recognized when approved by the shareholders in the general meeting. Consequently, the amounts recognized as of December 31, 2016 correspond to the minimum established by law of 25.0% of the net income and the difference of R\$823.5 million will be recorded in 2017 after the annual shareholders' meeting.

### **Distributions of dividends**

The following table sets forth the distributions of dividends that we made to our shareholders in respect of our 2016, 2015 and 2014 earnings. All these amounts distributed or to be distributed were or will be in the form of interest on shareholders' equity.

<b>Year ended December 31,</b>	<b>Aggregate amount distributed</b> (in millions of <i>reais</i> )	<b>Payment Dates</b>	<b>Payment per share</b>	<b>Payment per ADS</b> (in <i>reais</i> )
2016	823.5	*	1.20	1.20
2015	149.9	June 28, 2016	0.22	0.22
2014	252.3	June 29, 2015	0.37	0.37

\* We recorded dividends in the amount of R\$699.9 million, which pursuant to our bylaws is our minimum dividend amount. The dividends will be paid within 60 days after the annual general meeting, which has been convened for April 28, 2017.

### **Dividend Policy**

We intend to declare and pay dividends and/or interest on shareholders' equity, as required by Brazilian Corporate Law and our bylaws. Our board of directors may approve the distribution of interest on shareholders' equity, calculated based on our semiannual or quarterly financial statements. The declaration of dividends is annual, including dividends in excess of the mandatory distribution, and requires approval by the vote of the majority of the holders of our common shares. The amount of any distributions will depend on many factors, such as our results of operations, financial condition, cash requirements, prospects and other factors deemed relevant by our board of directors and shareholders. Within the context of our tax planning, we may in the future continue to determine that it is in our best interest to distribute interest on shareholders' equity.

### **B. Significant Changes**

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

## ITEM 9. THE OFFER AND LISTING

### A. Offer and Listing Details

#### Market Price of Common Shares

Our common shares have been listed on the BM&FBOVESPA under the symbol “SBSP3” since June 4, 1997 and, starting on April 24, 2002, have been included in the *Novo Mercado* segment of that exchange. As of December 31, 2016, we had 5,675 registered holders of common shares.

On April 30, 2007, our shareholders approved a reverse stock split of 125 common shares into one common share. Following a ratio change effected on January 24, 2013, each ADS currently represents one of our common shares. On April 22, 2013 our shareholders approved a stock split, following which each common share represented three new common shares. IFRS requires the retrospective application of earnings-per-share computations for stock dividends, stock splits, and reverse splits.

The table below sets forth, for the periods indicated, the reported high and low closing sale prices in *reais* for common shares on the BM&FBOVESPA. The table also sets forth prices per ADS assuming that ADSs had been outstanding on all such dates and translated into U.S. dollars at the commercial market rate for the sale of U.S. dollars for each of the respective dates of such quotations. In addition, the table sets forth the average daily trading volume for our common shares.

	<i>Reais</i> per common share		U.S. dollar equivalent per ADS <sup>(1)</sup>		Average daily trading volume
	Low	High	Low	High	
<b>2017</b>					
January	28.37	32.61	8.67	10.30	1,307,886
February	31.46	34.38	9.99	11.17	1,659,506
March	30.20	33.65	9.82	10.82	1,634,391
April	29.20	34.14	9.19	11.04	2,175,333
<b>2016</b>	16.62	33.70	4.11	10.51	1,973,766
First Quarter	16.62	21.32	4.11	5.27	1,551,121
Second Quarter	25.59	29.08	7.12	9.06	2,469,756
Third Quarter	28.39	31.49	8.50	9.58	1,450,438
Fourth Quarter	26.58	33.70	7.98	10.51	1,688,341
<b>2015</b>	13.25	20.29	5.10	5.45	1,341,147
First quarter	13.25	19.40	5.10	6.10	1,474,031
Second quarter	15.74	19.65	5.07	6.46	1,314,025
Third quarter	14.50	18.99	4.09	5.92	1,273,028
Fourth quarter	16.00	20.29	4.02	5.45	1,306,283
<b>2014</b>	15.98	25.96	5.83	10.83	1,432,670
First quarter	19.61	25.96	8.37	10.83	1,605,502
Second quarter	19.60	24.35	8.81	10.81	1,386,168
Third quarter	19.30	23.97	8.47	10.78	1,398,368
Fourth quarter	15.98	20.50	5.83	8.07	1,343,589
<b>2013</b>	19.55	32.13	8.15	15.95	1,373,958
First quarter	85.00	96.40	41.90	47.87	557,193
Second quarter <sup>(2)</sup>	20.40	31.38	9.06	15.66	1,755,594
Third quarter	19.55	23.96	8.15	10.76	1,719,845
Fourth quarter	21.40	26.55	9.70	11.28	1,401,226
<b>2012</b>	50.42	92.48	53.97	91.52	409,457
First quarter	50.42	69.66	53.97	76.46	372,200
Second quarter	68.50	77.32	74.85	74.48	321,627
Third quarter	75.67	92.48	74.51	91.52	417,208
Fourth quarter	80.54	90.50	76.98	89.40	534,115

(1) Following a ratio change effected on January 24, 2013, each ADS represents one common shares.

(2) After April 22, 2013 our common shares are traded considering the stock split.

#### Market Price of ADSs

Our ADSs, each of which represents one of our common shares, as of the date of this annual report, are listed on the NYSE under the symbol “SBS”. Prior to June 8, 2007, each ADS represented 250 of our common shares. From that date through January 23, 2013, each ADS represented two of our common shares. Following a ratio change effected on January 24, 2013, each ADS currently represents one of our common shares. On April 22, 2013 our shareholders approved a stock split, following which each common share represented three new common shares. Our ADSs began trading on the NYSE on May 10, 2002 in connection with the initial offering of our equity securities in the United States.

The table below sets forth, for the periods indicated, the reported high and low closing prices for our ADSs on the NYSE.

	Price in U.S. dollars per ADS		Average daily trading volume
	Low	High	
<b>2017</b>			
January	8.81	10.38	1,370,278
February	10.01	11.13	1,594,407
March	9.76	10.74	1,593,465
April	9.71	10.90	1,918,998
<b>2016</b>	4.07	10.52	2,317,594
First quarter	4.07	6.64	2,079,094
Second quarter	5.45	6.65	2,571,512
Third quarter	6.12	9.71	2,680,041
Fourth quarter	7.89	10.52	1,774,031
<b>2015</b>	3.57	6.56	2,300,672
First quarter	4.86	6.39	2,987,516
Second quarter	5.00	6.56	2,212,398
Third quarter	3.57	5.93	2,299,456
Fourth quarter	3.88	5.38	1,734,132
<b>2014</b>	5.86	10.93	2,554,714
First quarter	8.39	10.83	2,781,129
Second quarter	8.86	10.93	2,281,039
Third quarter	8.11	10.86	2,197,585
Fourth quarter	5.86	8.56	2,965,438
<b>2013</b>	41.60	48.63	490,280
First quarter <sup>(1)</sup>	9.33	15.88	1,649,436
Second quarter <sup>(2)</sup>	8.38	10.82	2,055,875
Third quarter	9.76	11.45	1,725,844
Fourth quarter	41.60	48.63	490,280
<b>2012</b>	56.62	91.48	311,242
First quarter	56.62	76.86	325,938
Second quarter	68.90	80.18	328,410
Third quarter	74.49	91.48	316,824
Fourth quarter	78.16	88.35	321,333

(1) After January 23, 2013 our common shares have traded considering the ratio change. On April 22, 2013 our shareholders approved a stock split, following which each common share represented three new common shares.

(2) After April 29, 2013 our ADSs are traded considering the stock split.

## B. Plan of Distribution

Not applicable.

## C. Markets

### Trading on the Brazilian Stock Exchange

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

Trading on the BM&FBOVESPA is conducted between 10:00 a.m. and 5:00 p.m. or from 11:00 a.m. to 6:00 p.m. (during daylight savings time in Brazil). The BM&FBOVESPA also permits trading from 5:30 p.m. to 6:00 p.m. or from 6:30 p.m. to 7:00 p.m. (during daylight savings time in Brazil) during a different trading period called the “after market”. Trading during aftermarket is subject to regulatory limits on price volatility and on the volume of shares transacted through internet brokers.

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

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

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

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

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

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

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

- maintain only voting shares;



- hold public offerings of shares in a manner favoring diversification of the company's shareholder base and broader access to retail investors;
- maintain a minimum free float of at least 25.0% of the outstanding capital stock of the company;
- grant tag along rights for all shareholders in connection with a transfer of control of the company;
- limit the term of all members of the board of directors to two years;
- ensure that at least 20.0% of the members of the board of directors are independent, as defined under the *Novo Mercado* regulation;
- prepare annual financial statements, including cash flow statements, in compliance with U.S. GAAP or IFRS or reconciled from Brazilian GAAP to U.S. GAAP or IFRS;
- disclose information on a quarterly basis, including share ownership of certain of our employees and directors and amount of free float of shares;
- hold a tender offer by the company's controlling shareholder (the minimum price of the shares to be offered will be determined by an appraisal process) if it elects to delist from the Novo Mercado; and
- make greater disclosure of related party transactions.

On May 10, 2011, the *Novo Mercado* rules were revised and currently establish the following additional obligations:

- the chairman of the board of directors is prohibited from simultaneously holding the position of chief executive officer;
- the board of directors must disclose its opinion on takeover proposals within 15 days from the presentation of the proposal; and
- the company must have a securities purchase policy and a code of ethics.

#### *Regulation of Brazilian Securities Markets*

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

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

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

We have the option to ask that trading in our securities on the BM&FBOVESPA be suspended in anticipation of a material announcement. Trading may also be suspended on the initiative of the BM&FBOVESPA or the CVM, among other reasons, based on or due to a belief that a company has provided inadequate information regarding a material event or has provided inadequate responses to the inquiries by the CVM or the São Paulo Stock Exchange.

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

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

**D. Selling Shareholders**

Not applicable.

**E. Dilution**

Not applicable.

**F. Expenses of the Issue**

Not applicable.

**ITEM 10. ADDITIONAL INFORMATION**

**A. Share Capital**

Not applicable.

**B. Memorandum and Articles of Association**

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

**Corporate Purposes**

We are a mixed capital company (*sociedade de economia mista*) of unlimited duration, incorporated on September 6, 1973, with limited liability, duly organized and operating under Brazilian Corporate Law. As set forth in Article 2 of our bylaws, our corporate purpose is to render basic sanitation services, aimed at the universalization of basic sanitation in the state of São Paulo without harming our long-term financial sustainability. Our activities comprise water supply, sanitary sewage services, urban rainwater management and drainage services, urban cleaning services, solid waste management services and related activities, including the planning, operation, maintenance and commercialization of energy, and the commercialization of services, products, benefits and rights that directly or indirectly arise from our assets, operations and activities. We are allowed to act, in a subsidiary form, in other Brazilian locations and abroad.

**Directors' Powers**

Although our bylaws contain no specific provisions regarding a director or executive officer's power to vote on a proposal, arrangement or contract in which that director has a material interest, under Brazilian Corporate Law, a director or an executive officer is prohibited from voting in any meeting or with respect to any transaction in which that director or executive officer has a conflict of interest with the company and must disclose the nature and extent of the conflicting interest to be recorded in the minutes of the meeting. In any case, a director or an executive officer may not transact any business with the company, including any borrowing, except on reasonable or fair terms and conditions that are identical to the terms and conditions prevailing in the market or offered by third parties.

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

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

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

## **Description of Common Shares**

### ***General***

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

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

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

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

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

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

Neither Brazilian Corporate Law nor our bylaws expressly addresses:

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

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

According to Brazilian Corporate Law and its regulations, shareholders representing at least 10 percent of our capital, may request that a multiple voting procedure be adopted to entitle each share to as many votes as there are board members and to give each shareholder the right to vote cumulatively for only one candidate or to distribute their votes among several candidates. Pursuant to Brazilian Corporate Law, shareholder action must be taken at a shareholders meeting, duly called for and not by written consent.

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

### ***Preemptive Rights***

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

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

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

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

- to reduce the mandatory distribution of dividends;
- to merge into another company or to consolidate with another company, subject to the conditions set forth in Brazilian Corporate Law;
- to participate in a centralized group of companies, as defined under Brazilian Corporate Law and subject to the conditions set forth therein;
- to change our corporate purpose;

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

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

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

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

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

#### **Conversion Right**

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

#### **Special and General Meetings**

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

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

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

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

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

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

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

## **Equal Treatment Provisions**

Pursuant to article 40 of our bylaws and the *Novo Mercado* regulations, any party that acquires our control must extend a tender offer for the shares held by non-controlling shareholders at the same conditions and purchase price paid to the controlling shareholder. In addition, State Law No. 119/1973, which created our Company, requires the State to hold the majority of our shares at all times.

## **Reserves**

### ***General***

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

### ***Capital Reserve***

Our capital reserve consists of tax incentives and donations from government agencies and private entities received through December 31, 2007. In 2014, we added to our capital the amount of R\$124.3 million held in the capital reserve account as of December 31, 2013.

### ***Investment Reserve***

Our investment reserve is comprised specifically of internal funds for expansion of water and sewage service systems. As of December 31, 2016, we had an investment reserve of R\$5,249.8 million.

### ***Legal Reserve***

Under Brazilian Corporate Law, we are required to record a legal reserve to which we must allocate 5% of the adjusted net income each year until the amount of the reserve equals 20.0% of paid-in capital. Any accumulated deficit may be charged against the legal reserve. As of December 31, 2016, the balance of our legal reserve was R\$932.3 million.

## **Arbitration**

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

## **Options**

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

## **C. Material Contracts**

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

## D. Exchange Controls

The right to convert dividend or interest payments and proceeds from the sale of shares into foreign currency and to remit such amounts outside Brazil is subject to restrictions under foreign investment legislation which generally requires, among other things, that the relevant investments have been registered with the Central Bank and the CVM. Such restrictions on the remittance of foreign capital abroad may hinder or prevent the custodian for our common shares represented by our ADSs or the holders of our common shares from converting dividends, distributions or the proceeds from any sale of these shares into U.S. dollars and remitting the U.S. dollars abroad. Holders of our ADSs could be adversely affected by delays in, or refusal to grant any, required government approval to convert Brazilian currency payments on the common shares underlying our ADS and to remit the proceeds abroad.

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

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

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

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

- appoint at least one representative in Brazil, with powers to perform actions relating to its investment;
- appoint an authorized custodian in Brazil for its investments, which must be a financial institution or entity duly authorized by the Central Bank or CVM;
- appoint a tax representative in Brazil;
- through its representative in Brazil, register itself as a foreign investor with the CVM;
- through its representative in Brazil, register its foreign investment with the Central Bank; and
- be registered with the Federal Tax Authority (*Secretaria da Receita Federal*), or the “RFB”, pursuant to RFB Normative Instruction No. 1,470/2014, of May 30, 2014, and RFB Normative Instruction No. 1,548/2015, of February 13, 2015.

## E. Taxation

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



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

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

### **Brazilian Tax Considerations**

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

A non-Brazilian holder of ADSs may withdraw them in exchange for common shares in Brazil. Pursuant to Brazilian law, the non-Brazilian holder may invest in the common shares under CMN Resolution 4,373/2014, as a 4,373 Holder.

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

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

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

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

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

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

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

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

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

Any other gains assessed on the disposition of the common shares that are not carried out on the Brazilian stock exchange are subject to income tax at a rate of 15%, except for Nil or Low Taxation Jurisdiction, which, in this case, would be subject to income tax at a rate of 25%. Law No. 13.259 of March 17, 2016 increased the income tax rates applicable to gains derived by Brazilian individuals up to 22.5% and, such increase, applicable as of January 2017, may also affect non-Brazilian Holders. Non-Brazilian Holders should consult with their own tax advisors regarding the consequences of Law 13.259/2016. In case these gains are related to transactions conducted on the Brazilian non-organized over-the-counter market with intermediation, the withholding income tax of 0.005% shall also be applicable and can be offset with the eventual income tax due on the capital gain.

For Brazilian purposes, as of January 2009, a Nil or Low Taxation Jurisdiction is considered a regime: (i) which does not impose income tax or does so at a rate of 20% or lower, or (ii) where applicable local legislation imposes restrictions on the disclosure of the shareholding composition or the ownership of investments, or on the ultimate beneficiary of the income derived from transactions carried out and attributable to a non-Brazilian holder. See “—Discussion on Low or Nil Taxation Jurisdictions”.

In the case of redemption of securities or capital reduction by a Brazilian corporation, such as ourselves, the positive difference between the amount effectively received by the non-Brazilian holder and the corresponding acquisition cost is treated, for tax purposes, as capital gain derived from disposition of common shares not carried out on a Brazilian stock exchange market, and is therefore subject to income tax at the rate of 15% or 25%, as the case may be.

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

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

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

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

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

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

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

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

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

With reference to the deposit of common shares in exchange for ADSs, the difference between the acquisition cost of the common shares and the market price of the common shares may be subject to Brazilian income tax at the rate of 15% or 25%, in case the non-Brazilian holder is located in a Nil or Low Taxation Jurisdiction. In some circumstances, there may be arguments to claim that this taxation is not applicable in the case of a non-Brazilian holder that is a 4,373 Holder and is not a resident in a Nil or Low Taxation Jurisdiction.

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

On June 24, 2008, Law No. 11,727/2008 was enacted defining the concept of a “privileged tax regime” in connection with transactions subject to transfer pricing and thin capitalization rules. In this conception, privileged tax regimes are more comprehensive than tax havens. A “privileged tax regime” is considered to be a jurisdiction which: (i) does not tax income or taxes income at a maximum rate lower than 20.0%; (ii) grants tax advantages to a non-resident entity or individual (a) without requiring substantial economic activity in the jurisdiction of such non-resident entity or individual or (b) to the extent such non-resident entity or individual does not conduct substantial economic activity in the jurisdiction of such non-resident entity or individual; (iii) does not tax income generated abroad, or imposes tax on income generated abroad at a maximum rate lower than 20.0%; or (iv) restricts the ownership disclosure of assets and ownership rights or restricts disclosure about economic transactions.

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

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

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

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

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

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

- (b) 50% of the sum of retained earnings and earnings reserves as of the date of the beginning of the period with respect to which the payment is made.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

### **ADSs**

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

### **Taxation of Dividends**

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

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

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

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

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

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

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

Based upon our current and projected income, assets, activities and business plans, we do not expect the common shares or ADSs to be considered shares of a PFIC for our current fiscal year (although the determination cannot be made until the end of such fiscal year), and we intend to continue our operations in such a manner that we do not expect to be classified as a PFIC in the foreseeable future. However, because the determination of whether the common shares or ADSs constitute shares of a PFIC will be based upon the composition of our income, assets and the nature of our business, as well as the income, assets and business of entities in which we hold at least a 25% interest, from time to time, and because there are uncertainties in the application of the relevant rules, there can be no assurance that the common shares or ADSs will not be considered shares of a PFIC for any fiscal year. If the common shares or ADSs were shares of a PFIC for any fiscal year, U.S. holders (including certain indirect U.S. holders) may be subject to adverse tax consequences, including the possible imposition of an interest charge on gains or “excess distributions” allocable to prior years in the U.S. holder’s holding period during which we were determined to be a PFIC. If we are deemed to be a PFIC for a taxable year, dividends on our ADSs would not be qualified dividend income eligible for preferential rates of U.S. federal income taxation. In addition, a U.S. holder that owns common shares or ADSs during any taxable year that we are treated as a PFIC would generally be required to file IRS form 8621, including in order to comply with additional annual filing requirements imposed under legislation enacted in 2010. U.S. holders should consult their own tax advisors regarding the application of the PFIC rules (including any information reporting requirements in connection therewith) to the common shares or ADSs.

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

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

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

#### **F. Dividends and Payments Agents**

Not applicable.

#### **G. Statements by Experts**

Not applicable.

#### **H. Documents on Display**

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

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

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

## I. Subsidiary Information

Not applicable.

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

#### Market Risk

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

#### Exchange Rate Risk

As of December 31, 2016 and 2015, R\$5,660.4 million and R\$6,617.8 million, or 47.3% and 50.4%, respectively, of our debt obligations were denominated in foreign currencies. As a result, we are exposed to exchange rate risks that may adversely affect our financial condition and results of operations, as well as our ability to meet debt service obligations.

#### Exchange Rate Sensitivity

We estimate that the potential loss to us in connection with U.S. dollar and yen-denominated debt that would have resulted as of December 31, 2016, 2015 and 2014 from each hypothetical instantaneous and unfavorable 1% change in the U.S. dollar and yen against the *real* would have been approximately R\$56.6 million, R\$66.2 million and R\$43.5 million, respectively. Consistent with these estimates, a hypothetical instantaneous and unfavorable 10% change in this exchange rate would have resulted in losses of approximately R\$566.0 million, R\$661.8 million and R\$434.6 million as of December 31, 2016, 2015 and 2014, respectively.

The fluctuation of the *real* in relation to the U.S. dollar and yen for the years ended December 31, 2016, 2015 and 2014 were as follows:

	Year ended December 31,		
	2016	2015 (in percentages)	2014
Depreciation (appreciation) of the <i>real</i> in relation to the U.S. dollar	(16.5)	47.0	13.4
Depreciation (appreciation) of the <i>real</i> in relation to the yen	(13.8)	46.0	(0.4)

We have not contracted derivative financial instruments in the years ended December 31, 2016, 2015 and 2014.

For further information regarding foreign currency risk, see Note 5.1(a) to our 2016 financial statements included in this annual report.

As of December 31, 2016, 2015 and 2014, we had no short-term indebtedness outstanding, other than the current portion of long-term debt.

#### Interest Rate Risk

As of December 31, 2016 and 2015, R\$1,541.3 million, or 12.9%, and R\$1,504.8 million, or 11.5%, respectively, of our total debt outstanding balance denominated in *reais* was based on variable rates of interest based on the UPR, which is equivalent to the TR. In addition, as of December 31, 2016 and 2015, R\$1,104.3 million, or 9.2%, and R\$1,651.1 million, or 12.6%, respectively, of our total debt denominated in *reais* was subject to interest rates based on the CDI. As of December 31, 2016 and 2015, R\$2,416.6 million and R\$2,938.6 million, respectively, of our foreign-currency denominated debt was based on the IADB and the IBRD variable rates of interest, which are determined based on the cost of funding of these multilateral organizations in each period.



As of December 31, 2016 and 2015, we did not have any derivative contracts outstanding which limited exposure to changes in the UPR or the CDI or in the IADB or IBRD variable rates. However, we are obliged by law to invest our excess cash with financial institutions controlled by the Brazilian government. We invest these excess funds, which totaled R\$1,886.2 million and R\$1,562.0 million as of December 31, 2016 and 2015, respectively, mainly in short-term instruments. As a result, our exposure to Brazilian interest rate risk is partially limited by our *real*-denominated floating interest time deposits investments, which generally earn interest based on the CDI. In addition to our exposure with respect to existing indebtedness, we may become exposed to interest rate volatility with respect to indebtedness incurred in the future.

We estimate that we would have suffered a loss over periods of one year, respectively, of up to R\$119.6 million, R\$131.2 million and R\$107.9 million if a hypothetical instantaneous and unfavorable change of 100 basis points in the interest rates applicable to financial liabilities as of December 31, 2016, 2015 and 2014, respectively, had occurred. Consistent with these estimates, a hypothetical instantaneous and unfavorable 1000 basis points change in these interest rates would have resulted in losses of approximately R\$1,196.4 million, R\$1,312.2 million, R\$1,078.6 million as of December 31, 2016, 2015 and 2014, respectively. This sensitivity analysis is based on the assumption of an unfavorable 100 basis point movement of the interest rates applicable to each homogeneous category of financial liabilities and sustained over a period of one year, as applicable, and that such movement may or may not affect interest rates applicable to any other homogenous category of financial liabilities.

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

The tables below provide information about our interest rate-sensitive instruments. For variable interest rate debt, the rate presented is the weighted average rate calculated as of December 31, 2016. For the foreign currency denominated obligations, these amounts have been converted at the selling rates as of December 31, 2016 and do not represent amounts which may actually be payable with respect to such obligations on the dates indicated.

	As of December 31, 2016					Average annual interest rate
	Expected maturity date					
	2017	2018	2019	2020 and after	Total	
	<i>(in millions, except percentages)</i>					
<b>Assets</b>						
Cash equivalents denominated in <i>reais</i>	1,886.2	-	-	-	1,886.2	
<b>Liabilities</b>						
<b>Long-term debt (current and noncurrent portion)</b>						
Floating rate, denominated in <i>reais</i> indexed by TR or UPR	112.4	109.4	110.8	1,208.6	1,541.2	10.0%
Floating rate, denominated in <i>reais</i> indexed by TJLP	164.6	162.5	171.0	833.9	1,332.0	9.4%
Floating rate, denominated in <i>reais</i> indexed by IPCA	123.2	381.7	642.2	626.6	1,773.7	13.3%
Floating rate, denominated in <i>reais</i> indexed by CDI	464.8	394.0	245.5	-	1,104.3	16.2%
Fixed rate, denominated in <i>reais</i>	14.9	39.1	29.1	469.4	552.5	
Floating rate, denominated in U.S. dollars	289.5	426.2	415.1	1,770.9	2,901.7	3.3%
Fixed rate, denominated in Yen	73.1	63.5	105.2	1,375.4	1,617.2	1.6%
Fixed rate, denominated in U.S. dollars	4.1	-	-	1,137.4	1,141.5	3.2%
<b>Total long-term debt</b>	<b>1,246.6</b>	<b>1,576.4</b>	<b>1,718.9</b>	<b>7,422.2</b>	<b>11,964.1</b>	<b>7.6%</b>

UPR stands for Standard Reference Unit (*Unidade Padrão Referência*) and is equal to TR, which was 0.1449% per month as of December 31, 2016; CDI stands for Interbank Deposit Rate (*Certificado de Depósitos Interbancários*), which was 13.63% per annum as of December 31, 2016; IGP-M was 7.17% per annum as of December 31, 2016; TJLP stands for Long-term Interest Rate (*Taxa de Juros a Longo Prazo*), published quarterly by the Central Bank, which was 7.5% per annum as of December 31, 2016.

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

	As of December 31,		
	2016	2015	2014
<b>Floating rate debt:</b>			
Denominated in U.S. dollars	24.3%	22.3%	18.1%
Denominated in <i>reais</i>	48.1%	45.5%	55.2%
<b>Fixed rate debt:</b>			
Denominated in <i>reais</i>	4.6%	4.1%	4.5%
Denominated in Yen	13.5%	13.4%	10.0%
Denominated in U.S. dollars	9.5%	14.7%	12.2%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

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

### A. Debt Securities

Not applicable.

### B. Warrants and Rights

Not applicable.

### C. Other Securities

Not applicable.

### D. American Depositary Shares

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

#### *Fees and Expenses*

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

<b>Persons depositing common shares or ADR holders must pay:</b>	<b>For:</b>
US\$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)	Issuance of ADSs, including issuances resulting from a distribution of common shares or rights or other property
Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates	
US\$0.05 (or less) per ADS or portion thereof (to the extent not prohibited by the rules of any stock exchange on which the ADSs are listed for trading)	Any cash distribution to you
A fee equivalent to the fee that would be payable if securities distributed to you had been common shares and the common shares had been deposited for issuance of ADSs	Distribution of securities distributed to holders of deposited securities which are distributed by the depositary to ADR holders
US\$0.05 (or less) per ADS or portion thereof per calendar year (in addition to the cash distribution fee of \$0.02 per ADS that the depositary has collected during the year)	Depositary services
Registration or transfer fees	Transfer and registration of common shares on our common share register to or from the name of the depositary or its agent when you deposit or withdraw common shares
Cable, telex and facsimile transmissions expenses (when expressly provided in the deposit agreement)	
Expenses of the depositary in converting foreign currency to U.S. dollars	
Expenses of the depositary	
Taxes and other governmental charges the depositary or the custodian have to pay on any ADR or common share underlying an ADR, for example, stock transfer taxes, stamp duty or withholding taxes	As necessary
Any charges incurred by the depositary or its agents for servicing the deposited securities	No charges of this type are currently made in the Brazilian market

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

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

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

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

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

### ***Reimbursement of Fees Incurred in 2016***

From January 1, 2016 to December 31, 2016, we received reimbursements in the amount of US\$7.9 million for standard out-of-pocket maintenance costs for the ADRs, any applicable performance indicators relating to the ADR facility, marketing fees and legal fees.

## PART II

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

Not applicable.

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

Not applicable.

### ITEM 15. CONTROLS AND PROCEDURES

#### A. Disclosure Controls and Procedures

We carried out an evaluation under the supervision of and with the participation of our management, including our Chief Executive Officer and Chief Financial and Investor Relations Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, including those defined in the United States Exchange Act Rule 13a-15(e), as of the year ended December 31, 2016.

As a result of this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were both designed and effective at the reasonable assurance level as of December 31, 2016, that the information required to be disclosed in our filings and submissions under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified by the SEC's rules and forms, and that this information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial and Investor Relations Officer, as appropriate to allow timely decisions regarding required disclosure.

#### B. Management's Report on Internal Control over Financial Reporting

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

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

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

Under the supervision and with the participation of our CEO and CFO, our management conducted an assessment of our internal control over financial reporting as of December 31, 2016 based on the criteria established in "Internal Control —Integrated Framework" issued by COSO in 2013.

As a result of the assessment described above, our management concluded that as of December 31, 2016, we maintained effective internal control over financial reporting based on the criteria established in “Internal Control — Integrated Framework” issued by COSO in 2013.

Our independent registered public accounting firm has issued an attestation report on the effectiveness of our internal control over financial reporting. That report is included below.

### **C. Attestation Report of the Registered Public Accounting Firm**

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

To the Board of Directors and Shareholders

Companhia de Saneamento Básico do Estado de São Paulo - SABESP:

We have audited Companhia de Saneamento Básico do Estado de São Paulo - SABESP’s internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework 2013 issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Companhia de Saneamento Básico do Estado de São Paulo - SABESP’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying “Management’s annual report on internal control over financial reporting”. Our responsibility is to express an opinion on the Companhia de Saneamento Básico do Estado de São Paulo - SABESP’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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

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

In our opinion, Companhia de Saneamento Básico do Estado de São Paulo - SABESP maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework 2013 issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the statement of financial position of Companhia de Saneamento Básico do Estado de São Paulo - SABESP as of December 31, 2016, and the related income statement, statements of comprehensive income, changes in equity, and cash flows for the year then ended, and our report dated May 15, 2017 expressed an unqualified opinion on those financial statements.

**D. Changes in internal control over financial reporting**

There have been no changes in our internal control over financial reporting that occurred during the fiscal year ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**ITEM 16. [RESERVED]**

**A. Audit Committee Financial Expert**

At our board meeting held on June 26, 2006, we established an audit committee, as defined under section 3(a)(58) of the Exchange Act. Our board of directors has determined that Jerônimo Antunes qualifies as an “audit committee financial expert” as defined for the purposes of this Item 16A in Item 16 of Form 20-F. Jerônimo Antunes is an “independent director” within the meaning of the SEC rules.

**B. Code of Ethics**

We have adopted a code of business conduct and ethics, as defined in Item 16B of Form 20-F under the Exchange Act. Our code of business conduct and ethics, called Code of Ethics and Conduct, applies to all of our employees, including our directors, chief executive officer, chief financial and investor relations officer and head of accounting, as well as our suppliers and third-party contractors. To ensure compliance with the Code of Ethics and Conduct, we have an Ethics Committee and an internal Whistle-Blower Channel, as well as a Corporate Accountability Procedure and an Ombudsman Office as well as a Customer Service that receive external complaints. The internal channel can receive anonymous whistle blowing. The results of the investigations are forwarded to the Audit Committee. Cases of recurrence are reported to the Ethics Committee, which urges the related departments to develop preventive actions. In 2016, 154 events were reported to the Whistle-Blower Channel, 65.0% of which were verified and 35.0% are under investigation. Out of the total, 17.0% refer to misconduct, such as moral harassment, discrimination, persecution and unfair treatment. During 2016, 64 of our employees or outsourced employees received penalties (6 warnings, 7 suspensions and 51 dismissals). Our Ethics Committee is also responsible for addressing relevant inquiries and interpreting the norms of the Code of Ethics for all of our employees. Our Code of Ethics and Conduct is available on our web site at <http://www.sabesp.com.br> at the following location: Investors Relations – Corporate Governance. If we amend the provisions of our Code of Ethics and Conduct, or if we grant any waiver of such provisions, we will disclose the amendment or waiver on our web site at the same address. You can obtain copies of our Code of Ethics and Conduct, without charge, upon request to [sabesp.ri@sabesp.com.br](mailto:sabesp.ri@sabesp.com.br).

**C. Principal Accountant Fees and Services**

KPMG Auditores Independentes served as our independent registered public accounting firm for the year ended December 31, 2016. KPMG Auditores Independentes’ activity began with the review of our interim financial information reporting for the second quarter of 2016.

Deloitte Touche Tohmatsu Auditores Independentes served as our independent registered public accounting firm for the years ended December 31, 2015, 2014, 2013, and 2012.

The following table presents the aggregate fees for professional services and other services rendered to us by KPMG Auditores Independentes and Deloitte Touche Tohmatsu Auditores Independentes in 2016 and 2015:

	Year ended December 31,	
	2016	2015
	<i>(in millions of reais)</i>	
Audit Fees <sup>(1)</sup>	1.9	1.7
Audit-Related Fees	-	-
Tax Fees	-	-
All Other Fees	-	-
<b>Total</b>	<b>1.9</b>	<b>1.7</b>

- (1) Audit Fees are the fees billed by our independent auditors for the audit of our annual financial statements, reviews of interim financial statements and attestation services that are provided in connection with statutory and regulatory filings or engagements.

#### Pre-approval policies and procedures

Pursuant to Brazilian law, our board of directors is responsible, among other matters, for the selection, dismissal and oversight of our independent registered public accounting firm. Our management is required to obtain the board of directors' approval before engaging an independent registered public accounting firm to provide any audit or permitted non-audit services to us. The Brazilian Federal and State Public Bidding Laws also apply to us with respect to obtaining services from third parties for our business, including the services provided by our independent registered public accounting firm. As part of the bidding process, the independent registered public accounting firm is required to submit proposals, and is then selected by us based on certain criteria including technical expertise and cost.

KPMG Auditores Independentes did not provide any non-audit services to us in 2016. Deloitte Touche Tohmatsu Auditores Independentes did not provide any non-audit services to us in 2016 or 2015.

#### D. Exemptions from the Listing Standards for Audit Committees

None

#### E. Purchases of Equity Securities by Issuer and Affiliated Purchasers

Not applicable.

#### ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

- In accordance with CVM Instruction 308/99, as amended, we have retained KPMG Auditores Independentes for the external audit of our company, replacing Deloitte Touche Tohmatsu Auditores Independentes.
- The appointment occurred due to the expiry of our contract with Deloitte Touche Tohmatsu Auditores Independentes, which was limited to 60 months in compliance with legislation applicable to us (Clause 57 of Law 8666/93). This appointment ended upon the issuance of their review report for statutory purposes for the first quarter of 2016 on May 12, 2016.
- Deloitte Touche Tohmatsu Auditores Independentes' audit reports of our financial statements for 2015 and 2014 did not contain an adverse opinion or disclaimer of opinion, nor were such reports qualified or modified as to uncertainty, audit scope, or accounting principles.
- During the financial years ended December 31, 2015 and 2014 and through May 12, 2016, except as described below, we had no disagreements with Deloitte Touche Tohmatsu Auditores Independentes on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Deloitte Touche Tohmatsu Auditores Independentes, would have caused Deloitte Touche Tohmatsu Auditores Independentes to make reference to the subject matter of such disagreements in its reports on our financial statements and ICFR - Internal control Over Financial Reporting for such periods.
- Deloitte Touche Tohmatsu Auditores Independentes identified a material weakness in our internal controls over financial reporting related to our control over the interpretation and application of the accounting treatment for the acquisition of a 30-year concession awarded to Sabesp by the Municipality of Santos in 2015. Deloitte Touche Tohmatsu Auditores Independentes proposed an adjustment during the performance of their 2015 interim procedures to correct the accounting treatment. This adjustment was recorded in our annual financial statements for the year ended December 31, 2015.
- The transaction and related accounting involved certain unpaid court judgments owed by Santos to us, which were the subject of a settlement agreement between Santos and us at the time of the award of the concession. The debt owed to us by the Municipality of Santos had previously been accounted for as an impaired accounts receivable. This transaction was unusual, both in terms of the economic settlement with Santos and due to specific regulations that apply to Sabesp. Indeed, because Santos is the anchor concession city for the metropolitan region of Baixada Santista, the economic characteristics of this case are so unique that our Management does not foresee that the same methodology would be applied in the future.
- Our Management believes that alternative interpretations are possible regarding the accounting treatment. On the basis of the amount involved, our Management did not consider the related adjustment to be material. Furthermore, this transaction was subject to our regular approval and control process.

8. Consequently, our Management does not believe there was a control deficiency or a material weakness in the design or operation of our internal control over financial reporting related to this transaction.
9. Our Management's conclusion was later confirmed by the opinion of a renowned accountancy advisory firm in Brazil that we retained in early 2016 to provide an opinion on this matter.
10. Deloitte Touche Tohmatsu Auditores Independentes issued an adverse audit report on the effectiveness of our internal control over financial reporting as of December 31, 2015, which was included in our Annual Report on Form 20-F for the year ended December 31, 2015.
11. During the financial years ended December 31, 2015 and 2014 and through May 12, 2016, there have been no reportable events as defined under Item 16F(a)(1)(v) of Form 20-F, except for the matter mentioned above.
12. We have provided Deloitte Touche Tohmatsu Auditores Independentes with a copy of this annual report prior to its filing with the SEC and requested that Deloitte Touche Tohmatsu Auditores Independentes furnish a letter addressed to the SEC stating whether it agrees with the statements made in this Item 16F. A copy of Deloitte Touche Tohmatsu Auditores Independentes's letter to the SEC dated May 15, 2017 is included as Exhibit 15.1 to this annual report.
13. On June 22, 2016, we engaged KPMG Auditores Independentes as our new independent registered public accounting firm to audit our financial statements. The decision to engage KPMG Auditores Independentes was approved by our board of directors at a meeting on June 16, 2016.
14. Prior to the engagement of KPMG Auditores Independentes as our independent registered public accounting firm, we had not previously consulted with KPMG Auditores Independentes regarding (1) the application of accounting principles to a specific completed or contemplated transaction, (2) the type of audit opinion that might be rendered on our financial statements, or (3) a reportable event (as provided in Item 16F(a)(1)(v) of Form 20-F) during our two most recent fiscal years and any later interim period, including the interim period up to and including the date that KPMG Auditores Independentes was engaged.

## **G. Corporate Governance**

### **Required Changes to Corporate Governance Practices of Brazilian Government-Controlled Companies**

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

Although the federal law gave the companies concerned two years in which to comply with the new standards, the State of São Paulo has decided that companies controlled by the State, like our company, must comply by the end of 2017.

In terms of corporate governance, the new law requires significant changes to internal controls and strengthens the rights not only of our shareholders, but also of any interested party, to inspect the finances and running of the company. It requires us to publish periodically a series of documents and reports to demonstrate our level of commitment to our business objectives, the financial impact of those commitments, and our policies and practices in terms of corporate governance and sustainability, among other things. Those documents and reports must be accompanied by further explanations, in plain language, that can be understood by the general public.

In order to comply with this law we will need to change our management structure, our by-laws and our Code of Ethics and Conduct. Among other requirements, we will need to implement the following rules:

- At least 25% of the members of the Board of Directors must be independent, in accordance with the definition of director independence set by Brazilian law (or, for companies whose minority shareholders exercise multiple votes, at least one of the directors must be independent).
- All directors and officers must have the same term of office, which may not be longer than two years. They may be re-elected up to a maximum of three times consecutively.
- The performance of the executive officers, directors and members of board committees must be subjected to yearly evaluation with respect to, at a minimum, the following matters:
  - a. the lawfulness and effectiveness of their management performance;
  - b. their contribution to the company's income for the year; and
  - c. their contribution to furthering the objectives in the company's business plan and compliance with its long-term strategy.



The new law requires that all officers and directors of the company must satisfy certain technical standards, in addition to the general requirement that they be of good reputation and have knowledge of the business sector concerned. These technical standards include satisfying both Point 1 and Point 2 below:

1. The individual must satisfy **at least** one of the requirements under (a), (b) or (c) of this Point 1:
  - a. a minimum of 10 years' experience in an appointed position, in either the public or private sector, in a business area that is similar or related to the company's business purpose; or
  - b. a minimum of four years' exercise of any one of (i), (ii) or (iii) below:
    - i. a senior management position in a company with a similar business purpose or similar size; or
    - ii. a position in the public sector that involves a high degree of trust (i.e., at level DAS-4 or higher); or
    - iii. a position as professor or researcher in the company's business sectors; or
  - c. a minimum of four years' practice as an independent professional in one or more areas that are directly or indirectly related to the company's business sectors;

**and:**

2. The individual must satisfy the requirements of **both** (a) and (b) of this Point 2:
  - a. the individual must have received sufficient training for the position for which she or he has been nominated; and
  - b. the individual must not have been declared ineligible for such position in accordance with applicable law.

We are in the process of implementing the requirements of the new legislation and we believe that we will have completed the implementation process by the end of 2017, as required by the State of São Paulo.

#### **Significant Differences between our Current Corporate Governance Practices and NYSE Corporate Governance Standards**

We are subject to the NYSE corporate governance listing standards. As a foreign private issuer, the standards applicable to us are considerably different than the standards applied to U.S. listed companies. Under the NYSE rules, we are required only to: (a) have an audit committee or audit board, pursuant to an applicable exemption available to foreign private issuers, that meets certain requirements, as discussed below, (b) provide prompt certification by our chief executive officer of any material non-compliance with any corporate governance rules, and (c) provide a brief description of the significant differences between our corporate governance practices and the NYSE corporate governance practice required to be followed by U.S. listed companies.

The following discussion summarizes the significant differences between our current corporate governance practices (which will remain in effect until we implement Federal Law No. 13,303/16) and those required of U.S. listed companies:

#### ***Majority of Independent Directors***

The NYSE rules require that a majority of the board must consist of independent directors. Independence is defined by various criteria, including the absence of a material relationship between the director and the listed company. Brazilian law does not have a similar requirement. Under Brazilian law, neither our board of directors nor our management is required to test the independence of directors before their election to the board. However, both the Brazilian Corporate Law and the CVM have established rules that require directors to meet certain qualification requirements and that address the compensation and duties and responsibilities of, as well as the restrictions applicable to, a company's executive officers and directors. Our board of directors must have a minimum of five members, and 20% of the board (even if the board consists of more than five members) must be independent as defined under Novo Mercado Regulations. Currently, five of our seven directors are independent, pursuant to the Novo Mercado Listing Regulations. We believe these rules provide adequate assurances that our directors are independent; however, they do not require that we have a majority of independent directors, as required under the NYSE rules.

### ***Executive Sessions***

NYSE rules require that the non-management directors must meet at regularly scheduled executive sessions without management present. The Brazilian Corporate Law does not have a similar provision. According to the Brazilian Corporate Law, up to one-third of the members of the board of directors can be elected from management. There is no requirement that non-management directors meet regularly without management. Our chairperson and Chief Executive Officer is a member of our board of directors. All other members of our board of directors meet the NYSE's definition of "non-management" directors. The non-management directors on our board do not typically meet in executive session. Our board of directors consists of five non-management directors.

### ***Fiscal Committee***

Under the Brazilian Corporate Law, the *Conselho Fiscal*, or fiscal committee, is a corporate body independent of management and a company's external auditors. The fiscal committee may be either permanent or non-permanent, in which case it is appointed by the shareholders to act during a specific fiscal year. A fiscal committee is not equivalent to, or comparable with, a U.S. audit committee. The primary responsibility of the fiscal committee is to review management's activities and a company's financial statements, and to report its findings to the company's shareholders. The Brazilian Corporate Law requires fiscal committee members to receive as remuneration at least 10% of the average annual amount paid to a company's executive officers. The Brazilian Corporate Law requires a fiscal committee to be composed of a minimum of three and a maximum of five members and their respective alternates.

Under the Brazilian Corporate Law, the fiscal committee may not contain members that (i) are on our board of directors, (ii) are on the board of executive officers, (iii) are employed by us or a controlled company, or (iv) are spouses or relatives of any member of our management, up to the third degree.

Our fiscal committee consists of five members and five alternates and the members meet once a month.

### ***Audit Committee***

NYSE rules require that listed companies have an audit committee that (i) is composed of a minimum of three independent directors who are all financially literate, (ii) meets the SEC rules regarding audit committees for listed companies, (iii) has at least one member who has accounting or financial management expertise and (iv) is governed by a written charter addressing the committee's required purpose and detailing its required responsibilities. However, as a foreign private issuer, we need only to comply with the requirement that the audit committee meet the SEC rules regarding audit committees for listed companies to the extent compatible with Brazilian Corporate Law. Our audit committee, which is not equivalent to, or comparable with, a U.S. audit committee, provides assistance to our board of directors on matters involving accounting, internal controls, financial reporting and compliance. The audit committee recommends the appointment of our independent auditors to our board of directors and reviews the compensation of our independent auditors and helps coordinate their activities. It also evaluates the effectiveness of our internal financial and legal compliance controls. The audit committee comprises three members elected by the board of directors for a two-year term with the right to re-election, all three of which are independent. The current members of our audit committee are Jerônimo Antunes, Francisco Luiz Sibut Gomide and Luís Eduardo Alves de Assis. All members meet the independent membership requirements of the SEC and NYSE as well as other NYSE requirements. Jerônimo Antunes is the committee's "financial expert" within the scope of the SEC rules covering the disclosure of financial experts on audit committees in periodic filings pursuant to the U.S. Securities Exchange Act of 1934.

### ***Corporate Risks Management Committee***

In 2009, our board of executive officers created a Corporate Risks Management Committee, which is responsible for: (a) evaluating the maximum level of risk that our Management should incur in our operations in order to obtain planned results; (b) evaluating the identification, measurement, treatment and processing of risks in action plans; and (c) forwarding statements, proposals and evaluations to the audit committee and to the board of executive officers for review, and submitting such statements, proposals and evaluations to the board of directors for approval. The Corporate Risks Management Committee has a coordinator and consists of representatives from the following management divisions: CEO's Office; Corporate Management; Technology, Enterprises and Environment; Metropolitan; Economics and Finance and Investor Relations; and Regional Systems.

### ***Nomination/Corporate Governance and Compensation Committees***

NYSE rules require that listed companies have a nominating/corporate governance committee and a compensation committee composed entirely of independent directors and governed by a written charter addressing the committee's required purpose and detailing its required responsibilities. Required responsibilities for the nominating/corporate governance committee include, among other things, identifying and selecting qualified board member nominees and developing a set of corporate governance principles applicable to the company. Required responsibilities for the compensation committee include, among other things, reviewing corporate goals relevant to the chief executive officer's compensation, evaluating the chief executive officer's performance, approving the chief executive officer's compensation levels and recommending to the board non-chief executive officer compensation, incentive-compensation and equity-based plans.

We are not required under applicable Brazilian law to have a nomination/corporate governance committee or compensation committee. Under the Brazilian Corporate Law, the total amount available for compensation of our directors and executive officers and for profit-sharing payments to our executive officers is established by our shareholders at the annual general meeting. The board of directors is then responsible for determining the individual compensation and profit-sharing of each executive officer, as well as the compensation of our board and committee members. In making such determinations, the board reviews the performance of the executive officers, including the performance of our chief executive officer, who typically excuses himself from discussions regarding his performance and compensation.

### ***Shareholder Approval of Equity Compensation Plans***

NYSE rules require that shareholders be given the opportunity to vote on all equity compensation plans and material revisions thereto, with limited exceptions. We do not currently have any equity compensation plan. If such a plan were to be implemented, there is no requirement under Brazilian Corporate Law for the plan to be approved by our shareholders. However, if the issuance of new shares in connection with any equity compensation plan exceeded the authorized capital under our bylaws, the increase in capital would require shareholder approval.

### ***Corporate Governance Guidelines***

NYSE rules require that listed companies adopt and disclose corporate governance guidelines. We are in compliance with the adoption of corporate governance provisions and guidelines required under the Novo Mercado Regulations. Additionally, under the CVM's guidelines, we have established (i) the Policy of Publicizing Acts or Relevant Facts and the Preservation of Confidentiality which requires us to publicly disclose all relevant information and (ii) the Securities Negotiation Policy which requires management to inform the CVM and the BM&FBOVESPA of any purchases or sales of our securities. We believe the corporate governance guidelines applicable to us under the Novo Mercado Regulations, as well as the CVM, do not conflict with the guidelines established by the NYSE. Our corporate governance guidelines and practices are available in our website at [www.sabesp.com.br](http://www.sabesp.com.br) and in our annual management report.

### ***Code of Business Conduct and Ethics***

NYSE rules require that listed companies adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers. Applicable Brazilian law does not have a similar requirement. We have decided to adopt and disclose a code of ethics and conduct applicable to all our officers, directors and employees. The adoption and disclosure of a formal code is not required under the Brazilian Corporate Law. We believe our formal code addresses the matters required to be addressed by the applicable NYSE and SEC rules.

### **Internal Audit Function**

NYSE rules require that listed companies maintain an internal audit function to provide management and the audit committee with ongoing assessments of the company's risk management processes and system of internal control. Our internal audit department is under the supervision of our Chief Executive Officer and our audit committee and is responsible for our compliance with the requirements of Section 404 of the U.S. Sarbanes Oxley Act of 2002 regarding internal control over financial reporting. Our internal audit department reports to our chief executive officer and the audit committee.

### **Anticorruption Compliance**

Law No. 12,846, of August 1, 2013 (the "Anticorruption Law"), as further regulated by Decree No. 8,420/2015, introduced the concept of strict liability for legal entities involved in harmful acts against the public administration, as defined in the Anticorruption Law, subjecting the violator to penalties both in administrative and civil law. Similar to the Foreign Corrupt Practices Act of the United States, to which we are also subject, the Anticorruption Law considers that an effective implementation of Compliance Programs may be used to mitigate the administrative penalties to be applied as a consequence of a harmful act against the public administration. In 2015, we analyzed our current compliance practices and defined action plans based on the analysis of 2014 corporate corruption and fraud risks.

As a mixed capital company, our Compliance Program encompasses two distinct situations – active corruption and passive corruption – and follows the recommendations of the Organization for Economic Cooperation and Development, the United Nations Office on Drugs and Crimes, and the World Bank. Our program incorporates and focuses on high management, structural functioning, the provision of complaint hotlines, monitoring of third-party relationships, governance and internal controls, risk management, training and communication.

### **Citizens' Access to Information at Sabesp**

Federal Law No. 12,527/2011 (LAI), regulated by State Decree No. 58.052/2012 and State Decree No. 61.559/2015 determines that government entities must create Citizen Information Services – SIC units which receive and manage information requests from the public, and make available to citizens information requested or otherwise provided the reasons for denial of such information requests.

In order to comply with LAI, we implemented the Citizen Information Service - SIC, structuring the internal flow of information to serve citizen within the terms provided for by laws and is drafting the Table of documents, data and information, defining restrictive information, protecting business strategic information and pursuing the transparent management. We also made available at our website basic information required by laws and the software to citizens to request information, according to the standards of the São Paulo State Government.

These duties are linked to the Risk Management area whose main assumption is the transparency, quality of information and compliance with strategic rules of a listed company.

### **H. Mine Safety Disclosure**

Not applicable.

## **PART III**

### **ITEM 17. FINANCIAL STATEMENTS**

Not applicable.

### **ITEM 18. FINANCIAL STATEMENTS**

The following financial statements, together with the reports of the independent registered public accounting firms, are filed as part of this annual report. See "Index to Financial Statements".

## ITEM 19. EXHIBITS

Item	Description
1.1	By-laws of the Registrant (English translation) (incorporated by reference to the Form 6-K filed on May 13, 2014).
4.1	Agreement between the Registrant and the State Department of Water and Energy ( <i>Departamento de Águas e Energia Elétrica—DAEE</i> ), dated April 24, 1997 (English translation) (incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form F-1 filed on April 8, 2002 (the "April 8, 2002 Form F-1").
4.2	Protocol of Understanding between the Registrant and the State of São Paulo, dated September 30, 1997 (English translation) (incorporated by reference to Exhibit 10.2 to the April 8, 2002 Form F-1).
4.3	Agreement between the Registrant and the State of São Paulo, through the Secretariat of Finance, dated September 10, 2001 (English translation) (incorporated by reference to Exhibit 10.3 to the April 8, 2002 Form F-1).
4.4	Agreement between the Registrant and the State of São Paulo, through the Secretariat of the Treasury, dated December 11, 2001 (English translation) (incorporated by reference to Exhibit 10.4 to the April 8, 2002 Form F-1).
4.5	Amendment to the Agreement, dated April 24, 1997, between the Registrant and the DAEE, dated March 16, 2000 (English translation) (incorporated by reference to Exhibit 10.5 to the April 8, 2002 Form F-1).
4.6	Amendment to the Agreement, dated April 24, 1997, between the Registrant and the DAEE, dated November 21, 2001 (English translation) (incorporated by reference to Exhibit 10.6 to the April 8, 2002 Form F-1).
4.7	First Amendment to the Agreement, dated December 11, 2001, between the Registrant and the State of São Paulo, dated March 22, 2004. (English translation) (incorporated by reference to Exhibit 4.7 to the Form 20-F filed on June 28, 2004).
4.8	Second Amendment to the Agreement, dated December 11, 2001, between the Registrant and the State of São Paulo, dated December 28, 2007. (English translation) (incorporated by reference to the Form 6-K filed on February 25, 2008).
4.9	Third Amendment to the Agreement, dated December 11, 2001, between the Registrant and the State of São Paulo, dated November 17, 2008. (English translation) (incorporated by reference to the Form 6-K filed on December 23, 2008).
4.10	Commitment Agreement, between the Registrant and the State of São Paulo, dated March 26, 2008. (English translation) (incorporated by reference to the Form 6-K filed on April 28, 2008).
4.11	Agreement Executed between the Registrant and the São Paulo City Government, dated November 14, 2007 (English Translation) (incorporated by reference to the Form 6-K filed on March 12, 2008).
4.12	Amendment to the Agreement Executed between the Registrant and the São Paulo City government, dated February 10, 2008 (English translation) (incorporated by reference to the Form 6-K filed on May 12, 2008).
4.14	The Audit Committee Charter dated April 19, 2016 (English translation) (incorporated by reference to the Form 6-K filed on April 21, 2016).
4.15	Convention between the State and the city of São Paulo, dated June 23, 2010, with the intermediation and consent of the Registrant and of ARSESP (English translation) (incorporated by reference to the Form 6-K filed on July 13, 2010).
4.16	Contract to provide public water supply and sewage services, among the Registrant, the State and the city of São Paulo, dated June 23, 2010 (English translation) (incorporated by reference to the Form 6-K filed on July 13, 2010).
4.17	Term of Agreement between the Registrant, the State of São Paulo and the DAEE, dated March 18, 2015 (English translation) (incorporated by reference to the Form 6-K filed on April 15, 2015).
4.18	Notice of Transactions with Related Parties, dated November 9, 2016, (English translation) (incorporated by reference to the Form 6-K filed on November 16, 2016)
11.1	Code of Ethics and Conduct dated June 1, 2014 (English translation) (incorporated by reference to the Form 6-K filed on July 24, 2014).
<a href="#"><u>12.1</u></a>	<a href="#"><u>Certification of Jerson Kelman, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u></a>
<a href="#"><u>12.2</u></a>	<a href="#"><u>Certification of Rui de Britto Álvares Affonso, Chief Financial Officer and Investor Relations Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u></a>
<a href="#"><u>13.1</u></a>	<a href="#"><u>Certification of Jerson Kelman, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u></a>
<a href="#"><u>13.2</u></a>	<a href="#"><u>Certification of Rui de Britto Álvares Affonso, Chief Financial Officer and Investor Relations Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u></a>
<a href="#"><u>15.1</u></a>	<a href="#"><u>Letter from Deloitte Touche Tohmatsu Auditores Independentes to the SEC, dated May 15, 2017 regarding the change in independent public accounting firm.</u></a>

## SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

### COMPANHIA DE SANEAMENTO BÁSICO DO ESTADO DE SÃO PAULO – SABESP

By: /s/ Jerson Kelman  
Name: Jerson Kelman  
Title: Chief Executive Officer

By: /s/ Rui de Britto Álvares Affonso  
Name: Rui de Britto Álvares Affonso  
Title: Chief Financial Officer and Investor  
Relations Officer

Date: May 15, 2017

# **Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

**Financial Statements as at December 31, 2016 and 2015  
And for the years ended  
December 31, 2016, 2015 and 2014**

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying statement of financial position of Companhia de Saneamento Básico do Estado de São Paulo - SABESP as of December 31, 2016, and the related income statement, statements of comprehensive income, changes in equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Companhia de Saneamento Básico do Estado de São Paulo - SABESP as of December 31, 2016, and the results of its operations and its cash flows for the year then ended, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

We also have audited the adjustment to the previously reported segment information for 2015 and 2014 described in note 24 to the financial statements. In our opinion, such adjustments to the 2015 and 2014 segment information are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2015 and 2014 financial statements of the Company other than with respect to the restatement of previously reported segment information and, accordingly, we do not express an opinion or any other form of assurance on the 2015 and 2014 financial statements taken as a whole.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Companhia de Saneamento Básico do Estado de São Paulo - SABESP's internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control – Integrated Framework 2013* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated May 15, 2017 expressed an unqualified opinion on the effectiveness of the Companhia de Saneamento Básico do Estado de São Paulo - SABESP's internal control over financial reporting.

/s/ KPMG Auditores Independentes

São Paulo – Brazil

May 15, 2017



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON  
FINANCIAL STATEMENTS

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

We have audited, before the effects of the retrospective adjustments to the disclosures for a change in the composition of reportable segments discussed in Note 24 to the financial statements, the accompanying statement of financial position of Companhia de Saneamento Básico do Estado de São Paulo - SABESP (the “Company”) as of December 31, 2015, and the related statements of income, comprehensive income, changes in equity and cash flows for each of the two years in the period ended December 31, 2015. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements, before the effects of the retrospective adjustments to the disclosures for a change in the composition of reportable segments discussed in Note 24 to the financial statements, present fairly, in all material respects, the financial position of Companhia de Saneamento Básico do Estado de São Paulo - SABESP as of December 31, 2015, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2015, in conformity with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB).

We were not engaged to audit, review, or apply any procedures to the retrospective adjustments to the disclosures for a change in the composition of reportable segments discussed in Note 24 to the financial statements and, accordingly, we do not express an opinion or any other form of assurance about whether such retrospective adjustments are appropriate and have been properly applied. Those retrospective adjustments were audited by other auditors.

/s/ Deloitte Touche Tohmatsu Auditores Independentes

São Paulo, Brazil  
May 11, 2016

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Statements of Financial Position as of December 31, 2016 and 2015

Amounts in thousands of reais

Assets	Note	December 31, 2016	December 31, 2015
Current assets			
Cash and cash equivalents	7	1,886,221	1,639,214
Trade receivables	9 (a)	1,557,472	1,326,972
Accounts receivable from related parties	10 (a)	202,553	156,155
Inventories		58,002	64,066
Restricted cash	8	24,078	29,156
Recoverable taxes	17 (a)	42,633	77,828
Other receivables		52,676	156,942
<b>Total current assets</b>		<b>3,823,635</b>	<b>3,450,333</b>
Noncurrent assets			
Trade receivables	9 (a)	153,834	182,616
Accounts receivable from related parties	10 (a)	669,156	715,952
Escrow deposits		77,915	76,663
Deferred income tax and social contribution	18	186,345	128,242
Water National Agency – ANA	11	81,221	88,368
Other receivables		114,693	140,676
Investments	12	31,096	28,105
Investment properties	13	57,968	56,957
Intangible assets	14	31,246,788	28,513,626
Property, plant and equipment	15	302,383	325,076
<b>Total noncurrent assets</b>		<b>32,921,399</b>	<b>30,256,281</b>
<b>Total assets</b>		<b>36,745,034</b>	<b>33,706,614</b>

The accompanying notes are an integral part of these financial statements.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Statements of Financial Position as of December 31, 2016 and 2015, continued

Amounts in thousands of reais

Liabilities and equity	Note	December 31, 2016	December 31, 2015
<b>Current liabilities</b>			
Trade payables and contractors		311,960	248,158
Current portion of long-term borrowings and financing	16	1,246,567	1,526,262
Accrued payroll and related taxes		458,299	347,976
Taxes and contributions	17 (b)	168,757	107,295
Interest on capital	22 (c)	700,034	127,441
Provisions	19 (a)	730,334	631,890
Services payable	21	460,054	387,279
Public-Private Partnership - PPP	14 (h)	31,898	33,255
Program Contract Commitments	14 (d) (iv)	109,042	228,659
Other liabilities		85,563	102,101
<b>Total current liabilities</b>		<b>4,302,508</b>	<b>3,740,316</b>
<b>Noncurrent liabilities</b>			
Borrowings and financing	16	10,717,576	11,595,338
Deferred Cofins and PASEP		138,071	132,921
Provisions	19 (a)	442,741	450,324
Pension obligations	20 (b)	3,265,250	2,832,216
Public-Private Partnership - PPP	14 (h)	2,217,520	1,001,778
Program Contract Commitments	14 (d) (iv)	69,051	92,055
Other liabilities		173,106	145,060
<b>Total noncurrent liabilities</b>		<b>17,023,315</b>	<b>16,249,692</b>
<b>Total liabilities</b>		<b>21,325,823</b>	<b>19,990,008</b>
<b>Equity</b>			
Capital stock	22	10,000,000	10,000,000
Earnings reserves		6,244,859	4,069,988
Other comprehensive loss		(825,648)	(353,382)
<b>Total equity</b>		<b>15,419,211</b>	<b>13,716,606</b>
<b>Total equity and liabilities</b>		<b>36,745,034</b>	<b>33,706,614</b>

The accompanying notes are an integral part of these financial statements.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Income Statements for the Years ended December 31, 2016, 2015 and 2014 Amounts in thousands of reais, unless otherwise indicated

	<u>Note</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
<b>Net operating revenue</b>	26 (b)	14,098,208	11,711,569	11,213,216
Cost of services	27	(9,013,120)	(8,260,763)	(7,635,599)
<b>Gross profit</b>		<u>5,085,088</u>	<u>3,450,806</u>	<u>3,577,617</u>
Selling expenses	27	(730,047)	(598,125)	(736,608)
Administrative income (expenses)	27	(934,896)	44,958	(924,359)
Other operating income (expenses), net	29	4,722	143,755	(3,488)
Equity in results of investments in affiliates	12	4,740	2,597	(2,453)
<b>Profit from operations before finance income (expenses) and income tax and social contribution</b>		<u>3,429,607</u>	<u>3,043,991</u>	<u>1,910,709</u>
Financial expenses	28	(839,891)	(859,732)	(712,293)
Financial revenues	28	448,710	395,234	422,732
Exchange result, net	28	1,090,628	(1,991,964)	(346,305)
<b>Financial expenses, net</b>		<u>699,447</u>	<u>(2,456,462)</u>	<u>(635,866)</u>
<b>Profit before income tax and social contribution</b>		<u>4,129,054</u>	<u>587,529</u>	<u>1,274,843</u>
Income tax and social contribution				
Current	18 (d)	(1,121,289)	(1,226)	(437,417)
Deferred	18 (d)	(60,667)	(50,024)	65,557
		<u>(1,181,956)</u>	<u>(51,250)</u>	<u>(371,860)</u>
<b>Profit for the year</b>		<u>2,947,098</u>	<u>536,279</u>	<u>902,983</u>
<b>Earnings per share – basic and diluted (in reais)</b>	23	<u>4.31</u>	<u>0.78</u>	<u>1.32</u>

The accompanying notes are an integral part of these financial statements.

## Companhia de Saneamento Básico do Estado de São Paulo - SABESP

### Statements of Comprehensive Income for the Years ended December 31, 2016, 2015 and 2014 Amounts in thousands of reais

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	<u>Note</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Profit for the year		2,947,098	536,279	902,983
Other comprehensive income (loss)		(472,266)	36,366	(256,217)
Items which will not be subsequently reclassified to the income statement:				
Actuarial gains and (losses) on defined benefit plans	20 (b)	(472,266)	36,366	(256,217)
Total comprehensive income for the year		<u>2,474,832</u>	<u>572,645</u>	<u>646,766</u>

The accompanying notes are an integral part of these financial statements.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Statements of Changes in Equity for the Years ended December 31, 2016, 2015 and 2014 Amounts in thousands of reais, unless otherwise indicated

	Note	Capital stock	Capital reserve	Earnings reserves			Retained earnings	Other comprehensive loss	Total
				Legal Reserve	Investment reserve	Additional dividend proposed			
<b>Balances as of December 31, 2013</b>		6,203,688	124,255	712,992	5,980,535	42,862	-	(133,531)	12,930,801
Net income for the year		-	-	-	-	-	902,983	-	902,983
Actuarial gains (losses)	20 (b)	-	-	-	-	-	-	(256,217)	(256,217)
Total comprehensive income for the year		-	-	-	-	-	902,983	(256,217)	646,766
Legal reserve	22 (d)	-	-	45,149	-	-	(45,149)	-	-
Interest on capital (R\$0.3138 per share)	22 (c)	-	-	-	-	-	(214,458)	-	(214,458)
2013 additional proposed dividends, approved (R\$0.1180 per share)		-	-	-	-	(42,862)	-	-	(42,862)
Additional proposed dividends	22 (c)	-	-	-	-	37,846	(37,846)	-	-
Withholding income tax on interest on capital attributable as minimum mandatory dividends		-	-	-	-	(15,844)	-	-	(15,844)
Capitalization of reserves		3,796,312	(124,255)	-	(3,672,057)	-	-	-	-
Transfer to investments reserve		-	-	-	605,530	-	(605,530)	-	-
<b>Balances as of December 31, 2014</b>		10,000,000	-	758,141	2,914,008	22,002	-	(389,748)	13,304,403
Net income for the year		-	-	-	-	-	536,279	-	536,279
Actuarial gains (losses)	20 (b)	-	-	-	-	-	-	36,366	36,366
Total comprehensive income for the year		-	-	-	-	-	536,279	36,366	572,645
Legal reserve	22 (d)	-	-	26,814	-	-	(26,814)	-	-
Interest on capital (R\$0.1863 per share)	22 (c)	-	-	-	-	-	(127,366)	-	(127,366)
2014 additional proposed dividends, approved (R\$0.0554 per share)		-	-	-	-	(22,002)	-	-	(22,002)
Additional proposed dividends	22 (c)	-	-	-	-	22,527	(22,527)	-	-
Withholding income tax on interest on capital attributable as minimum mandatory dividends		-	-	-	-	(11,074)	-	-	(11,074)
Transfer to investments reserve		-	-	-	359,572	-	(359,572)	-	-
<b>Balances as of December 31, 2015</b>		10,000,000	-	784,955	3,273,580	11,453	-	(353,382)	13,716,606
Net income for the year		-	-	-	-	-	2,947,098	-	2,947,098
Actuarial gains (losses)	20 (b)	-	-	-	-	-	-	(472,266)	(472,266)
Total comprehensive income for the year		-	-	-	-	-	2,947,098	(472,266)	2,474,832
Legal Reserve	22 (d)	-	-	147,355	-	-	(147,355)	-	-
Interest on capital (R\$1.0240 per share)	22 (c)	-	-	-	-	-	(699,936)	-	(699,936)
2015 additional proposed dividends, approved (R\$0.0330 per share)		-	-	-	-	(11,453)	-	-	(11,453)
Additional proposed dividends	22 (c)	-	-	-	-	123,557	(123,557)	-	-
Withholding income tax on interest on capital attributable as minimum mandatory dividends		-	-	-	-	(60,838)	-	-	(60,838)
Transfer to investments reserve	22 (f)	-	-	-	1,976,250	-	(1,976,250)	-	-
<b>Balances as of December 31, 2016</b>		10,000,000	-	932,310	5,249,830	62,719	-	(825,648)	15,419,211

The accompanying notes are an integral part of these financial statements.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Statements of Cash Flows for the Years ended December 31, 2016, 2015 and 2014 Amounts in thousands of reais, unless otherwise indicated

	December 31, 2016	December 31, 2015	December 31, 2014
<b>Cash flow from operating activities</b>			
<b>Profit before income tax and social contribution</b>	<b>4,129,054</b>	<b>587,529</b>	<b>1,274,843</b>
<b>Adjustments for:</b>			
Depreciation and amortization	1,146,626	1,074,032	1,004,471
Residual value of property, plant and equipment and intangible assets written-off	15,168	52,040	48,248
Bad debt expense	90,488	2,420	139,589
Provisions and inflation adjustment	276,654	(4,706)	236,122
Pension plan liabilities – early reduction (curtailment)	(334,152)	-	-
Interest calculated on borrowings and financing payable	449,470	474,056	379,489
Inflation adjustment and exchange gains (losses) on borrowings and financing	(969,430)	2,163,754	443,414
Interest and inflation adjustment on liabilities	24,297	27,168	17,900
Interest and inflation adjustment on assets	(80,675)	(130,762)	(36,227)
Finance charges from customers	(207,789)	(125,966)	(195,948)
Margin of fair value on intangible assets arising from concession	(81,513)	(72,908)	(62,520)
Provision for Consent Decree (TAC)	89,083	(15,601)	52,008
Equity in results of investments in affiliates	(4,740)	(2,597)	2,453
Provision from São Paulo agreement	-	11,252	(23,306)
Provision for pension plan - Sabesprev Mais	235	8,349	8,395
Pension obligations	377,886	352,710	289,294
Other adjustments	24,412	(6,103)	43,543
GESP Agreement	-	(696,283)	-
	<b>4,945,074</b>	<b>3,698,384</b>	<b>3,621,768</b>
<b>Changes in assets</b>			
Trade receivables	(34,665)	(111,738)	363,343
Accounts receivable from related parties	(3,163)	(2,818)	42,670
Inventories	7,156	(550)	(8,699)
Recoverable taxes	35,195	70,940	(148,578)
Escrow deposits	33,232	35,083	4,528
Other receivables	144,920	(9,785)	(47,590)
<b>Changes in liabilities</b>			
Trade payables and contractors	6,371	(18,314)	(85)
Services payable	72,775	57,054	19,071
Accrued payroll and related taxes	21,240	(24,394)	21,037
Taxes and contributions payable	(90,325)	35,947	28,383
Deferred Cofins/PASEP	5,150	3,570	(498)
Provisions	(185,793)	(133,427)	(196,157)
Pension obligations	(201,736)	(182,514)	(172,820)
Other liabilities	17,842	(47,607)	(6,946)
<b>Cash generated from operations</b>	<b>4,773,273</b>	<b>3,369,831</b>	<b>3,519,427</b>
Interest paid	(739,944)	(710,688)	(603,563)
Income tax and social contribution paid	(1,029,737)	(17,743)	(435,612)
<b>Net cash generated from operating activities</b>	<b>3,003,592</b>	<b>2,641,400</b>	<b>2,480,252</b>
<b>Cash flows from investing activities</b>			
Acquisition of intangible	(2,108,167)	(2,397,352)	(2,658,857)
Restricted cash	5,078	(9,406)	(9,417)
Investment increase	-	(2,540)	(16)
Purchase of property, plant and equipment	(27,631)	(54,794)	(89,451)
Dividends received	-	4,612	-
<b>Net cash used in investing activities</b>	<b>(2,130,720)</b>	<b>(2,459,480)</b>	<b>(2,757,741)</b>

The accompanying notes are an integral part of these financial statements.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Statements of Cash Flows for the Years ended December 31, 2016, 2015 and 2014, continued Amounts in thousands of reais

	December 31, 2016	December 31, 2015	December 31, 2014
<b>Cash flows from financing activities</b>			
Borrowings and financing			
Proceeds from loans	1,250,524	1,303,296	1,258,101
Payment of loans	(1,535,312)	(1,292,322)	(529,535)
Payment of interest on capital	(139,399)	(202,115)	(467,469)
Public-Private Partnership - PPP	(30,498)	(23,799)	(4,189)
Program Contract Commitments	(171,180)	(50,757)	(38,429)
<b>Net cash generated by (used in) financing activities</b>	<b>(625,865)</b>	<b>(265,697)</b>	<b>218,479</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>247,007</b>	<b>(83,777)</b>	<b>(59,010)</b>
<b>Represented by :</b>			
Cash and cash equivalents at the beginning of the year	1,639,214	1,722,991	1,782,001
Cash and cash equivalents at the end of the year	1,886,221	1,639,214	1,722,991
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>247,007</b>	<b>(83,777)</b>	<b>(59,010)</b>

The accompanying notes are an integral part of these financial statements.



# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2016, 2015 and 2014

Amounts in thousands of reais, unless otherwise indicated

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### 1 Operations

Companhia de Saneamento Básico do Estado de São Paulo ("SABESP" or the "Company") is a mixed-capital company headquartered in São Paulo, at Rua Costa Carvalho, 300, CEP 05429-900, controlled by the São Paulo State Government. The Company is engaged in the provision of basic and environmental sanitation services in the State of São Paulo, as well as it supplies treated water and sewage services on a wholesale basis.

In addition to providing basic sanitation services in the State of São Paulo, SABESP may performs these activities in other states and countries, and can operate in drainage, urban cleaning, solid waste handling and energy markets. SABESP aims to be a world reference in the provision of sanitation services, in a sustainable, competitive and innovative manner, with a focus on customers.

As of December 31, 2016, the Company operated water and sewage services in 366 municipalities of the State of São Paulo. Most of these municipalities operations are based on 30-year concession, program and services contracts. As of November 9, 2016, the Company signed an agreement with the municipality of Santa Branca, stipulating the beginning of operations for February 2017; thus, Santa Branca is not included in the aforementioned 366 municipalities. The Company has two partial contracts with the municipality of Mogi das Cruzes, however, since most of municipality is serviced by wholesale, it was not included in the 366 municipalities. As of December 31, 2016, the Company had 369 contracts.

SABESP is not temporarily operating in some municipalities due to judicial orders. The lawsuits in progress refer to Macatuba and Cajobi, and the carrying amount of these municipalities' intangible assets was R\$4,345 as of December 31, 2016 (R\$4,345 as of December 31, 2015).

As of December 31, 2016, 54 concession agreements (53 as of December 31, 2015) had expired and are being negotiated. From 2017 to 2030, 34 concession agreements will expire. Management believes that concession agreements expired and not yet renewed will result in new contracts, disregarding the risk of discontinuity in the provision of municipal water supply and sewage services. By December 31, 2016, 281 program and services contracts were signed (278 contracts as of December 31, 2015).

As of December 31, 2016, the carrying amount of the underlying assets used in the 54 concessions of the municipalities under negotiation totaled R\$6,582,569, accounting for 21.07% of the total, and the related gross revenue for the year ended December 31, 2016 totaled R\$1,811,003, accounting for 12.19% of the total.

The Company's operations are concentrated in the municipality of São Paulo, which represents 55.46% of the gross revenues on December 31, 2016 (51.79% on December 31, 2015 and 49.42% in December 2014) and 46.57% of intangible assets (43.37% on December 31, 2015).

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2016, 2015 and 2014

Amounts in thousands of reais, unless otherwise indicated

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On June 23, 2010, the State of São Paulo, the Municipality of São Paulo, the Company and the regulatory agency “Sanitation and Energy Regulatory Agency – ARSESP” signed an agreement to share the responsibility for water supply and sewage services to the Municipality of São Paulo based on a 30-year concession agreement. This agreement is extendable for another 30 years, pursuant to the law. This agreement sets forth SABESP as the exclusive service provider and designates ARSESP as regulator, establishing prices, controlling and monitoring services. On the same date, the State of São Paulo, the Municipality of São Paulo and SABESP signed the “Public service provision agreement of water supply and sewage services”, a 30-year concession agreement which is extendable for another 30 years. This agreement involves the following activities:

- i. protection of the sources of water in collaboration with other agencies of the State and the City;
- ii. capture, transport and treatment of water;
- iii. collect, transport, treatment and final dispose of sanitary sewage; and
- iv. adoption of other actions of basic and environmental sanitation.

The Company operates under an authorization by public deed in some municipalities in the Santos coast region and in the Ribeira Valley, where the Company started to operate after the merger of the companies that formed it. In September 2015, the Company entered into a water supply and sewage public utility services agreement with the municipality of Santos; the gross revenue calculated in the year ended December 31, 2016 totaled R\$280,689 (R\$269,530 in the year ended December 31, 2015) and the intangible asset was R\$303,540 in the year ended December 31, 2016 (R\$310,693 as of December 31, 2015).

Article 58 of Law 11,445/07 determines that precarious and overdue concessions, as well as those effective for an undetermined period of time, including those that do not have an instrument formalizing them, will be valid until December 31, 2010. However, Article 2 of Law 12,693 of July 24, 2012, which amended Article 7º-A of Law 11,578, of November 26, 2007, allowed the provision of public basic sanitation services to be executed until December 31, 2016.

The Company’s Management understands that in the municipalities where the concession agreements were not yet renewed, the operation is governed by Laws 8,987/95 and 11,445/07, including those municipalities served without an agreement.

Public deeds are valid and governed by the Brazilian Civil Code.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2016, 2015 and 2014

Amounts in thousands of reais, unless otherwise indicated

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The Company's shares have been listed in the Novo Mercado (New Market) segment of BM&FBovespa under the ticker symbol SBSP3 since April 2002 and on the New York Stock Exchange (NYSE) as American Depositary Receipts ("ADRs") Level III, under the SBS code, since May 2002.

Since 2008, the Company has been setting up partnerships with other companies, which resulted in the following companies: Sesamm, Águas de Andrada, Saneaqua Mairinque, Aquapolo Ambiental, Águas de Castilho, Attend Ambiental and Paulista Geradora de Energia. Although SABESP has no majority interest in the capital stock of these companies, the shareholders' agreements provide for the power of veto and casting vote in certain issues jointly with associates, indicating the shared control in the management of investees.

The 2014-2015 water condition presented the lowest rainfall and inflow ever seen in 85 years, especially in the reservoirs composing the Cantareira System. During the rainy season, from October 2015 to March 2016, rainfall in the region returned to the normal levels expected for the period which, jointly with the various measures adopted by the Company to mitigate water shortage impacts, the collaboration of the population in water saving and the emergency works undertaken in 2014 and 2015 resulted in the recovery of water levels in the reservoirs of the Cantareira System.

Consequently, since May 1, 2016, the Water Consumption Reduction Incentive Program, effective since February 2014, and the Contingency Tariff, effective as of January 2015, were cancelled.

In December 2016, the reservoirs in the São Paulo Metropolitan Region stored 1.2 trillion liters of water for treatment, versus 703 billion liters in December 2015, including the technical reserve.

However, although the measures adopted in 2014 and 2015 to ensure water supply in the São Paulo Metropolitan Region were discontinued in 2016, billed water volume has not reached pre-crisis levels yet, which is a sign that consumer habits may have changed. Another factor that probably played a role in the decline of consumption in 2016 was the slowdown in the Brazilian economy.

At the end of 2017 and beginning of 2018 two important projects aimed to increase water security in the São Paulo Metropolitan Region are expected to be concluded, as follows: (i) the Jaguari-Atibainha interconnection, which will transfer up to 5.13 cubic meters per second ( $m^3/s$ ) from the Paraíba do Sul Basin to the Cantareira System; and (ii) the construction of the São Lourenço Production System, which will expand water production and capacity by  $6 m^3/s$ .

In 2016, the water monthly production for the São Paulo Metropolitan Region averaged  $58.5 m^3/s$ , compared to  $52.0 m^3/s$  in 2015,  $62.2 m^3/s$  in 2014 and  $69.1 m^3/s$  in 2013, the year before the beginning of the water crisis.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2016, 2015 and 2014

Amounts in thousands of reais, unless otherwise indicated

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Management expects that with improved water conditions, the generation of operating cash and the credit lines available for investment, the Company will have sufficient funds to meet its commitments and not compromise its necessary investments.

See other disclosures about this matter in Note 26 – operating revenue.

These financial statements were approved by Management on May 15, 2017.

### **2 Basis of preparation and presentation of the financial statements**

The financial statements of the Company have been prepared in accordance with the International Financial Reporting Standards – IFRS as issued by the International Accounting Standards Board – IASB. All material information related to the financial statements, and this information alone, is being disclosed and corresponds to the information used by the Company's Management in its administration.

The financial statements have been prepared under the historical cost except for certain financial instruments measured at fair value when required by the standards.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires Management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree to judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are described in Note 6.

### **3 Summary of Significant Accounting Policies**

The main accounting policies applied in the preparation of these financial statements are defined below. These policies have been applied consistently in all years presented.

#### **3.1 Cash and cash equivalents**

Cash and cash equivalents include cash in hand, bank deposits, overdraft accounts and other short-term highly liquid investments with original maturities less than three months as of the investment date, with an insignificant risk of changing value.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2016, 2015 and 2014

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### 3.2 Financial assets and liabilities

#### Financial Asset - Classification

The Company classifies its financial assets according to the following categories: measured at fair value through profit or loss, borrowings and receivables, held-to-maturity and available for sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of the financial assets at inception. As of December 31, 2016, the Company did not have financial assets classified under the fair value through profit or loss, held-to-maturity and available-for-sale financial instruments category. As of December 31, 2015, the Company held CTEEP shares only, classified as held-for-trading financial assets, which were measured at fair value through profit or loss.

#### Borrowings and receivables

These comprise receivables, which are non-derivative financial assets with fixed or determinable payments, not quoted in an active market. Borrowings and receivables are presented in current assets, except for those with maturity of more than 12 months after the reporting date (these are classified as noncurrent assets). The Company's borrowings and receivables include cash and cash equivalents, restrict cash, balances of trade receivables, accounts receivable from related parties, other receivables, receivables from the Water National Agency – ANA. Borrowings and receivables are recorded at fair value and subsequently at amortized cost, under the effective interest rate method.

#### Financial Liabilities - Classification

The Company classifies its financial liabilities into the following categories: measured at fair value through profit or loss and other liabilities. Classification depends on the purpose to which the financial liabilities were assumed. As of December 31, 2016 and 2015, the Company did not have liabilities classified into the “fair value through profit or loss” category.

#### Other liabilities

This category comprises balances payable to contractors and suppliers, borrowings and financing, services payable, balances payable from public-private partnership (PPP), and program contract commitments.

The effective interest rate method is adopted to calculate the amortized cost of a financial liability and allocate its interest expense under the respective period. The effective interest rate exactly deducts the estimated future cash flows (including fees, transaction costs and other issue costs) throughout the financial liability's estimated life or, when appropriate, during a shorter period, for initial recognition of the net carrying amount.

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### 3.3 Operating revenue

#### (a) Revenue from sanitation services

Revenue from sanitation services are recognized as the water is consumed and services are provided. Revenues, including the revenues unbilled, are recognized at the fair value of the consideration received or receivable for the sale of those services. Revenue is shown net of value-added tax, rebates and discounts. Unbilled revenues represent incurred revenues in which the services were provided, but not yet billed until the end of the each period and are recorded as trade receivables based on monthly estimates of the completed services. Concerning revenues of wholesale municipal governments, which do not pay the full invoice, the Company establishes an allowance for doubtful accounts upon invoicing in revenue reduction account.

The Company recognizes revenue when: i) products are delivered or services are rendered; ii) the amount of revenue can be reliably measured, iii) it is probable that future economic benefits will flow to the Company and iv) it is probable that the amounts will be collected. The amount of revenue is not considered to be reliably measurable until all conditions relating to the sale have been satisfied. Amounts in dispute are recognized as revenue when collected.

#### (b) Construction revenue

Revenue from concession construction contracts is recognized in accordance with IFRIC 12 (Service Concession Arrangements) and IAS 11 (Construction Contracts), using the percentage-of-completion method, provided that the applicable conditions for application are fulfilled. The percentage of completion is calculated from the ratio of the actual costs incurred on the balance sheet date to the planned total costs (cost-to-cost method). Revenue from cost plus contracts is recognized by reference to the construction costs incurred during the period plus a fee earned. The fee represents the additional margin related to the work performed by the Company in relation to such construction contracts and it is added construction costs, resulting in the construction revenue.

### 3.4 Trade receivables and allowance for doubtful accounts

Trade receivables are amounts due from customers for services performed in the ordinary course of business. These are classified as current assets, except when maturity exceeds 12 months after the end of the reporting period. In these cases, they are presented as noncurrent assets.

The Company establishes an allowance for doubtful accounts for receivable balances at an amount that Management considers to be sufficient to cover eventual losses. The analysis is carried out based on objective accounts receivable data, past receipts and existing guarantees and it does not expect to incur additional significant losses

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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### 3.5 Inventories

Inventories of supplies for consumption and maintenance of the water and sewage systems are stated at the lower of average cost of acquisition or realizable value, and are classified in current assets.

### 3.6 Investment properties

The investment properties are recorded at the acquisition or construction cost, less accumulated depreciation, except for the land group, calculated by the straight-line method at rates that consider the estimated useful life of assets. Expenditures related to repairs and maintenance are recorded in the income statement when incurred.

The Company also maintains few assets for indeterminate use in the future, i.e., it is not defined if the Company will use these assets in the operation or sell them in the short term during the ordinary course of business.

### 3.7 Property, plant and equipment

Property, plant and equipment comprise mainly administrative facilities not composing the assets, subject-matter of the concession agreements. Those assets are stated at historical acquisition or construction cost less depreciation, net of impairment charge, when necessary. Interest, other finance charges and inflationary effects deriving from financing effectively applied to construction in progress are recorded as cost of respective property, plant and equipment.

Subsequent costs included in the existing asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that the future economic benefit associated with the item will flow to the Company and the cost of the item can be measured reliably. Repairs and maintenance are charged to the income statement during the financial period in which they were incurred.

Depreciation is calculated using the straight-line method to allocate their cost and is described in Note 15(c). Lands are not depreciated.

Residual values and the useful life of assets are revised and adjusted, where applicable, at the end of each year.

Gain and losses on disposals are determined by the difference between the proceeds with the carrying amount and are recognized within other operating income (expenses) in the income statement.

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### 3.8 Intangible assets

Intangibles are stated at acquisition cost and/or construction of the underlying assets, including construction margin, interest and other finance charges capitalized during the construction period, in this case, for the qualifying assets. Qualifying assets are assets that, necessarily, take a substantial period to get ready for its intended use or sale. The Company considers that substantial period means a period greater than 12 months. This period was established by considering the completion period of the majority of its constructions, which is greater than 12 months, which corresponds to one fiscal year of SABESP.

The intangible has its amortization initiated when the intangible assets are available for use in location and the necessary condition when this asset becomes operational.

The amortization of intangible assets reflects the period over the expected future economic benefits generated by the intangible asset are consumed by the Company and can be the period of the contract or the useful life of the asset.

The amortization of the intangible assets is discontinued when the asset is totally consumed or it is disposed of, whatever occurs first.

Donations in assets, received from third parties and governmental entities, to allow the Company to render water and sewage supply services are not recorded in the Company's financial statements, since these assets are controlled by the concession grantor.

Financial resources received as donations for the construction of infrastructure are recorded under "Other operating income".

#### (a) Concession arrangements/program

The Company operates concession agreements including the rendering of basic sanitation, environmental, water supply and sewage collection services signed with the concession grantor. The infrastructure used by SABESP subject to service concession arrangements is considered to be controlled by the concession grantor when:

- (i) The grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
- (ii) The grantor controls the infrastructure, i.e., retains the right to take back the infrastructure at the end of the concession.



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SABESP's rights over infrastructure operated under concession arrangements is accounted for as an intangible asset as SABESP has the right to charge for use of the infrastructure assets, and users (consumers) have the primary responsibility to pay SABESP for the services.

The fair value of construction and other work on the infrastructure is recognized as revenue, as its fair value, when the infrastructure is built, provided that this work is expected to generate future economic benefits. The accounting policy to recognize construction revenue is described in Note 3.3.

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

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

Law 11,445/07 indicates, whenever possible, that basic sanitation public utilities will have the economic and financial sustainability ensured through the remuneration due to service collection, preferably as tariffs and other public prices, which may be established for each service or both jointly. Therefore, investments made and not recovered through services rendered, within original term of the contract, are recorded as intangible assets and amortized by the useful life of the asset, taking into consideration a solid track record of concession renewal and, therefore, the continuity of services.

### **(b) Software licenses**

Software licensing is capitalized based on the acquisition costs and other implementation costs. Amortizations are recorded according to the useful lives and the expenses associated with maintaining these are recognized as expenses when incurred.

### **3.9 Impairment of non-financial assets**

Property, plant and equipment, intangibles and other noncurrent assets with definite useful lives, are reviewed annually for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company does not have assets with indefinite useful life and assessed that there are no indications of impairment losses, mainly supported by Law 11,445/07, which ensures that basic sanitation public utilities will have assured its economic and financial sustainability through tariffs or via indemnity.

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### 3.10 Trade accounts payable and contractors

Accounts payable to contractors and suppliers are obligations to pay for goods or services purchased from suppliers in the ordinary course of business and are classified as current liabilities if the payment is due in the period up to one year. Otherwise, the accounts payable are presented as noncurrent liabilities and are initially measured at fair value, which generally correspond to the bill and subsequently at amortized cost.

### 3.11 Borrowings and financing

Borrowings are initially recognized at fair value, upon receipt of funds, net of transaction costs. Subsequently, borrowings are stated at amortized cost, as presented in Note 16. Borrowings and financing are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.

Nonconvertible bonds issued by the Company are recognized in a similar manner to borrowings.

### 3.12 Borrowing costs

Borrowing costs attributable to acquisition, construction or production of an asset, which, necessarily, requires a substantial time period to be ready for use or sale are capitalized as part of the cost of these assets. Other borrowing costs are recognized as expenses in the period they are incurred. Borrowing costs are interest rates and other charges incurred by the Company related to loans, including exchange variation, as described below.

The capitalization occurs during the period in which the asset has been built, considering the weighted average rate of loans effective on the capitalization date.

For foreign currency-denominated loans or financing, the Company analyzes them as if they were contracted in local currency, restricting the capitalization of interest and/or exchange variation by the amount that would be capitalized if these were contracted in the domestic market in similar lines of credit and loans.

### 3.13 Payroll, related charges and contributions

Salaries, vacations and the 13th salary and additional payments negotiated in collective labor agreements plus related charges and contributions are recorded on the accrual basis.

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### 3.14 Profit sharing

The profit sharing plan for its employees is based on operational and financial targets of the Company as a whole. The Company recognizes a provision when it is contractually required or when there is a practice in the past that created a constructive obligation. The cost for profit sharing is recognized as incurred and is reported in other operating costs and expenses.

### 3.15 Provisions, legal obligations, escrow deposits, contingent assets and liabilities

Provisions related to claims are recognized when: i) the Company has a present (legal or constructive) obligation as a result of past event; ii) it is probable that an outflow of resources that comprise economic benefits will be required to settle the obligation; and iii) the amount can be reliably estimated. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

Provisions are measured at the present value of the disbursements expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

For financial statement presentation purposes, the provision is stated net of the related escrow deposits based on the legal right to offset. The bases and the nature of the provisions for civil, tax, labor and environmental risks are described in Note 19.

Escrow deposits not linked to related liabilities are presented in noncurrent assets. Escrow deposits are restated for inflation.

Contingent assets and liabilities are not recognized in the statements of financial position. Contingent liabilities are disclosed in the notes unless the possibility of any outflow is remote.

### 3.16 Environmental costs

Costs related to ongoing environmental programs are expensed in the income statement, when there is any indication of an event. Ongoing programs are designed to minimize the environmental impact of the operations and to manage the environmental risks inherent to the Company's activities.

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### 3.17 Income taxes – current and deferred

Income taxes expenses comprise current and deferred income tax and social contributions.

#### Current tax

The provision for income tax and social contribution is based on the taxable income for the year. The income tax was accrued at rate 15%, plus 10% surtax on taxable income exceeding R\$ 240. The social contribution was accrued at rate 9% over adjusted net income. Taxable income differs from net income (profit presented in the income statement), because it excludes income and expenses taxable or deductible in other years, and excludes items not permanently taxable or not deductible. Income tax and social contribution are accrued based on legislation in place in the end of the year. Management periodically evaluates and measures the positions taken in the income tax return with respect to situations in which applicable tax regulations are subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

#### Deferred tax

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax basis of assets and liabilities and their carrying amounts in the financial statements, according to IAS 12. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction that at the time of the transaction affects neither accounting nor taxable profit nor loss, except for business combinations. Deferred income tax is determined using tax rates (and laws) effective at the end of the reporting period and expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax and social contribution assets are recognized only to the extent that it is probable that future taxable profit will be available for which temporary differences can be utilized and tax losses can be carryforward.

Deferred taxes assets and liabilities are offset when there is a legally enforceable right of offsetting current tax assets against current tax liabilities and when deferred income tax assets and liabilities are related to income taxes levied by same tax authority over the tax entity.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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### 3.18 Taxes on revenues

Revenues from water and sewage services are recognized on accrual basis for PASEP and Cofins, calculated at the rates of 1.65% and 7.60%, respectively. Taxes levied on billed amounts to public entities are due when bills are received.

As these taxes are calculated by the non-cumulativeness regime and presented net of tax credits, as deductions from gross revenues. Debts measured on “other operating income” are presented as deductions from the respective operating income or expense.

### 3.19 Pension obligations

#### (a) Defined benefit

The Company makes contributions to defined benefit plans on a contractual basis and sponsored thereby, managed by Fundação Sabesp de Seguridade Social (“Sabesprev”), a supplementary private pension closely-held entity. The regular contributions comprise the net administrative expenses and are recognized in the income statement for the period.

Liabilities from defined benefit pension plan obligations correspond to the present value of the defined benefit obligation at the end of the reporting period, less the fair value of the plan’s assets. The defined benefit obligation (G1) and (Go) are calculated on an annual basis by independent actuaries, using the projected unit credit method. The estimated future cash outflows is discounted to its present value, using the interest rates of Government bonds with maturities that approximate the maturity of the related liability.

Referring to actuarial gains and losses deriving from adjustments based on the experience and changes in actuarial assumptions are directly recorded under equity, as other comprehensive income (OCI), so that the plan's net assets or liabilities are recognized in the statement of financial position in order to reflect the full amount of plan’s deficit or surplus.

The expenses related to pension plan are recognized in profit and loss of the year as operating cost, selling expenses or administrative expenses, according to employee’s allocation.

In an event where a curtailment relates to only some of the employees covered by a plan, or where only part of an obligation is settled, the gain or loss includes a proportionate share of the past service cost and actuarial gains and losses. The proportionate share is determined on the basis of the present value of the obligations before and after the curtailment or settlement.

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### (b) Defined contribution

The Company makes contributions to defined contribution plans (Sabesprev Mais) on a contractual basis and sponsored thereby, managed by Sabesprev, a supplementary private pension closely-held entity that provides post-employment benefits to its employees.

A defined contribution plan is a pension plan according to which the Company makes fixed contributions to a separate entity. The Company has no obligation of making contributions if the fund has no sufficient funds to pay to all employees the benefits related to employee's services in current and previous period.

### 3.20 Financial revenues and expenses

Financial revenue is primarily comprised of interest, inflation adjustments and exchange rate changes resulting from financial investments, escrow deposits and negotiations with customer to pay by installments, using the effective interest rate method.

Financial expenses are primarily comprised of interest, inflation adjustments and exchange rate changes on borrowings and financing, provisions, public-private partnership, program contract commitments and provisions. These financial income and expenses are calculated using the effective interest rate method.

Inflation adjustments and exchange gains and losses derive from the collection or payment to third parties, as contractually required by law or court decision, and recognized on an accrual basis pro rata temporis. Inflation adjustments included in the agreements are not considered embedded derivatives, since they are deemed as inflation adjustment rates for the Company's economic scenario.

### 3.21 Leases

Lease agreements are classified as finance lease when property, risks and rewards inherent to the ownership of asset to the lessee are transferred. Other leases are classified as operational lease, recognized as expenses in the income statement on a straight-line basis during the lease term.

Finance lease agreements are measured based on the lower amount between the present value of minimum mandatory payments of the agreement or the fair value of asset on the start date the lease agreement. The amounts payable deriving from considerations of finance lease agreements are impacted by financial expenses and amortization of finance lease payables so that to obtain a constant interest rate. The corresponding lessor's liability is presented as current and noncurrent debt.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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### 3.22 Other current and noncurrent assets and liabilities

Other assets are stated at cost of acquisition, net of any impairment loss, where applicable. The amounts recognized as other liabilities are stated at known or estimated amounts, including, where applicable, related charges and inflation adjustments.

### 3.23 Dividends and interest on capital

The Company uses the tax benefits of distributing dividends as interest on capital, as permitted by Brazilian Law. This distribution of dividend is accounted for in accordance with Brazilian Law 9249/95 for tax deductibility purposes, limited to the daily pro rata fluctuation of the Long-term Interest Rate (TJLP). The benefit attributed to the shareholders is recognized in the current liability against Equity, based on its by-laws. Dividends and interest on capital over the minimum established in the by-laws are recognized when approved by the shareholders in the shareholders' meeting, except for taxes incurring in the distribution of interest on capital. The tax benefit of the interest on capital are accrued in the income statement of the year, under the same recognition basis of expenses with interest on capital.

### 3.24 Present value adjustment

Current and noncurrent financial assets and liabilities are adjusted to present value based on discount rate at current market rate as of the transaction date, when the effects are relevant.

### 3.25 Operating segment and Geographic information

Operating segments are determined in a manner consistent with the internal reporting to the Company's chief operating decision maker ("CODM"), which, in the case of SABESP, is the Board of Executive Officers, to make strategic decisions, allocate resources and evaluate performance.

Consequently, the Company determined that it has one operating segment (sanitation services).

The accounting policies used to determine segment information are the same as those used to prepare the Company's financial statements.

The measure of the segment's profit or loss is operating income before other operating expenses, net and equity accounting, which excludes construction revenue and related costs.

The CODM analyzes asset and liability information on a consolidated basis. Consequently, the Company does not disclose segment information on assets and liabilities.

Substantially all of the Company's noncurrent assets and revenue generated from customers are located in São Paulo State. Consequently, financial information is not disclosed by geographic area.

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### 3.26 Translation into foreign currency

#### (a) Functional and reporting currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the company operates ("the functional currency"). The financial statements are presented in Brazilian reais (R\$), which is also the Company's functional currency. All financial information has been stated in reais and rounded to the next thousand, except where otherwise indicated.

#### (b) Foreign currency translation

Foreign currency-denominated transactions are translated into Brazilian reais using the exchange rates prevailing at the transaction dates. Statement of financial position accounts are translated by the exchange rate prevailing at reporting date.

Exchange gains and losses resulting from the settlement of these transactions and the translation of foreign currency-denominated cash assets and liabilities are recognized in the income statement, except for borrowings and financing referring to property, plant and equipment or intangible assets in progress, where exchange losses are recognized as corresponding entry to the asset while construction is in progress, as described in Note 3.12.

## 4 Changes in accounting practices and disclosures

### 4.1 New standards, amendments and interpretations effective for periods beginning on or after January 1, 2016

#### New standards and revisions

<b>Standard</b>	<b>Description</b>	<b>Impact</b>
Amendments to IAS 16 and IAS 38 – Clarifying of the acceptable methods of depreciation and amortization	Clarify the use of depreciation and amortization for the revenue curve is inappropriate.	The application of this amendment did not impact the disclosures or amounts recognized in the annual financial statements.
Amendments to IAS 1 - Disclosure	Improvements to understand materiality concepts.	The application of these amendments did not impact the disclosures or amounts recognized in the annual financial statements.
Amendments to IFRS 10 and IAS 28 – Sales or contributions of assets between an investor and its associate or joint venture	Require the sale or contribution considered as a business – IFRS 3 must be recognized in the investor's financial statements and partially recognized in the statement of profit or loss when is not considered as a business.  Clarify the exemption to prepare consolidated financial statements involving investment activities.	The application of these amendments did not impact the disclosures or amounts recognized in the annual financial statements.



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### 4.2 New standards, amendments and interpretations to existing standards that are not yet effective

The Company did not early adopt the standards and is assessing the impacts of the new and revised IFRS below on the disclosures or amounts recognized in the financial statements:

<b>Standard</b>	<b>Description</b>	<b>Impact</b>
IFRS 9 - Financial Instruments <sup>2</sup>	Changes in the classification and measurement requirements, mainly for impairment and hedge accounting.	The Company believes that this standard will not impact the classification and measurement of losses on its financial assets and financial liabilities or hedge accounting, given that it does not have any operation of this nature.
IFRS 15 - Revenue from Contracts with Customers <sup>2</sup>	Establishes a single comprehensive framework to determine if and when a revenue is recognized and how revenue is measured.  IFRS 15 will supersede the current revenue recognition guidance including IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Interpretation A – Customer Loyalty Programmes.	The Company assessed the impacts on its customer contracts, including those with consumers with special billing characteristics, and concluded that the adoption of this standard will not have material impacts.
IFRS 16 – Leases <sup>3</sup>	Establishes a single model for the accounting of leases in the balance sheet for lessees. A lessee recognizes a right of use asset that represents his right to use the leased asset and a lease liability that represents his obligation to make lease payments. The lessor's accounting remains similar to the current standard, that is, the lessors continue to classify the leases as financial or operating.  IFRS 16 will supersede the current leases guidance including IAS 17 Leases and IFRIC 4, SIC 15 and SIC 27 Determining Whether an Arrangement Contains a Lease.	The Company has not yet quantified the impact of adopting IFRS 16 on its assets and liabilities. The Company is still assessing all of its transactions that will be impacted by the new standard. Additionally the quantitative effect of the adoption of IFRS 16 will depend specifically on the Company's decision related to the method of transition, the use of practical expedients approach and exemptions for recognition, and any additional leases that Company will hold. The Company expects to adopt this standard on January 1, 2019.
Amendments to IAS 12 – Recognition of Deferred Income Tax for Unrealized Losses <sup>1</sup>	Describe about the treatment of the temporary differences.	The Company is assessing the impacts and effects of the amendments, however it does not expect material effects from adopting this standard.
Amendments to IAS 7 – Disclosure Initiatives <sup>1</sup>	Describe about disclosures that enable users to measure the changes in liabilities related to financing activities.	The Company is assessing the impacts and effects of the amendments, however it does not expect material effects from adopting this standard.
Amendments to IFRS 2 – Classification and measurement of share-based payment transactions <sup>2</sup>	Describe about modifications of settled options of shares.	The Company is assessing the impacts and effects of the amendments, however it does not expect material effects from adopting this standard.



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1 Effective for annual periods beginning on or after January 1, 2017.

2 Effective for annual periods beginning on or after January 1, 2018.

3 Effective for annual periods beginning on or after January 1, 2019.

There are no other standards and interpretations not yet adopted that may, in the opinion of Management, have a significant impact on the result for the year of equity disclosed by the Company in its financial statements.

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### 5 Risk Management

#### 5.1 Financial Risk Management

##### Financial risk factors

The Company's activities are affected by Brazilian economic scenario, making it exposed to market risk (exchange rate and interest rate), credit risk and liquidity risk. The Company's financial risk management is focused on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance.

The Company has not utilized derivative instruments in any of the reported periods.

##### (a) Market risk

##### Foreign currency risk

SABESP's foreign exchange exposure implies market risks associated with currency fluctuations, since the Company has foreign currency-denominated liabilities, mainly US dollar and yen-denominated short and long-term borrowings.

The management of SABESP's foreign currency exposure considers several current and projected economic factors, besides market conditions.

This risk arises from the possibility that the Company may incur in losses due to exchange rate fluctuations that would impact liability balances of foreign currency-denominated borrowings and financing raised in the market and related financial expenses. The Company does not maintain hedge or swap contracts or any derivative financial instrument to hedge against this risk.

A significant amount of the Company's financial debt is indexed to the U.S. dollar and Yen, in the total amount of R\$5,692,984 as of December 31, 2016 (R\$6,640,256 as of December 31, 2015). Below, the Company's exposure to exchange risk:

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	December 31, 2016		December 31, 2015	
	Foreign currency	R\$	Foreign currency	R\$
Borrowings and financing – US\$	1,241,963	4,047,682	1,242,273	4,850,827
Borrowings and financing – Yen	57,643,930	1,609,419	53,906,927	1,748,202
Interest and charges from borrowings and financing – US\$		25,114		29,813
Interest and charges from borrowings and financing – Yen		10,769		11,414
Total exposure		5,692,984		6,640,256
Borrowing cost – US\$		(29,650)		(19,786)
Borrowing cost – Yen		(2,971)		(2,646)
Total foreign currency-denominated borrowings (Note 16)		<u>5,660,363</u>		<u>6,617,824</u>

The 14% decrease in foreign currency-denominated debt from December 31, 2015 to December 31, 2016 was mainly due to the following:

- 1) Exchange rate changes, due to the 16.5% decrease in the US dollar, from R\$3.9048 as of December 31, 2015 to R\$3.2591 as of December 31, 2016. The US dollar-denominated debt accounts for 71.4% of foreign currency-denominated debts; and
- 2) A 6.9% increase in the Yen-denominated debt and 13.9% increase in the Yen, from R\$0.03243 as of December 31, 2015 to R\$0.02792 as of December 31, 2016.

As of December 31, 2016, if the Brazilian real had depreciated or appreciated by 10%, in addition to the impacts mentioned above, against the US dollar and Yen with all other variables held constant, effects on results before taxes on the year would have been R\$569,298 (R\$664,026 as of December 31, 2015), lower or higher, mainly as a result of exchange losses or gains on the translation of foreign currency-denominated loans.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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### Interest rate risk

This risk arises from the possibility that the Company could incur losses due to fluctuations in interest rates, increasing the financial expenses related to borrowings and financing.

The Company has not entered into any derivative contract to hedge against this risk; however continually monitors market interest rates, in order to evaluate the possible need to replace its debt.

The table below provides the Company's borrowings and financing subject to variable interest rate:

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	December 31, 2016	December 31, 2015
TR <sup>(i)</sup>	1,535,030	1,498,085
CDI <sup>(ii)</sup>	1,082,228	1,617,191
TJLP <sup>(iii)</sup>	1,326,631	1,114,977
IPCA <sup>(iv)</sup>	1,697,452	1,623,201
LIBOR <sup>(v)</sup>	2,906,999	2,926,628
Interest and charges	142,644	144,546
Total	8,690,984	8,924,628

(i) TR – Interest Benchmark Rate

(ii) CDI – (Certificado de Depósito Interbancário), an interbank deposit certificate

(iii) TJLP – (Taxa de Juros a Longo Prazo), a long-term interest rate index

(iv) IPCA – (Índice Nacional de Preços ao Consumidor Amplo), a consumer price index

(v) LIBOR – London Interbank Offered Rate

Another risk to which the Company is exposed, is the mismatch of the monetary restatement indices of its debts with those of its service revenues. Water supply and sewage services tariff adjustments do not necessarily follow the increases in the inflation indexes to adjust loans, financing and interest rates affecting indebtedness

As of December 31, 2016, if interest rates on borrowings and financing had been 1% higher or lower with all other variables held constant, the effects on profit for the year before taxes would have been R\$86,910 (R\$89,246 as of December 31, 2015) lower or higher, mainly as a result of a lower or higher interest expense on floating rate borrowings and financing.

### (b) Credit risk

Credit risk arises from cash and cash equivalents, deposits in banks and financial institutions, as well as credit exposures to wholesale basis and retail customers, including outstanding accounts receivable, restricted cash and accounts receivable from related parties. Credit risk exposure to customers is mitigated by sales to a dispersed base.

The maximum exposures to credit risk as of December 31, 2016 are the carrying amounts of instruments classified as cash equivalents, deposits in banks and financial institutions, restricted cash, trade receivables and accounts receivable from related parties in the balance sheet date. See additional information in Notes 7, 8, 9 and 10.

Regarding the financial assets held with financial institutions, the credit quality that is not past due or subject to impairment can be assessed by reference to external credit ratings (if available) or to historical information about counterparty default rates. The credit quality of counterparties which are banks, such as deposits and financial investments, the Company considers the lower rating of the counterparty published by three main international rating agencies (Fitch, Moody's and S&P), according to internal policy of market risk management:

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	December 31, 2016	December 31, 2015
Cash at bank and short-term bank deposits		
AA+(bra)	1,850,220	-
AAA(bra)	35,452	1,638,589
Other (*)	549	625
	1,886,221	1,639,214

(\*) This category includes current accounts and investment funds in banks which have no credit rating information available.

The available credit rating information of the banks, as at December 31, 2016, in which the Company made deposit transactions and financial investments in domestic currency (R\$ - domestic rating) during the year is as follows:

Banks	Fitch	Moody's	Standard Poor's
Banco do Brasil S/A	AA+(bra)	Aa1.br	-
Banco Santander Brasil S/A	AAA(bra)	Aaa.br	brAA-
Caixa Econômica Federal	AA+(bra)	Aa1.br	brAA-
Banco Bradesco S/A	AAA(bra)	Aa1.br	brAA-
Itaú Unibanco Holding S/A	AAA(bra)	Aa1.br	brAA-

### (c) Liquidity risk

The Company's liquidity is primarily reliant upon cash provided by operating activities, loans from Brazilian Federal and State governmental financial institutions, and financing in the domestic and international capital markets. The liquidity risk management considers the assessment of its liquidity requirements to ensure it has sufficient cash to meet its operating and capital expenditures needs, as well as the payment of debts.

The funds held by the Company are invested in interest-bearing current accounts, time deposits and securities, selecting instruments with appropriate maturity or liquidity sufficient to provide margin as determined by projections mentioned above.

The table below shows the financial liabilities of the Company, into relevant maturities, including the installment of principal and future interest to be paid according to the agreement.



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	2017	2018	2019	2020	2021	2022 onwards	Total
<b>As of December 31, 2016</b>							
Liabilities							
Borrowings and financing	1,779,684	1,946,655	2,494,837	2,394,553	891,910	5,784,614	15,292,253
Accounts payables to suppliers and contractors	311,960	-	-	-	-	-	311,960
Services payable	460,054	-	-	-	-	-	460,054
Public-Private Partnership – PPP (*)	46,038	46,038	351,689	351,689	351,689	5,681,712	6,828,855
Program contract commitments	106,362	40,953	29,548	872	1,009	16,680	195,424

(\*) The Company also considered future commitments (construction not yet performed) still not recognized in the financial statements related to São Lourenço PPP, due to the relevance of future cash flows, the impacts on its operations and the fact the Company already has formalized this commitment through an agreement signed by the parties.

### Future interest

Future interest was calculated based on the contractual clauses for all agreements. For agreements with floating interest rate, the interest rates used correspond to the base dates above.

### Cross default

The Company has borrowings and financing agreements including cross default clauses, i.e., the early maturity of any debt, may imply the early maturity of these agreements. The indicators are continuously monitored in order to avoid the execution of these clauses.

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### 5.2 Capital management

The Company's objectives when managing capital are ensure its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders, and to maintain an optimal capital structure to reduce the cost of capital.

The Company monitors capital based on the leverage ratio. This ratio corresponds to net debt divided by total capital. Net debt corresponds to total borrowings and financing less cash and cash equivalents. Total capital is calculated as total equity as shown in the statement of the financial position plus net debt.

	<u>December 31, 2016</u>	<u>December 31, 2015</u>
Total borrowings and financing (Note 16)	11,964,143	13,121,600
(-) Cash and cash equivalents (Note 7)	(1,886,221)	(1,639,214)
Net debt	10,077,922	11,482,386
Total equity	15,419,211	13,716,606
Total capital	25,497,133	25,198,992
Leverage ratio	40%	46%

As of December 31, 2016, the leverage ratio decreased to 40% from the 46% as of December 31, 2015, due to the decreased balance of foreign currency-denominated loan and financing as a result of 16.5% and 13.9% depreciations of the US dollar and the Yen, respectively, in 2016.

### 5.3 Fair value estimates

It is assumed that balances from trade receivables (current) and accounts payable to suppliers by carrying amount, less impairment approximate their fair values, considering the short maturity. Long-term trade receivables also approximate their fair values, as they will be adjusted by inflation and/or will bear contractual interest rates over time.

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### 5.4 Financial instruments

The Company had CTEEP's shares, which were classified as financial asset held for trading and recognized at fair value through profit or loss. As of April 20, 2016, the Company sold these shares for R\$111,117. The Company's financial instruments included in the borrowings and receivables category comprise cash and cash equivalents, restricted cash, trade receivables, balances with related parties, other receivables, and balances receivable from the Water National Agency – ANA. The financial instruments under the “other liabilities” category comprise accounts payable to contractors and suppliers, borrowings and financing, services payable, balances payable deriving from the Public Private Partnership-PPP and program contract commitments, which are non-derivative financial assets and liabilities with fixed or determinable payments, not quoted in an active market.

As of December 31, 2016, the Company did not have financial assets and financial liabilities classified as fair value through profit or loss.

The estimated fair values of financial instruments are as follows:

#### Financial assets

	December 31, 2016		December 31, 2015	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash and cash equivalents	1,886,221	1,886,221	1,639,214	1,639,214
Restricted cash	24,078	24,078	29,156	29,156
Trade receivables	1,711,306	1,711,306	1,509,588	1,509,588
Water National Agency – ANA	81,221	81,221	88,368	88,368
Financial asset held for trading (*)	-	-	101,500	101,500
Other receivables	167,369	167,369	196,118	196,118

(\*)Amount reported under “other receivables” in current assets.

Additionally, SABESP has financial instrument assets receivables from related parties, in the amount of R\$871,709 as of December 31, 2016 (R\$872,107 as of December 31, 2015), which were calculated in accordance with the conditions negotiated between related parties. The conditions and additional information referring to these financial instruments are disclosed in Note 10 to the financial statements. Part of this balance, in the amount of R\$788,180 (R\$786,501 as of December 31, 2015), refers to reimbursement of additional retirement and pension plan - Go and is indexed by IPCA plus simple interest of 0.5% p.m. This interest rate approximates that one practiced by federal government bonds (NTN-b) with terms similar to those of related-party transactions.

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### Financial liabilities

	December 31, 2016		December 31, 2015	
	Carrying amount	Fair value	Carrying amount	Fair value
Borrowings and financing	11,964,143	11,776,178	13,121,600	12,625,454
Trade payables and contractors	311,960	311,960	248,158	248,158
Services payable	460,054	460,054	387,279	387,279
Program contract commitments	178,093	178,093	320,714	320,714
Public-Private Partnership - PPP	2,249,418	2,249,418	1,035,033	1,035,033

To obtain fair value of borrowings and financing, the following criteria have been adopted:

- (i) Agreements with Banco do Brasil and CEF (Federal Savings Bank) were projected until their final maturities, at contractual rates (projected TR + spread) and discounted at present value by TR x DI, both rates were obtained from BM&FBovespa.
- (ii) Debentures were projected up to the final maturity date according to contractual rates (IPCA, DI, TJLP or TR), and discounted to present value considering the future interest rate published by ANBIMA in the secondary market, or by market equivalent rates, or the Company's share traded in the Brazilian market.
- (iii) BNDES loans are financial instruments valued at carrying amount plus contractual interest rate until the maturity date, and are indexed by long term interest rate – TJLP.

These financing have specific characteristics and the conditions defined in the financing agreements with BNDES between independent parties, and reflect the conditions for those types of loan. In Brazil, a consolidated market of long-term debts does not exist with the same characteristics of BNDES financing, the offering of credit to the entities in general, with this long-term characteristic, usually is restricted to BNDES.

- (iv) Other financing in local currency are considered by carrying amount plus contractual interest rate till mature date, discounted to present value considering a future interest rate published by BM&FBovespa.
- (v) Agreements with BID and IBRD, were projected until final maturity in origin currency, applying interest rates contracted, discounted at present value at Libor futures rate, obtained from Bloomberg. Eurobonds were priced at market value through quotes published by Bloomberg. All the amounts obtained were translated into Brazilian reais at the exchange rate of December 31, 2016.

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(vi) Agreements with JICA, were projected until final maturity in origin currency, using interest rates contracted and discounted at present value, at Tibor futures rate obtained from Bloomberg. The amounts obtained were translated into Brazilian reais at the exchange rate of December 31, 2016.

(vii) Leases are financial instruments considered by face value restated until maturity date, whose characteristic is the indexation by fixed contractual rate, which is a specific type, not compared to any other market rate. Thus, the Company discloses as market capitalization, the amount recorded as of December 31, 2016.

Financial instruments referring to financial investments and borrowings and financing are classified as Level 2 in the fair value hierarchy.

Considering the nature of other financial instruments, assets and liabilities of the Company, the balances recognized in the statement of financial position approximate the fair values, taking into account the maturities close to the end of the reporting period, comparison of contractual interest rates with market rates in similar operations at the end of the reporting periods, their nature and maturity terms.

### **6 Key accounting estimates and judgments**

Estimates and judgments are continually evaluated and are based on historical experience and on other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates, by definition, may differ from actual results. The estimates and assumptions that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below:

#### **(a) Allowance for doubtful accounts**

The Company establishes an allowance for doubtful accounts in an amount that Management considers sufficient to cover expected losses, based on an analysis of trade receivables, in accordance with the accounting policy stated in Note 3.4.

The methodology for determining the allowance for doubtful accounts receivable requires significant estimates, considering a number of factors including historical receipt experience, current economic trends, estimates of forecast write-offs, the aging of the accounts receivable portfolio. While the Company believes that the assumptions used are reasonable, actual results could be different.

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### **(b) Intangible assets arising from concession and program contracts**

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

Concession intangible assets under Concession agreements and Program contracts, in which, at the end of the contract, the Company has no right to receive a payment equivalent to the unamortized asset balance of the concession intangible, are amortized on a straight-line basis over the useful life of asset or contract period, which occurs first. Additional information on the accounting for intangible assets arising from concession agreements is described in Note 3.8.

The recognition of fair value for the intangible assets arising on concession agreements is subject to assumptions and estimates, and the use of different assumptions could affect the balances recorded. Different assumptions and estimates and changes in the useful lives of the intangible assets may have relevant impacts on the results of operations.

### **(c) Provisions**

The Company is party to a number of legal proceedings involving significant claims. These legal proceedings include, but are not limited to, tax, labor, civil, environmental, disputes with customers and suppliers. The Company recognizes a provision for lawsuits when it has a present obligation (legal or constructive) arising from a past event, it is probable that an outflow of resources embodying economic benefits will be necessary to settle the liability and the amount of such obligation can be reliably estimated. Judgments regarding future events may differ significantly from actual estimates and could exceed the amounts provisioned. Provisions are revised and adjusted to take into consideration changes in circumstances involved. Additional information of these legal proceedings is disclosed in Note 19.

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### (d) Pension benefits

The Company sponsors the defined benefit plan and the defined contribution plan, as described in Note 20.

The liability recognized in the balance sheet in relation to defined benefit pension plans is the present value of defined benefit obligation on the balance sheet date, less the fair value of plan assets. The benefit obligation is calculated yearly by independent actuaries, applying the projected credit unit method. The present value of defined benefit obligation is determined by discounting the estimated future cash outflows, using interest rates compatible with the market, which are denominated in currency in which benefits will be paid and with maturity terms close to those of corresponding pension plan obligation.

### (e) Deferred income tax and social contribution

The Company recognizes and settles taxes on income based on the results of operations verified according to the Brazilian Corporation Law, taking into consideration the provisions of the tax laws. Pursuant to IAS 12 the Company recognizes deferred tax assets and liabilities based on the differences between the accounting balances and the tax bases of assets and liabilities.

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

## 7 Cash and cash equivalents

	<b>December 31, 2016</b>	<b>December 31, 2015</b>
Cash and banks	137,395	77,233
Cash equivalents	1,748,826	1,561,981
	<u>1,886,221</u>	<u>1,639,214</u>

Cash and cash equivalents include cash, bank deposits and high-liquidity short-term financial investments, mainly represented by repurchase agreements (accruing CDI interest rates), deposited at Banco do Brasil, whose original maturities are lower than three months, which are convertible into a cash amount and subject to an insignificant risk of change in value.

The average yield of financial investments corresponds to 99.24% of CDI in December 2016 and 2015.

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### 8 Restricted cash

	<u>December 31, 2016</u>	<u>December 31, 2015</u>
Current		
Agreement with the São Paulo municipal government (i)	15,858	13,005
Funds raised with the BNDES (ii)	-	7,109
Brazilian Federal Savings – escrow deposit (iii)	2,989	1,433
Other	5,231	7,609
	<u>24,078</u>	<u>29,156</u>

- (i) Agreement with the municipal government of São Paulo where the Company transfers 7.5% of the Municipal revenue to the Municipal Fund;
- (ii) Refers to funds raised with the Brazilian Development Bank– BNDES, awaiting authorization for use restrictions;
- (iii) Refers to savings account for receiving escrow deposits regarding lawsuits with final and unappealable decisions in favor of the Company, which are blocked as per contractual clause.



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### 9 Trade receivables

#### (a) Financial position balances

	<u>December 31, 2016</u>	<u>December 31, 2015</u>
Private sector:		
General and special customers (i) (ii)	1,205,498	1,044,692
Agreements (iii)	315,351	317,871
	<u>1,520,849</u>	<u>1,362,563</u>
Government entities:		
Municipal	520,950	503,309
Federal	3,414	5,738
Agreements (iii)	279,449	207,066
	<u>803,813</u>	<u>716,113</u>
Wholesale customers – Municipal governments: (iv)		
Guarulhos	778,106	810,285
Mauá	467,775	416,749
Mogi das Cruzes	2,527	2,158
Santo André	946,045	857,424
São Caetano do Sul	2,371	2,057
Diadema	222,671	222,671
	<u>2,419,495</u>	<u>2,311,344</u>
Total wholesale customers – Municipal governments		
Unbilled supply	481,389	427,361
Subtotal	5,225,546	4,817,381
Allowance for doubtful accounts	(3,514,240)	(3,307,793)
Total	<u>1,711,306</u>	<u>1,509,588</u>
Current	1,557,472	1,326,972
Noncurrent	153,834	182,616
	<u>1,711,306</u>	<u>1,509,588</u>

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- (i) General customers - residential and small and mid-sized companies
- (ii) Special customers - large consumers, commercial, industries, condominiums and special billing consumers (fixed demand agreements, industrial waste, wells, etc.).
- (iii) Agreements - installment payments of past-due receivables, plus monetary restatement and interest, when provided for in the agreements.
- (iv) Wholesale basis customers - municipal governments - This balance refers to the sale of treated water to municipalities, which are responsible for distributing to, billing and charging final customers. Some of these municipalities are questioning in court the tariffs charged by SABESP, which have full allowance for doubtful accounts. Additionally, the overdue amounts are included in the allowance for doubtful accounts.

### (b) The aging of trade receivables is as follows

	<u>December 31, 2016</u>	<u>December 31, 2015</u>
Current	1,337,503	1,195,098
Past-due:		
Up to 30 days	263,157	182,025
From 31 to 60 days	148,927	123,765
From 61 to 90 days	53,268	78,089
From 91 to 120 days	109,138	84,654
From 121 to 180 days	124,001	80,447
From 181 to 360 days	203,837	158,182
Over 360 days	<u>2,985,715</u>	<u>2,915,121</u>
Total past-due	<u>3,888,043</u>	<u>3,622,283</u>
Total	<u>5,225,546</u>	<u>4,817,381</u>

The increase in the overdue balance was mainly due to the default of the municipalities that purchased water on a wholesale basis, given that they are challenging the tariffs charged by SABESP in court, and the increase in default of amounts overdue up to 360 days, related to private customers.

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### (c) Allowance for doubtful accounts

	<u>December 31, 2016</u>	<u>December 31, 2015</u>	<u>December 31, 2014</u>
Balance at beginning of the year	3,307,793	3,164,288	2,856,684
Bad debt expense recognized during the year - Private sector /government entities	144,217	103,231	130,398
Recoveries recognized during the year	(241,109)	(177,993)	(59,341)
Bad debt expense recognized during the year - Wholesale customers	331,295	283,113	236,679
Net bad debt expense for the year	234,403	208,351	307,736
Write-offs of accounts receivable during the year	(27,956)	(64,846)	(132)
Balance at end of the year	<u>3,514,240</u>	<u>3,307,793</u>	<u>3,164,288</u>

### Reconciliation of estimated losses of income

	<u>December 31, 2016</u>	<u>December 31, 2015</u>	<u>December 31, 2014</u>
Write-offs	177,492	63,076	52,900
Losses with state entities (related parties)	7,292	3,999	(1,341)
Losses with private sector / government entities	144,217	103,231	130,398
Losses with wholesale customers	2,596	10,107	16,973
Recoveries	(241,109)	(177,993)	(59,341)
Amount reported in selling expenses	90,488	2,420	139,589

Wholesale sales losses, amounting to R\$328,699, R\$273,006 and R\$219,706 in 2016, 2015 and 2014, respectively, were also reported as a reduction of revenue.

The Company does not have customers representing 10% or more of its total revenues.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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### 10 Related-Party Balances and Transactions

The Company is a party to transactions with its controlling shareholder, the State Government, and companies related to it.

#### (a) Accounts receivable, interest on capital payable, revenue and expenses with the São Paulo State Government

	<u>December 31, 2016</u>	<u>December 31, 2015</u>
Accounts receivable		
Current:		
Water and sewage services (i)	134,005	115,633
Allowance for losses (i)	(56,624)	(49,332)
Reimbursement for retirement and pension benefits paid (Go):		
- monthly flow (payments) (ii) and (vi)	22,696	20,564
- GESP Agreement – 2008 (ii) and (vi)	56,512	49,985
- GESP Agreement – 2015 (vii)	39,816	-
“Se Liga na Rede” program (l)	6,148	19,305
Total current	<u>202,553</u>	<u>156,155</u>
Noncurrent:		
Reimbursement for retirement and pension benefits paid (Go):		
- GESP Agreement – 2008 (ii) and (vi)	18,838	66,646
- GESP Agreement – 2015 (vii)	650,318	649,306
Total noncurrent	<u>669,156</u>	<u>715,952</u>
Total receivables from shareholders	<u>871,709</u>	<u>872,107</u>
Assets:		
Water and sewage services	77,381	66,301
Reimbursement of additional retirement and pension benefits (Go)	788,180	786,501
“Se Liga na Rede” program (l)	6,148	19,305
Total	871,709	872,107
Liabilities:		
Interest on capital payable to related parties	351,788	64,013
Other (g)	1,853	2,210

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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	<u>2016</u>	<u>2015</u>	<u>2014</u>
Revenue from water and sewage services			
Water supply	235,686	195,478	216,816
Sewage services	210,040	162,034	195,218
Payments received from related parties	(424,549)	(338,471)	(431,607)
Receipt of GESP reimbursement referring to Law 4819/58	(139,472)	(121,709)	(112,534)

### (i) Water and sewage services

The Company provides water supply and sewage collection services to the São Paulo State Government and other companies related to it in accordance with usual market terms and conditions, as considered by management, except for the settlement of credits which can be made according to items (iii), (iv) and (v).

The Company recognized R\$56,624 as of December 31, 2016 (R\$49,332 as of December 31, 2015) as allowance for losses of amounts past due for more than 360 days has been recorded due to the uncertainty involving these receipts.

### (ii) Reimbursement of additional retirement and pension benefits paid

Refers to amounts of supplementary retirement and pension benefits provided for in State Law 4819/58 ("Benefits") paid by the Company to former employees and pensioners, referred to as Go.

Under the Agreement referred on item (iii) with the São Paulo State Government ("GESP" or the "State"), GESP recognizes its liability from charges arising from the Benefits, provided that the payment criteria set forth by the State Department of Personnel (DDPE), based on legal guidance of the Legal Consultancy of the Department of Finance and of the State Attorney General's Office (PGE).

As discussed on item (vi), during the assessment of the debt due from GESP to the Company there were certain divergences in the calculation and eligibility criteria of the benefits paid by the Company on behalf of GESP.

See additional information about the Go plan in Note 20 (b) (iii).

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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In January 2004, the payments of supplement retirement and pension benefits were transferred to the Department of Finance and would be made in accordance with the calculation criteria determined by the PGE. As a result of a court decision, the responsibility for making the payments returned to SABESP, as originally established.

### (iii) GESP Agreement

On December 11, 2001, the Company, the São Paulo State Government (through the State Department of Finance Affairs, currently Department of Finance) and the Water and Electricity Department (DAEE), with the intermediation of the State Department of Sanitation and Energy (former Department of Water Resources, Sanitation and Construction Works), entered into the Obligations, Payment Commitment and Other Covenants Acknowledgement and Consolidation Agreement ("GESP Agreement") for the settlement of outstanding debts between GESP and the Company related to the provision of water supply and sewage services and to the retirement benefits.

In view of the strategic importance of the Taiaçupeba, Jundiá, Biritiba, Paraitinga and Ponte Nova reservoirs for ensuring and maintaining the Alto Tietê water volume, the Company agreed to receive them as partial repayment of the reimbursement related to the Benefits. The DAEE would transfer the reservoirs to the Company, replacing the amount owed by GESP. However, the São Paulo State Public Prosecution Office challenges the legal validity of this agreement, and its main argument is the lack of bidding and the absence of a specific legislative authorization for disposal of DAEE's assets. There is an unfavorable decision to SABESP not yet unappealable. The Company's legal advisors assess the risk of loss in this lawsuit pursuant to item 3.15. See additional information in item (viii) below.

### (iv) First Amendment to the GESP Agreement

On March 22, 2004, the Company and the São Paulo State Government amended the terms of the original GESP Agreement, (1) consolidating and recognizing the amounts due by the São Paulo State Government for water supply and sewage collection services provided, monetarily adjusted through February 2004; (2) formally authorizing the offset of amounts due by the São Paulo State Government with interest on capital declared by the Company and any other debt owed to the São Paulo State Government as of December 31, 2003, monetarily adjusted through February 2004; and (3) defining the payment conditions of the remaining liabilities of the São Paulo State Government for the receipt of the water supply and sewage services.

### (v) Second Amendment to the GESP Agreement

On December 28, 2007, the Company and the São Paulo State Government, represented by the Department of Finance, signed the second amendment to the terms of the original GESP Agreement, agreeing upon the payment in installments of the remaining balance of the First Amendment, amounting to R\$133,709 at November 30, 2007, to be paid in 60 monthly and consecutive installments of the same amount, beginning on January 2, 2008. In December 2012 the last installment was paid.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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The State and SABESP agreed on immediately resuming their compliance with their mutual obligations under new assumptions: (a) implementation of an electronic bill management system to facilitate and speed up the monitoring of payment processes and budget management procedures; (b) structuring of the Rational Water Use Program (PURA) to rationalize the consumption of water and the amount of the water and sewage bills under the responsibility of the State; (c) establishment, by the State, of criteria for budgeting so as to avoid the reallocation of amounts to a specific water and sewage accounts as from 2008; (d) possibility of registering state bodies and entities in a delinquency system or reference file; (e) possibility of interrupting water supply to state bodies and entities in case of nonpayment of water and sewage bills.

(vi) Third Amendment to the GESP Agreement

On November 17, 2008, GESP, SABESP and DAEE signed the third amendment to the GESP Agreement, through which GESP recognized a debt balance payable to SABESP totaling R\$915,251, monetarily adjusted up to September 2008 in accordance with the fluctuation of the IPCA-IBGE, corresponding to the Undisputed Reimbursement, determined by FIPECAFI. SABESP accepted on a provisional basis the reservoirs (see information on item (iii) of this note) as part of the payment of the Undisputed Reimbursement and offered to GESP a provisional settlement, recognizing a credit totaling R\$696,283, corresponding to the value of the reservoirs in the Alto Tietê system. The Company did not recognize the reimbursement receivable of R\$696,283 related to the reservoirs, as it is not virtually certain that will be transferred by the State. In March 2015, Sabesp and GESP entered into an agreement to pay the amounts receivable, totaling R\$696,283 (more information in item (vii) of this note). The remaining balance totaling R\$218,967 has been paid in 114 monthly, consecutive installments, totaling R\$1,920 each, including the annual IPCA-IBGE fluctuation, plus interest of 0.5% p.m., the first of which fell due on November 25, 2008.

In addition, the third amendment provides for the regularization of the monthly flow of benefits. While SABESP is liable for the flow of monthly payment of benefits, the State shall reimburse SABESP based on the criteria identical to those applied when determining the Undisputed Reimbursement. Should there be no preventive court decision, the State will assume the flow of monthly payment of benefits portion deemed as undisputed.

(vii) Agreement with the São Paulo State Government entered into in 2015

On March 18, 2015, the Company, the State of São Paulo and the Department of Water and Electricity (DAEE), and the Sanitation and Water Resources Department as the intervening party, entered into a Term of Agreement in the amount of R\$1,012,310, of which R\$696,283 refer to the principal of the Undisputed Amount mentioned in item (iii) and R\$316,027 corresponding to the inflation adjustment of the principal until February 2015.

The Principal Amount will be paid in 180 installments, as follows:

The first 24 installments were settled by immediately transferring 2,221,000 preferred shares issued by Companhia de Transmissão de Energia Elétrica Paulista - CTEEP, totaling R\$87,174, based on the share closing on March 17, 2015; and

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The amount of R\$609,109 is adjusted by IPCA (Extended Consumer Price Index) until the date when payments start and paid in cash, by means of other 156 monthly installments, beginning on April 5, 2017. When payment starts, installments will be adjusted by IPCA plus simple interest of 0.5% per month.

Considering the lawsuit which objects the possibility of transferring the reservoirs is pending final and unappealable court decision, the agreement also provides for the following situations:

If transfer is possible and the Reservoirs are effectively transferred to SABESP and registered at the notary's office, SABESP will reimburse to the State the amounts paid in replacement of Reservoirs (Principal Amount) in 60 monthly installments adjusted by IPCA until the date of payment of each installment; and

If the transfer of Reservoirs is not possible, the State will pay to SABESP, in addition to the Principal Amount, the inflation adjustment credit of R\$316,027 in 60 installments, starting these payments at the end of Principal Amount installment payment. The amount will be adjusted by IPCA to the start date of payments and, as of this date, IPCA will be incurred plus 0.5% simple interest rates/month over the amount of each installment.

The accounting impacts of the agreement generated a debit of R\$696,283 in accounts receivable from related parties and a credit in the same amount in administrative expenses on the transaction date. Due to such transaction, as of December 31, 2015, the Company recorded receivables from GESP in the amount of R\$649,306, in non-current assets, and CTEEP shares in the amount of R\$101,500, under "other receivables" in current assets. As of December 31, 2016, the balance receivable totaled R\$39,816 in current assets and R\$650,318 in noncurrent assets and CTEEP shares were disposed of on April 20, 2016 for R\$111.1 million.

### (viii) Disputed Amount of Benefits

As mentioned before, on November 17, 2008 the Company and the State signed the third amendment to the GESP Agreement, when the reimbursements called disputed and undisputed were quantified. The amendment established the efforts to calculate the so-called Disputed Reimbursement of the Benefits. Under the fourth clause of the amendment, the Disputed Reimbursement represents the difference between the Undisputable Reimbursement and the amount actually paid by the Company as pension benefits and pensioners set out in Law 4,819/58, for which, the Company understands, the State of São Paulo is originally liable, but paid by SABESP under a court order.

By entering into the third amendment, the State's Legal Representative (PGE) agreed to reassess the differences that gave rise to the Disputed Amount of benefits set out in Law 4,819/58. At the time, the expectation was based on the willingness of the PGE to reanalyze the issue and the implied right of the Company to the reimbursement, including based on opinions from outside legal advisors.

However, the last opinions issued by the PGE and received on September 4 and 22, 2009 and January 4, 2010, refute the reimbursement of previously defined as Disputed Amount.

Even though the negotiations with the State are still in progress, it is not possible to assure that the Company will recover the disputed receivables without dispute.



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As part of the actions intended to recover the receivables that management considers due by the State, related to discrepancies in the reimbursement of the pension benefits paid by the Company, SABESP: (i) on March 24, 2010, reported to the controlling shareholder the official letter approved by the executive committee, proposing that the matter be discussed at the São Paulo Stock Exchange (BM&FBovespa) Arbitration Chamber; (ii) in June 2010, presented to Department of Finance a proposal to solve the outstanding items, such proposal was not accepted; (iii) on November 9, 2010, filed a judicial action against the State of São Paulo pleading the entire reimbursement related to employee benefits set out in Law 4,819/58 to finalize the discussion between the Company and GESP. Despite the legal action, the expectation of which is a possible gain, the Company will persist to obtain an agreement with GESP since the management believes that it is the better to the Company and to its shareholders than wait until the end of the judicial action.

The Company's Management decided to not recognize the reimbursements which were not considered virtually certain that will be reimbursed by the State. As of December 31, 2016 and 2015, the amounts not recorded by the Company, related to the pension benefits paid on behalf of the State by the Company, totaled R\$937,035 and R\$855,054, respectively, as disclosed in item 10 (b) below.

As a result, the Company also recognized the obligation related to the pension benefit obligations maintained with the beneficiaries, retirees and pensioners of Plan Go. As of December 31, 2016 and 2015, the pension benefit obligations of Plan Go totaled R\$2,512,080 and R\$2.166.942, respectively. For detailed information on the pension benefit obligations refer to Note 20 (b) (iii).

### **(b) Contingent assets - GESP (not recognized)**

As mentioned above, as of December 31, 2016 and December 31, 2015, SABESP had contingent assets with GESP, not recorded in assets referring to the additional retirement and pension paid (Law 4,819/58), named "Disputed amounts receivable", totaling R\$937,035 and R\$855,054, respectively.

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### (c) Use of reservoirs – EMAE

Empresa Metropolitana de Águas e Energia S.A. - EMAE planned to receive for the credit and obtain financial compensation for alleged past and future losses in electricity generation, due to water collection, and compensation for costs already incurred and to be incurred with the operation, maintenance and inspection of the Guarapiranga and Billings reservoirs used by SABESP in its operations.

Several lawsuits were filed by EMAE. An arbitration proceeding was in progress related to the Guarapiranga reservoir and a lawsuit related to the Billings reservoir, both pleading for financial compensation due to SABESP's water collect for public supply, alleging that this conduct has been causing permanent and growing loss in the capacity of generating electricity of Henry Borden hydroelectric power plant with financial losses.

As of April 10, 2014, the Company issued a Notice to the Market including the information about an eventual future agreement.

As of October 28, 2016, the Company entered into an agreement based on a Private Transaction Agreement and Other Adjustments aimed to fully and completely settle the disputes involving the two companies. The transaction is subject to the condition precedent of approval by the competent bodies of the Company and EMAE, as well as the Brazilian Electricity Regulatory Agency – ANEEL, and involves the payment by SABESP to EMAE of the following amounts:

- R\$ 6,610 annually, adjusted for inflation, as of the execution date of this instrument, by the IPCA or any other index that may replace it, by the last business day of October of each fiscal year, with (i) the first of such annual payments due up to the last business day of October 2017 and (ii) the last payment due up to the last business day of October 2042; and

- R\$46,270, in five annual and successive installments, adjusted for inflation by the IPCA or any other index that may replace it, with the first installment of R\$9,254 due on April 30, 2017 and the subsequent ones in 4 (four) installments of same amount, due on every April 30 of the subsequent years, or on the first subsequent business day.

The agreement was based on the following assumptions: (i) SABESP payments should not exceed the amount necessary to indemnify EMAE for the maintenance and operating costs of the Guarapiranga and Billings reservoirs, in the proportion of their collect considering the natural outflow of each reservoir; (ii) payments will be made while SABESP's and EMAE's concessions are valid, and as long as SABESP withdraws water from these reservoirs, in compliance with the statute of limitations of the objects of the proceedings; (iii) SABESP must request ARSESP to incorporate these expenses into the tariff revision process in progress.

In order to estimate the maintenance and preservation expenses of the hydraulic and property structures of the Billings and Guarapiranga reservoirs, the technical area involved in water production adopted the following assumptions: (i) expenses related to the Guarapiranga Reservoir, whose water is used exclusively to supply the population of the São Paulo Metropolitan Region, will be fully paid by SABESP; (ii) the Billings reservoir has multiple uses – flood control, generation of electricity and public supply – and its maintenance and operating expenses should be shared based on the proportion of water used by each of the functions mentioned; (iii) SABESP has grants to use water in several points of the Billings reservoir that total an available outflow of 10.0 m<sup>3</sup>/s, representing 61.7% of the reservoir's long-term average outflow (16.2 m<sup>3</sup>/s); and (iv) considering the water volume usage percentages - 100% Guarapiranga and 61.70% Billings – an annual amount of R\$6,610 will be charged as shared expenses, based on the terms of the agreement.

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The Company adopted the annual amount of R\$6,610 from 2010 to 2042, including the statute of limitations and the year of expiration of the EMAE concession.

For these reasons, the Company has concluded that it was in its interest to enter into the agreement since: (i) it eliminates the incidence of future risks with the dismissal of all proceedings; (ii) its amount is limited to a reasonable amount to be paid for the sharing of the operating and maintenance costs of the Guarapiranga and Billings reservoirs; and (iii) the form of payment is appropriate to its financial situation.

By entering into the Agreement, all litigation between the parties will cease permanently and the Company will continue using the reservoirs.

In addition to the lawsuits that were part of the Agreement, on April 11, 2016, SABESP was named in the Indemnification proceeding commenced by EMAE's minority shareholders, who claimed compensation for damages suffered by EMAE, based on the amounts that the latter did not earn due to the decrease in the outflow of these reservoirs and in the generation of electricity as a result of the use of water of the Billings and Guarapiranga reservoirs by SABESP, and also requested that SABESP be sentenced to reimburse the loss of profits related to EMAE's unearned amounts resulting from the fact that water was not pumped from the Pinheiros and Tietê Rivers to the Henry Borden hydroelectric power plant. In summary, EMAE's minority shareholders claim that the São Paulo State, in its capacity as controlling shareholder of EMAE, has acted unduly to EMAE's detriment and in favor of SABESP's interests by allowing and consenting water intake from the Billings and Guarapiranga reservoirs, in detriment to the output of these reservoirs and generation of electricity by EMAE, without the necessary financial compensation, making impracticable the satisfactory use of the Henry Borden hydroelectric power plant. Although this lawsuit was not the object of the agreement, the Company understands that the approval of the agreement by the Extraordinary Shareholders' Meeting would eliminate the risk that this proceeding would continue in the judicial level.

As of December 31, 2016, the Company recorded R\$9,018 and R\$29,749 in Other Liabilities, under current and noncurrent liabilities, respectively, which represent the present value of the balance of R\$46,270 that will be paid in five annual installments.

As of November 9, 2016, EMAE's Board of Directors approved the transaction with SABESP, pursuant to the Private Transaction Agreement, in accordance with the Notice to the Market disclosed by EMAE on the same date.

As of November 10, 2016, the transaction was approved by SABESP's Board of Directors.

As of December 30, 2016, the Brazilian Electricity Regulatory Agency - ANEEL, by means of Order 3,431, decided to approve the Private Transaction Agreement and other Covenants entered into between Empresa Metropolitana de Águas e Energia S.A. - EMAE, and the Company, thus meeting the "second condition precedent" required for the effectiveness of the agreement.

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### **(d) Agreements with reduced tariffs with State and Municipal Government Entities that joined the Rational Water Use Program (PURA)**

The Company has signed agreements with government entities related to the State Government and municipalities where it operates that benefit from a reduction of 25% in the tariff of water supply and sewage services when they are not in default. These agreements provide for the implementation of the rational water use program, which takes into consideration the reduction in water consumption.

### **(e) Guarantees**

The State Government provides guarantees for some borrowings and financing of the Company and does not charge any fee with respect to such guarantees.

### **(f) Personnel assignment agreement among entities related to the State Government**

The Company has personnel assignment agreements with entities related to the State Government, whose expenses are fully passed on and monetarily reimbursed. In 2016, the expenses related to personnel assigned by SABESP to other state government entities amounted to R\$10,393 (R\$10,481 in 2015 and R\$9,651 in 2014).

In 2016, expenses related to personnel assigned by other entities to SABESP totaled R\$10 (R\$342 in 2015 and R\$403 in 2014).

### **(g) Services obtained from state government entities**

As of December 31, 2016 and 2015, SABESP had an outstanding amounts payable of R\$1,853 and R\$2,210, respectively, for services rendered by São Paulo State Government entities.

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### (h) Non-operating assets

As of December 31, 2016 and December 31, 2015, the Company had an amount of R\$969 related to a free land lent to DAEE (Department of Water and Electricity).

### (i) Sabesprev

The Company sponsors a private defined benefit pension plan, which is operated and administered by Sabesprev. The net actuarial liability recognized as of December 31, 2016 amounted to R\$753,170 (R\$665,274 as of December 31, 2015), according to Note 20 (b).

### (j) Compensation of Management Key Personnel

- Compensation:

SABESP's compensation policy for the Management and officers is set out according to guidelines of the São Paulo State Government, the CODEC (State Capital protection Board), and are based on performance, market competitiveness, or other indicators related to the Company's business, and is subject to approval by shareholders at an Annual Shareholders' Meeting.

Officers' compensation is limited to the compensation of the State Governor, the Board of Directors' and the Fiscal Council's compensation is equivalent to 30 percent and 20 percent, respectively, of the executive committee' overall compensation, contingent on attendance of at least one monthly meeting.

The objective of the compensation policy is to set a private sector management paradigm to retain its staff and recruit competent, experienced and motivated professionals, considering the level of management efficiency currently required by the Company.

In addition to monthly fee, the members of the Board of Directors, Fiscal Council and the Board of Executive Officers receive annual reward equivalent to a monthly fee, calculated on a prorated basis in December of each year. The purpose of this reward is to correspond to the thirteenth salary paid to the Company's employees, as officers and directors' relationship with the Company is governed by its bylaws and not the labor code.

Benefits paid only to statutory officers - meal ticket, basket of food staples, medical care, annual paid rest typified as a paid leave of 30 calendar days, and payment of a premium equivalent to one third of the monthly fee and bonuses.

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SABESP pays bonuses for the purposes of compensating directors, in accordance with the guidelines of the São Paulo State government, as an incentive policy, as long as the Company records quarterly, semiannual, and yearly profits, and distributes mandatory dividends to shareholders, even if in the form of interest on capital. Annual bonuses cannot exceed six times the monthly compensation of the officers/directors or 10 percent of the interest on capital paid by the Company, prevailing the shortest amount.

Expenses related to the compensation to the members of its Board of Directors, Fiscal Council and Board of Executive Officers amounted to R\$3,912, R\$4,078 and R\$3,749 for the years ended December 31, 2016, 2015 and 2014, respectively. An additional amount of R\$494, related to the bonus program, was recorded in 2016 (R\$521 in 2015 and R\$504 in 2014).

### (k) Loan agreement through credit facility

The Company entered into a loan agreement through credit facility with the SPEs Aquapolo Ambiental S.A. and Attend Ambiental S.A. As of May 9, 2014, to finance the operations of these companies, until the borrowings and financing requested with financial institutions is cleared. These agreements remain with the same characteristics, according to the table below:

SPE	Principal disbursed amount	Interest balance	Total	Interest rate	Maturity
Attend Ambiental	5,400	3,071	8,471	SELIC + 3.5 % p.a.	(i)
Aquapolo Ambiental	5,629	6,090	11,719	CDI + 1.2% p.a.	04/30/2016 (ii)
Aquapolo Ambiental	19,000	13,217	32,217	CDI + 1.2% p.a.	10/30/2015 (ii)
Total	30,029	22,378	52,407		

(i) The loan agreement with SPE Attend Ambiental S/A matures within 180 days, from the date when the respective amount is available in the borrower's account, renewable for the same period. The credit has been overdue since May 11, 2015 and is subject to contractual default charges (inflation adjustment considering the IGP-M variation, 2% fine and default interest of 1% p.m.). The agreement has been renegotiated between the parties.

(ii) The agreement expired on April 30, 2015 was amended and its maturity was extended to October 30, 2015. The Company and Aquapolo Ambiental S/A are renegotiating the payment terms and the maturity of both agreements.

As a result of the renegotiations, the principal, in the amount of R\$30,029, and interest, in the amount of R\$22,378, that used to be recognized in current assets, under "other receivables", were reclassified to the same group of noncurrent assets until new payment conditions are agreed upon. As of December 31, 2016, the balance of principal and interest rates of these agreements was R\$52,407 (R\$45,289 as of December 31, 2015). In 2016, a financial income recognized was R\$7,118 (R\$10,123 in 2015 and R\$5,222 in 2014).

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### (I) “Se Liga na Rede” (Connect to the Network Program)

The State Government enacted the State Law nº 14,687/12, creating the pro-connection program, destined to financially subsidize the execution of household branches necessary to connect to the sewage collecting networks, in low income households which agreed to adhere to the program. The program expenditures, except for indirect costs, construction margin and borrowing costs are financed with 80% of funds deriving from the State Government and the remaining 20% invested by SABESP, which is also liable for the execution of works. As of December 31, 2016, the program total amount was R\$79,274 (R\$78,447 as of December 31, 2015), R\$6,148 (R\$19,305 as of December 31, 2015) recorded in balances receivable from related parties, the amount of R\$34,915 (R\$34,089 as of December 31, 2015) recorded in the group of intangible assets and R\$38,211 (R\$25,053 as of December 31, 2015) reimbursed by GESP.

### 11 Water National Agency - ANA

The Company has agreements executed within the scope of the Hydrographic Basin Depollution Program (PRODES), also known as "Treated Sewage Purchase Program".

This program does not finance works or equipment, remunerates by results achieved, i.e., by effectively treated sewage. In this program, the Water National Agency (ANA) makes available funds, which are restricted to a specific current account and applied in investment funds at the Caixa Econômica Federal - Federal Savings Banks (CEF), until the fulfillment of treated sewage volume is evidenced, as well as, the reduction of polluting cargoes of each agreement.

When resources are made available, liabilities are recorded until funds are released by ANA. After the evidence of targets stipulated in each contract, the revenue deriving from these funds is recognized, but if these targets are not met, funds will return to the National Treasury with the appropriate funds earnings. As of December 31, 2016, the balances of assets and liabilities were R\$81,221 (R\$88,368 as of December 31, 2015), and the liabilities are recorded under "other liabilities" of noncurrent liabilities.

### 12 Investments

The Company holds interest in certain Special Purpose Entities (SPE). Although SABESP has no majority shares of its investees, the shareholders' agreement provides for the power of veto in certain management issues, however, with no ability to use such power of veto in a way to affect returns over investments, indicating participating shared control (joint venture – IFRS 11).

The Company holds interest valued by the equity accounting in the following investees:

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### Sesamm

On August 15, 2008, the Company, together with the companies OHL Médio Ambiente, Inima S.A.U. Unipersonal ("Inima"), Técnicas y Gestión Medioambiental S.A.U. ("TGM") and Estudos Técnicos e Projetos ETEP Ltda. ("ETEP") incorporated the company Serviços de Saneamento de Mogi Mirim S.A. - SESAMM for a period of 30 years from the date the concession agreement with the municipality of Mogi Mirim for the purpose of providing complementary services to the sewage diversion system and implementing and operating sewage treatment system in the municipality of Mogi Mirim, including the disposal of solid waste.

Sesamm's capital as of December 31, 2016, totaled R\$19,532, and was represented by 19,532,409 registered common shares without a par value. SABESP holds 36% of its equity interest and Inima holds another 46% of its equity interest.

The operations initiated in June 2012.

### Águas de Andradina

On September 15, 2010, the Company, together with the company Companhia de Águas do Brasil – Cab Ambiental incorporated the company Águas de Andradina S.A., with indefinite term, for the purpose of providing water supply and sewage services to the municipality of Andradina.

As of December 31, 2016, the capital of Águas de Andradina totaled R\$11,551, divided into 11,551,089 registered common shares without a par value. SABESP holds 30% of its equity interest. The amount of R\$12 is recorded under investee's equity, as advance for future capital increase.

The Company pledges as guarantee 100% of its shares in Águas de Andradina.

The operations initiated in October 2010.

### Águas de Castilho

On October 29, 2010, the Company, together with the company Águas do Brasil – Cab Ambiental, incorporated the company Águas de Castilho, for the purpose of providing water supply and sewage services to the municipality of Castilho.

As of December 31, 2016, the company's capital was R\$1,620, and was represented by 1,620,000 registered share without par value. SABESP holds 30% equity interest.

The Company pledges as guarantee 100% of its shares in Águas de Castilho.

The operations initiated in January 2011.

### Saneaqua Mairinque



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On June 14, 2010, the Company, together with the company Odebrecht Utilities S/A, former Foz do Brasil S.A., with indefinite term, for the purpose of exploring the water supply and sewage public utilities of the municipality of Mairinque.

As of December 31, 2016, the capital of Saneaqua Mairinque totaled R\$2,000, and was represented by 2,000,000 registered common shares without a par value. SABESP holds 30% equity interest.

The Company pledges as guarantee 100% of its shares in Saneaqua Mairinque.

The operations initiated in October 2010.

### Attend Ambiental

On August 23, 2010, SABESP, jointly with Companhia Estre Ambiental S.A, merged the company Attend Ambiental S.A, for constructing and operating a pretreatment of non-domestic effluent station, sludge transportation and related services in the city of São Paulo as well as implement similar structures in other areas in Brazil and abroad.

As of December 31, 2016, the capital totaled R\$13,400, and was represented by 13,400,000 registered common shares without par value. SABESP holds 45% equity interest.

The operations initiated in December 2014.

### Aquapolo Ambiental S/A.

On October 8, 2009, the Company, together with the company Odebrecht Utilities S/A, formerly Foz do Brasil S.A., incorporated the company Aquapolo Ambiental S.A., for the purpose of producing, providing and trading reused water for Quattor Química S.A., Quattor Petroquímica S.A., Quattor Participações S.A. and other companies comprising the Petrochemical Complex.

As of December 31, 2016, the capital of Aquapolo totaled R\$36,412, and was represented by 42,419,045 registered common shares without a par value. SABESP holds 49% of its equity interest.

The Company pledges as collateral 100% of its shares in Aquapolo Ambiental S/A.

The operations initiated in October 2012.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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### Paulista Geradora de Energia

On April 13, 2015, the Company acquired shares from Empresa Paulista Geradora de Energia S/A - PGE, jointly with Servtec Investimentos e Participações Ltda ("Servtec") and Tecniplan Engenharia e Comércio Ltda ("Tecniplan"), which operational purpose is implementation and commercial exploration of water potential in small hydroelectric power plants (PCHs), located at the Guaraú and Vertedouro Cascata Water Treatment Stations.

As of December 31, 2016, the capital stock of Paulista Geradora de Energia was R\$8,679, and was represented by 8,679,040 registered common shares without a par value, in which SABESP holds a 25% interest.

As of December 31, 2016, operations had not initiated yet.

Below is a summary of the investees' financial statements and SABESP's equity interest:

Company	Equity			Provisioned	Profit (loss) for the year		
	2016	2015	2014	dividends	2016	2015	2014
Sesamm	37,198	32,313	26,788	(3,716)	8,601	6,082	3,904
Águas de Andradina (i)	16,161	15,191	4,582	(802)	1,772	2,371	960
Águas de Castilho	3,706	3,449	2,866	(374)	631	773	802
Saneaqua Mairinque	4,090	3,560	2,697	(193)	723	1,145	(405)
Attend Ambiental	3,925	3,084	(111)	-	841	3,195	(6,127)
Aquapolo Ambiental	12,340	11,651	16,220	-	689	(4,569)	(3,180)
Paulista Geradora de Energia	8,469	8,509	-	-	(40)	(114)	-

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Company	Investments		Dividends distributed	Equity in results of investments in affiliates			Interest percentage		
	2016	2015	2016	2016	2015	2014	2016	2015	2014
Sesamm	13,391	11,633	(1,338)	3,096	2,190	1,405	36%	36%	36%
Águas de Andradina	4,849	4,558	(241)	532	711	288	30%	30%	30%
Águas de Castilho	1,112	1,035	(112)	189	232	241	30%	30%	30%
Saneaqua Mairinque	1,227	1,068	(58)	217	344	(122)	30%	30%	30%
Attend Ambiental	1,766	1,388	-	378	1,388	(2,707)	45%	45%	45%
Aquapolo Ambiental	6,047	5,709	-	338	(2,239)	(1,558)	49%	49%	49%
Paulista Geradora de Energia	2,117	2,127	-	(10)	(29)	-	25%	25%	-
Total	30,509	27,518	(1,749)	4,740	2,597	(2,453)			
Other investments	587	587							
Overall total	31,096	28,105							

### 13 Investment properties

As of December 31, 2016, the balance of "Investment properties" is R\$57,968 (December 31, 2015 – R\$56,957). As of December 31, 2016 and 2015, the market value of these properties is approximately R\$404,000 and R\$392,000, respectively.

	December 31, 2015	Transfers	Write-offs and disposals	Reversal of estimated losses	Depreciation	December 31, 2016
Investment properties	56,957	1,231	(124)	10	(106)	57,968
Total	56,957	1,231	(124)	10	(106)	57,968

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	December 31, 2014	Transfers	Write-offs and disposals	Depreciation	December 31, 2015
Investment properties	54,039	9,182	(5,859)	(405)	56,957
Total	54,039	9,182	(5,859)	(405)	56,957

There were no changes in 2014.

## 14 Intangible assets

### (a) Statement of financial position details

	December 31, 2016			December 31, 2015		
	Cost	Accumulated amortization	Net	Cost	Accumulated amortization	Net
Intangible right arising from:						
Agreements – equity value	9,222,543	(1,739,588)	7,482,955	8,862,581	(1,574,951)	7,287,630
Agreements – economic value	1,925,361	(543,709)	1,381,652	1,819,219	(466,199)	1,353,020
Program contracts	9,209,367	(2,633,346)	6,576,021	8,660,552	(2,371,977)	6,288,575
Program contracts – commitments	991,848	(168,632)	823,216	986,086	(135,556)	850,530
Services contracts – São Paulo	17,457,658	(2,904,951)	14,552,707	14,767,591	(2,400,574)	12,367,017
Software license	575,494	(145,257)	430,237	474,294	(107,440)	366,854
Total	39,382,271	(8,135,483)	31,246,788	35,570,323	(7,056,697)	28,513,626

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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### (b) Changes

	December 31, 2015	Additions	Contract renewal	Estimated losses	Transfers	Write-offs and disposals	Amortization	December 31, 2016
Intangible right arising from:								
Agreements – equity value	7,287,630	391,545	(9,587)	(1,335)	1,014	(6,233)	(180,079)	7,482,955
Agreements – economic value	1,353,020	106,307	-	(8)	6	(110)	(77,563)	1,381,652
Program contracts	6,288,575	553,126	9,587	(4,360)	2,023	(5,571)	(267,359)	6,576,021
Program contracts – commitments	850,530	5,762	-	-	-	-	(33,076)	823,216
Services contracts – São Paulo	12,367,017	2,697,724	-	(4,495)	9,696	(2,894)	(514,341)	14,552,707
Software license	366,854	101,367	-	-	(167)	-	(37,817)	430,237
<b>Total</b>	<b>28,513,626</b>	<b>3,855,831</b>	<b>-</b>	<b>(10,198)</b>	<b>12,572</b>	<b>(14,808)</b>	<b>(1,110,235)</b>	<b>31,246,788</b>

	December 31, 2014	Additions	Contract renewal	Reversal of estimated losses	Transfers	Write-offs and disposals	Amortization	December 31, 2015
Intangible right arising from:								
Agreements – equity value	7,369,271	574,421	(463,362)	747	(324)	(4,303)	(188,820)	7,287,630
Agreements – economic value	1,281,260	140,732	-	-	(17)	(139)	(68,816)	1,353,020
Program contracts	5,379,153	663,399	463,362	4,459	(752)	(11,045)	(210,001)	6,288,575
Program contracts – commitments	702,909	177,424	-	-	-	-	(29,803)	850,530
Services contracts – São Paulo	10,986,386	1,900,218	-	18,879	(4,997)	(30,321)	(503,148)	12,367,017
Software license	260,547	148,248	-	-	-	-	(41,941)	366,854
<b>Total</b>	<b>25,979,526</b>	<b>3,604,442</b>	<b>-</b>	<b>24,085</b>	<b>(6,090)</b>	<b>(45,808)</b>	<b>(1,042,529)</b>	<b>28,513,626</b>

	December 31, 2013	Additions	Contract renewal	Provision for losses	Transfers	Write-offs and disposals	Amortization	December 31, 2014
Intangible assets arising from:								
Agreements – equity value	7,079,790	693,960	(165,093)	(1,598)	(34,011)	(14,542)	(189,235)	7,369,271
Agreements – economic value	1,186,146	150,647	-	-	(57)	(496)	(54,980)	1,281,260
Program contracts	4,668,567	878,947	165,093	(2,919)	(122,940)	(9,726)	(197,869)	5,379,153
Program contracts – commitments	613,320	115,632	-	-	-	-	(26,043)	702,909
Services contracts – São Paulo	10,124,603	1,264,861	-	(30,352)	112,507	(23,162)	(462,071)	10,986,386
Software license	173,805	132,734	-	-	-	-	(45,992)	260,547
<b>Total</b>	<b>23,846,231</b>	<b>3,236,781</b>	<b>-</b>	<b>(34,869)</b>	<b>(44,501)</b>	<b>(47,926)</b>	<b>(976,190)</b>	<b>25,979,526</b>

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In 2016, the Company started operations with the municipalities of Iperó, Tarumã and Santa Isabel for a 30-year term and, in February 2017, it started operations in the municipality of Santa Branca.

### (c) Construction services

	2016		
	Water supply	Sewage services	Total
Construction revenue	2,564,769	1,168,108	3,732,877
Construction cost incurred	2,508,022	1,143,342	3,651,364
Margin	56,747	24,766	81,513

	2015		
	Water supply	Sewage services	Total
Construction revenue	2,090,012	1,246,704	3,336,716
Construction cost incurred	2,044,606	1,219,202	3,263,808
Margin	45,406	27,502	72,908

	2014		
	Water supply	Sewage services	Total
Construction revenue	1,204,380	1,713,656	2,918,036
Construction cost incurred	1,181,596	1,673,920	2,855,516
Margin	22,784	39,736	62,520

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### (d) Intangible arising from concession agreements

The Company operates public service concession agreements for water supply and sewage services mostly based on agreements that set out rights and obligations relative to the exploration of assets related to the public service (See Note 3.8 (a)). A general obligation also exists to return the concession infrastructure to the concession grantor in good working condition at the end of the concession.

As of December 31, 2016, the Company operated in 366 municipalities in the State of São Paulo (364 as of December 31, 2015). Most of these contracts have a 30-year concession period.

The services provided by the Company are billed at a price regulated and controlled by São Paulo State Sanitation and Energy Regulatory Agency (ARSESP).

Intangible rights arising on concession agreements include:

#### (i) Service concession agreements – equity value

These refer to municipalities assumed until 2006, except for the municipalities assumed by economic value through assets valuation report prepared by independent experts. The amortization of assets is calculated according to the straight-line method, which considers the assets useful life.

#### (ii) Concession agreements – economic value

From 1999 through 2006, the negotiations for new concessions were conducted on the basis of the economic and financial result of the transaction, determined in a valuation report issued by independent appraisers.

The amount determined in the related contract, after the transaction is closed with the municipal authorities, realized through the subscription of the Company's shares or in cash, is recorded as "concession agreements" and amortized over the period of the related concession (usually 30 years). As of December 31, 2016 and 2015 there were no amounts pending related to these payments to the municipalities.

Intangible assets are amortized on a straight line basis over the period of the concession agreements or for the useful lives of the underlying assets, whichever is shorter.

#### (iii) Program contracts

These refer to the renewal of contracts previously referred to as concession agreements whose purpose is to provide sanitation services. The amortization of the assets acquired until the dates of signatures of the program contracts is calculated according to the straight-line method, which considers the assets' useful lives. Assets acquired or built after the signature dates of program contracts are amortized during the contracted period (30 years) or during the useful lives of underlying assets, whichever is shorter.

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### (iv) Program contracts - Commitments

After the enactment of the regulatory framework in 2007, renewals of concessions started to be made through of program contracts. In some of these program contracts, the Company undertook the commitment to financially participate in social and environmental actions. The assets built and financial commitments assumed within the program contracts are recorded as intangible assets and are amortized by the straight-line method in accordance with the duration of the program contract (mostly, 30 years).

In 2016, amortization expenses related to the commitments of the program contract were R\$33,076 (R\$29,803 in 2015 and R\$26,043 in 2014).

The amounts not yet disbursed related to commitments under the program contracts are recorded in “Program Contracts – Commitments” in current liabilities (in the amount of R\$109,042 and R\$228,659 as of December 31, 2016 and 2015, respectively) and noncurrent liabilities (in the amount of R\$69,051 and R\$92,055 as of December 31, 2016 and 2015, respectively). In 2016, the annual rate of 8.06% was applied (WACC) to calculate the present value adjustment of these contracts.

### (v) Services agreement with the Municipality of São Paulo

On June 23, 2010, the Company entered into an agreement with the State of São Paulo and the Municipality of São Paulo to regulate the provision of water and sewage services in the city of São Paulo for a 30-year period, which is extendable for an another 30-year period.

Also on June 23, 2010, an agreement was signed between the state and municipal government, and SABESP and the Sanitation and Energy Regulatory Agency of the State of São Paulo (“ARSESP”) are the consenting and intervening parties, whose main aspects are the following:

1. The State and the Municipality of São Paulo grant to SABESP the right to explore the sanitation service in the capital of the State of São Paulo, which consists of the obligation to provide such service and charge the respective tariff for this service;
2. The State and the Municipality sets forth ARSESP as the agency responsible for regulating the tariff, controlling and monitoring the services.
3. The evaluation model of the contract was the discounted cash flow, which considered the financial and economic sustainability of SABESP’s operations in the metropolitan region of São Paulo;
4. All operating costs, taxes, investments and the opportunity cost of investors and the creditors of SABESP’s were considered in the cash flow analysis;
5. The agreement provides for investments established in the agreement comply with the minimum of 13% of the gross revenue from the municipality of São Paulo, net of the taxes on revenues. Investment plans referring to SABESP’s execution shall be compatible with the activities and programs foreseen in the state, municipal sanitation plans, and where applicable, the metropolitan plan. The investment plan is not definite and will be revised by Managing Committee every four years, especially as to investments to be made in the following period;



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6. The payment related to the Municipal Fund of Environmental Sanitation and Infrastructure to be applied in the sanitation service within the municipality must be recovered through the tariffs charges. Such payment represents 7.5% of the total revenue from the municipality of São Paulo, net of the taxes on revenue and delinquency in the period, recognized in profit or loss, as operating cost;

7. The opportunity cost of the investors and the creditors was established by the Weighted Average Cost of Capital (WACC) methodology. The WACC was the interest rate used to discount the cash flow of the operation; and

8. The agreement considers the recovery of net assets in operation, preferably evaluated through equity valuation or carrying amount monetarily restated, as defined by ARSESP. In addition, the agreement provides for the remuneration of investments to be made by SABESP, so that there is no residual value at the end of the agreement.

Referring to the recovery through tariff, mentioned in item 6 above, of transfer to the Municipal Fund of Environmental Sanitation and Infrastructure, ARSESP issued in April 2013, the Resolution no. 413, postponing the application of Resolution no. 407 until the conclusion of the tariff revision process, the transfer to the bill of services of amounts referring to the municipal charges which were stipulated in Resolution no. 407. The postponement to apply Resolution no. 407 was due to a request by the São Paulo State Government to analyze, among other things, methods to reduce the impact on consumers.

On April 18, 2014, ARSESP Resolution no. 484 was published with the final results of SABESP's Tariff Revision, however, both the São Paulo Municipal Government, through Official Letter no. 1,309/14-SGM/GAB and the São Paulo State Government through a petition filed by the São Paulo State Office, through the Official Letter ATG/Official Letter no. 092/14-CC, requested a postponement of the effects of ARSESP Resolution no. 413, published in the São Paulo State Official Gazette on March 20, 2013, until the conclusion of the revision of the Agreement entered into between the São Paulo Municipal Government, the São Paulo State Government and SABESP.

By means of Resolution 488 of May 7, 2014, ARSESP maintained the suspension of the effectiveness of ARSESP Resolution 407, published on March 22, 2013, until the results obtained in the revision of the Agreement entered into by the São Paulo Municipal Government, the São Paulo State Government and SABESP postponing authorization for the transfer to the bill of the services related to the legally established municipal fees that, by force of the Program Agreements and Water Supply and Sewage Services Agreements, should be included in the Tariff Revision.

The agreement represents 55.46% of the total revenue of the Company as of December 31, 2016, and ensures the judicial and assets security, adequate return to shareholders and quality services to its customers.

The municipality of São Paulo and the Company did not conclude an agreement to equalize financial pending issues existing until the signature date of the Agreement related to the rendering of water supply and sewage collection services to the real properties of the municipality, reason that, the Company filed a suit to collect these accounts, which are accrued for losses.

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### (e) Capitalization of interest and other finance charges

In 2016, the Company capitalized interest and inflation adjustment, including related foreign currency exchange effects in concession intangible assets, totaling R\$700,743, including the São Lourenço Production System and Leases (R\$466,544 in 2015 and R\$278,265 in 2014) during the construction period.

### (f) Construction margin

The Company acts as a primary responsible to construct and install the infrastructure related to the concession, using own efforts or hiring outsourcing services, receiving the risks and benefits.

As a consequence, the Company recognizes revenue from construction service corresponding to the cost of construction increased by margin. Generally, the constructions related to the concessions are performed by third parties, in such case, the margin of the Company is lower, normally, to cover eventual administration costs, and the responsibility of the primary risk. In 2016 and 2015 the margin was 2.3%.

Construction margin for 2016, 2015 and 2014 were R\$81,513, R\$72,908 and R\$62,520, respectively.

### (g) Expropriations

As a result of the construction of priority projects related to water and sewage systems, the Company was required to expropriate third-parties' properties, and the owners of these properties will be compensated either amicably or through courts.

The costs of these expropriations are recorded as concession intangible assets after the transaction is concluded. In 2016, the total amount related to expropriations was R\$40,452 (R\$66,801 in 2015 and R\$13,200 in 2014).

### (h) Public-Private Partnership - PPP

SABESP carries out operations related to the PPPs mentioned below. These operations and their respective obligations and guarantees are supported by agreements executed according to Law 11,079/04.

#### Alto Tietê Production System

The Company and the special purpose entity CAB-Sistema Produtor Alto Tietê S/A, formed by Galvão Engenharia S.A. and Companhia Águas do Brasil – Cab Ambiental, signed in June 2008 the contract of public-private- partnership of Alto Tietê production system.

The contract last 15 years which purpose is to expand the capacity of treated water of Taiaçupeba from 10 thousand to 15 thousand of liters per second, whose operation began in October 2011.

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As of December 31, 2016 and 2015, the amounts recognized as intangible asset related to PPP were R\$382,103 and R\$393,275, respectively. In 2016, a discount rate of 8.20% p.a. was used to calculate the adjustment to present value of the agreement.

On a monthly basis, SABESP assigns funds from tariffs to the SPE CAB Sistema Produtor Alto Tietê S/A, in the amount of R\$9,773, corresponding to the monthly remuneration. This amount is annually adjusted by the IPC – FIPE and is recorded in a restricted account, pursuant to the contractual operating proceeding. Should SABESP comply with its monthly obligations with the SPE, the funds from the restricted account will be released.

The guarantee is effective since the beginning of the operation and will be valid until the conclusion, termination, intervention, annulment or caducity of the Administrative Concession, or other extinction events provided for in the Concession Agreement or in the law applicable to administrative concessions, including in the event of bankruptcy or extinction of the SPE.

### São Lourenço Production System

SABESP and the special purpose entity Sistema Produtor São Lourenço S/A, composed of Construções e Comércio Camargo Corrêa S/A and Construtora Andrade Gutierrez S/A, in August 2013 signed the public-private partnership agreements of the São Lourenço Production System.

The objective of the contract is: a) the construction of a water producing system, mainly consisting of a water pipeline connecting Ibiúna to Barueri, a water collection station in Ibiúna, a water treatment station in Vargem Grande Paulista and water reservoirs; and b) the provision of services for a 25-year term, aiming at rendering services to operate the dehydration system, drying and final disposal of sludge, maintenance and works of the São Lourenço Production System. Works started in April 2014.

Pursuant to the agreement, the works should end in April 2018. However, since these are essential works to guarantee water security, the Company has been making efforts to finish them by the end of 2017.

The estimated amount monetarily restated through December 31, 2016 is approximately R\$7.9 billion. This amount was calculated considering the early startup mentioned above.

After the beginning of the operations, every month SABESP will transfer to the SPE Sistema Produtor São Lourenço S/A funds from tariffs arising from the services provided, in the amount of R\$24.4 million, equivalent to the monthly remuneration plus interest and charges. The amount above will be annually restated by the IPC - FIPE and should be monthly recorded in a restricted account, in accordance with the operating procedures of the agreements. Should SABESP perform its monthly obligations with the SPE, the funds from the restricted account will be released.

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The guarantee will become effective as of the beginning of the system's appropriate operation, duly accepted by SABESP, valid until the occurrence of any of the following events, whichever occurs first: (i) the original payment date of the last installment of interest / amortization of the principal taken out by the SPE to execute the works; (ii) the end, termination, intervention, annulment, caducity of the Administrative Concession, or other extinction events provided for in the Concession Agreement or in the law applicable to administrative concessions, including bankruptcy or extinction of the SPE.

As of December 31, 2016 and 2015, the carrying amount recorded in the Company's intangible assets, related to this PPP, amounted to R\$1,951,538 and R\$699,335, respectively. Intangible assets are accounted for based on the physical evolution of the works which, as of December 31, 2016, was approximately 64%, with a counter-entry in the Private Public Partnership (PPP) liabilities account. In 2016, a discount rate of 7.80% p.a. was used to calculate the adjustment to present value of the agreement.

The obligations assumed by the Company as of December 31, 2016 and 2015 are shown in the table below, and the increase in liabilities was mainly due to the progress of PPP São Lourenço works in 2016.

	December 31, 2016			December 31, 2015		
	Current liabilities	Noncurrent liabilities	Current liabilities	Noncurrent liabilities	Current liabilities	Noncurrent liabilities
Alto Tietê	31,898	309,858	341,756	33,255	319,076	352,331
São Lourenço	-	1,907,662	1,907,662	-	682,702	682,702
Total	31,898	2,217,520	2,249,418	33,255	1,001,778	1,035,033

### (i) Works in progress

The amount of R\$9,156 million is recorded under intangible assets as works in progress as of December 31, 2016 (R\$6,596 million as of December 31, 2015), and, in 2016, the major projects are located in the municipalities of São Paulo, Praia Grande and Franca, totaling R\$5,693 million (including R\$1,952 million from PPP São Lourenço), R\$257 million and R\$234 million, respectively.

### (j) Amortization of intangible assets

The amortization average rate totaled 3.9% as of December 31, 2016 and 2015 and 3.8% as of December 31, 2014.

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### (k) Software license of use

The software license of use is capitalized based on the costs incurred to acquire software and make them ready for use. The project to implement an integrated business management solution (ERP system), which includes the administrative/financial module and the commercial module, is in progress. The administrative/financial module is expected to begin operations in April 2017.

## 15 Property, plant and equipment

### (a) Statement of financial position details

	December 31, 2016			December 31, 2015		
	Cost	Accumulated depreciation	Net	Cost	Accumulated depreciation	Net
Land	92,494	-	92,494	102,708	-	102,708
Buildings	77,548	(34,286)	43,262	79,257	(33,366)	45,891
Equipment	338,696	(189,556)	149,140	326,598	(164,380)	162,218
Transportation equipment	11,141	(6,610)	4,531	12,169	(6,477)	5,692
Furniture and fixtures	23,633	(11,647)	11,986	18,664	(10,246)	8,418
Other	1,181	(211)	970	435	(286)	149
<b>Total</b>	<b>544,693</b>	<b>(242,310)</b>	<b>302,383</b>	<b>539,831</b>	<b>(214,755)</b>	<b>325,076</b>

### (b) Changes

	December 31, 2015	Additions	Transfers	Write-offs and disposals	Depreciation	December 31, 2016
Land	102,708	-	(10,214)	-	-	92,494
Buildings	45,891	-	(911)	(45)	(1,673)	43,262
Equipment	162,218	26,061	(6,380)	(181)	(32,578)	149,140
Transportation equipment	5,692	214	(556)	-	(819)	4,531
Furniture and fixtures	8,418	511	4,258	(10)	(1,191)	11,986
Other	149	845	-	-	(24)	970
<b>Total</b>	<b>325,076</b>	<b>27,631</b>	<b>(13,803)</b>	<b>(236)</b>	<b>(36,285)</b>	<b>302,383</b>

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	December 31, 2014	Additions	Transfers	Write-offs and disposals	Depreciation	December 31, 2015
Land	100,533	1,032	1,143	-	-	102,708
Buildings	42,515	1,383	3,347	-	(1,354)	45,891
Equipment	146,922	51,610	(8,123)	(340)	(27,851)	162,218
Transportation equipment	7,613	135	(1,109)	(10)	(937)	5,692
Furniture and fixtures	7,124	634	1,629	(23)	(946)	8,418
Other	138	-	21	-	(10)	149
<b>Total</b>	<b>304,845</b>	<b>54,794</b>	<b>(3,092)</b>	<b>(373)</b>	<b>(31,098)</b>	<b>325,076</b>

	December 31, 2013	Additions	Transfer	Write-offs and disposals	Depreciation	Depreciation 31, 2014
Land	88,332	-	12,201	-	-	100,533
Buildings	23,954	28,407	(8,561)	-	(1,285)	42,515
Equipment	71,833	58,002	42,481	(280)	(25,114)	146,922
Transportation equipment	7,895	1,481	(707)	-	(1,056)	7,613
Furniture and fixtures	6,821	1,187	(29)	(39)	(816)	7,124
Other	661	374	(884)	(3)	(10)	138
<b>Total</b>	<b>199,496</b>	<b>89,451</b>	<b>44,501</b>	<b>(322)</b>	<b>(28,281)</b>	<b>304,845</b>

### (c) Depreciation

The Company annually revises the depreciation rates of: buildings – 2.3%; equipment- 15.4%; transportation equipment - 10% and furniture, fixture and equipment – 7.0%. Lands are not depreciated.

The depreciation average rate was 10.9% in 2016, 11.5% in 2015 and 11.4% in 2014.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2016, 2015 and 2014

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### 16 Borrowings and financing

Borrowings and financing outstanding balance	December 31, 2016			December 31, 2015		
	Current	Noncurrent	Total	Current	Noncurrent	Total
<b>Financial institution</b>						
<b>Local currency</b>						
10th issue debentures	40,967	120,343	161,310	39,619	155,815	195,434
12th issue debentures	45,450	340,165	385,615	45,450	385,667	431,117
14th issue debentures	39,802	178,571	218,373	38,519	210,961	249,480
15th issue debentures	97,692	672,657	770,349	94,819	728,529	823,348
17th issue debentures	140,144	904,094	1,044,238	140,144	997,259	1,137,403
18th issue debentures	32,436	223,840	256,276	3,167	247,683	250,850
19th issue debentures	199,461	-	199,461	-	498,587	498,587
20th issue debentures	-	495,533	495,533	-	494,500	494,500
Brazilian Federal Savings Bank	59,199	1,088,160	1,147,359	49,491	1,014,850	1,064,341
Brazilian Development Bank - BNDES BAIXADA SANTISTA	16,603	33,207	49,810	16,368	49,104	65,472
Brazilian Development Bank - BNDES PAC	10,987	60,293	71,280	10,329	66,984	77,313
Brazilian Development Bank - BNDES PAC II 9751	4,288	27,007	31,295	4,264	31,206	35,470
Brazilian Development Bank - BNDES PAC II 9752	2,341	21,659	24,000	2,308	23,660	25,968
Brazilian Development Bank - BNDES ONDA LIMPA	23,219	168,083	191,302	22,347	184,082	206,429
Brazilian Development Bank - BNDES TIETÊ III	30,054	307,862	337,916	17,725	265,663	283,388
Brazilian Development Bank - BNDES 2015	-	233,967	233,967	-	-	-
Leases	14,914	537,602	552,516	11,955	522,940	534,895
Other	746	10,829	11,575	649	1,270	1,919
Interest and charges	121,605	-	121,605	127,862	-	127,862
<b>Total in local currency</b>	<b>879,908</b>	<b>5,423,872</b>	<b>6,303,780</b>	<b>625,016</b>	<b>5,878,760</b>	<b>6,503,776</b>

Borrowings and financing outstanding balance	December 31, 2016			December 31, 2015		
	Current	Noncurrent	Total	Current	Noncurrent	Total
<b>Financial institution</b>						
<b>Foreign currency</b>						
Inter-American Development Bank - BID 713 – US\$25,097 thousand (US\$50,195 thousand in December 2015)	81,794	-	81,794	98,001	98,001	196,002
Inter-American Development Bank - BID 896 – (US\$2,778 thousand in December 2015)	-	-	-	10,848	-	10,848
Inter-American Development Bank - BID 1212 – US\$92,503 thousand (US\$102,781 thousand in December 2015)	33,499	267,979	301,478	40,134	361,204	401,338
Inter-American Development Bank - BID 2202 – US\$438,071 thousand (US\$405,072 thousand in December 2015)	75,143	1,339,803	1,414,946	-	1,572,181	1,572,181
International Bank of Reconstruction and Development - BIRD – US\$79,946 thousand (US\$61,158 thousand in December 2015)	-	260,224	260,224	-	238,464	238,464
Deutsche Bank – US\$150,000	-	480,244	480,244	-	-	-
Eurobonds – (US\$140,000 thousand in December 2015)	-	-	-	546,570	-	546,570
Eurobonds – US\$350,000 thousand (US\$350,000 thousand in December 2015)	-	1,137,395	1,137,395	-	1,362,570	1,362,570
JICA 15 – ¥14,981,590 thousand (¥16,134,020 thousand in December 2015)	32,175	386,111	418,286	37,373	485,853	523,226
JICA 18 – ¥13,470,080 thousand (¥14,506,240 thousand in December 2015)	28,930	346,889	375,819	33,603	436,548	470,151
JICA 17 – ¥1,596,251 thousand (¥ 1,565,564 thousand in December 2015)	1,205	42,675	43,880	-	50,201	50,201
JICA 19 – ¥27,596,009 thousand (¥21,701,103 thousand in December 2015)	-	768,463	768,463	-	701,978	701,978

BID 1983AB – US\$106,346 thousand (US\$130,289 thousand in December 2015)	78,030	263,921	341,951	93,490	409,578	503,068
Interest and charges	35,883	-	35,883	41,227	-	41,227
<b>Total in foreign currency</b>	<u>366,659</u>	<u>5,293,704</u>	<u>5,660,363</u>	<u>901,246</u>	<u>5,716,578</u>	<u>6,617,824</u>
<b>Total borrowings and financing</b>	<u>1,246,567</u>	<u>10,717,576</u>	<u>11,964,143</u>	<u>1,526,262</u>	<u>11,595,338</u>	<u>13,121,600</u>

Exchange rate as of December 31, 2016: US\$3.2591; ¥0.02792 (as of December 31, 2015: US\$3.9048; ¥0.03243).

As of December 31, 2016, the Company did not record balances of borrowings and financing raised during the year to mature within 12 months.



# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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<u>Local currency</u>	<u>Guarantees</u>	<u>Maturity</u>	<u>Annual interest rates</u>	<u>Inflation adjustment</u>
10th issue debentures	Own funds	2020	TJLP +1.92% (Series 1 and 3) and 9.53% (Series 2)	IPCA (Series 2)
12th issue debentures	Own funds	2025	TR + 9.5%	
14th issue debentures	Own funds	2022	TJLP +1.92% (Series 1 and 3) and 9.19% (Series 2)	IPCA (Series 2)
15th issue debentures	Own funds	2019	CDI + 0.99% (Series 1) and 6.2% (Series 2)	IPCA (Series 2)
17th issue debentures	Own funds	2023	CDI +0.75 (Series 1) and 4.5% (Series 2) and 4.75% (Series 3)	IPCA (Series 2 and 3)
18th issue debentures	Own funds	2024	TJLP 1.92 % (Series 1 and 3) and 8.25% (Series 2)	IPCA (Series 2)
19th issue debentures	Own funds	2017	CDI + 0.80% to 1.08%	
20th issue debentures	Own funds	2019	CDI + 3.80%	
Brazilian Federal Savings Bank	Own funds	2017/2038	5% to 9.5%	TR
Brazilian Development Bank - BNDES BAIXADA SANTISTA	Own funds	2019	2.5%+TJLP	
Brazilian Development Bank - BNDES PAC	Own funds	2023	2.15%+TJLP	
Brazilian Development Bank - BNDES PAC II 9751	Own funds	2027	1.72%+TJLP	
Brazilian Development Bank - BNDES PAC II 9752	Own funds	2027	1.72%+TJLP	
Brazilian Development Bank - BNDES ONDA LIMPA	Own funds	2025	1.92%+TJLP	
Brazilian Development Bank - BNDES TIETÊ III	Own funds	2028	1.66%+TJLP	
Brazilian Development Bank - BNDES 2015	Own funds	2035	2.5%+TJLP	
Leases		2035	7.73% to 10.12%	IPC
Other	Own funds	2018/2025	12% (Presidente Prudente) and TJLP + 1.66% (FINEP)	TR

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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Foreign currency	Guarantees	Maturity	Annual interest rates	Exchange rate changes
Inter-American Development Bank - BID 713 – US\$25,097 thousand	Government	2017	4.92% (*)	US\$
Inter-American Development Bank - BID 1212 - US\$92,503 thousand	Government	2025	2.68% (*)	US\$
Inter-American Development Bank - BID 2202 - US\$438,071 thousand	Government	2035	2.14% (*)	US\$
International Bank for Reconstruction and Development - BIRD US\$79,946 thousand	Government	2034	1.46% (*)	US\$
Deutsche Bank US\$150,000 thousand	-	2019	Libor+4.50% (*)	US\$
Eurobonds – US\$350,000 thousand	-	2020	6.25%	US\$
JICA 15 – ¥14,981,590 thousand	Government	2029	1.8% and 2.5%	Yen
JICA 18 – ¥13,470,080 thousand	Government	2029	1.8% and 2.5%	Yen
JICA 17– ¥1,596,251 thousand	Government	2035	1.2% and 0.01%	Yen
JICA 19– ¥27,596,009 thousand	Government	2037	1.7% and 0.01%	Yen
BID 1983AB – US\$106,346 thousand	-	2023	Libor + 1.88% to 2.38% (*)	US\$

(\*)Rates comprising LIBOR + contractually defined spread.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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(i) Payment schedule – accounting balances as of December 31, 2016

	2017	2018	2019	2020	2021	2022	2023 to 2038	TOTAL
<i>LOCAL CURRENCY</i>								
Debentures	595,952	889,446	1,001,491	416,885	197,109	176,668	253,604	3,531,155
Brazilian Federal Savings Bank	59,199	63,465	65,376	67,607	71,067	74,810	745,835	1,147,359
BNDES	87,492	93,280	101,383	83,450	83,007	83,007	407,951	939,570
Leasing	14,914	39,086	29,074	30,619	32,298	34,124	372,401	552,516
Other	746	1,453	1,356	1,356	1,356	1,356	3,952	11,575
Interest and charges	121,605	-	-	-	-	-	-	121,605
<b>TOTAL IN LOCAL CURRENCY</b>	<b>879,908</b>	<b>1,086,730</b>	<b>1,198,680</b>	<b>599,917</b>	<b>384,837</b>	<b>369,965</b>	<b>1,783,743</b>	<b>6,303,780</b>
<i>FOREIGN CURRENCY</i>								
BID	190,436	108,640	108,640	108,640	108,640	108,640	1,064,582	1,798,218
BIRD	-	-	8,676	17,353	17,353	17,353	199,489	260,224
Deutsche Bank	-	240,122	240,122	-	-	-	-	480,244
Eurobonds	-	-	-	1,137,395	-	-	-	1,137,395
JICA	62,310	63,514	105,162	105,162	105,162	105,162	1,059,976	1,606,448
BID 1983AB	78,030	77,417	57,661	55,852	25,070	25,070	22,851	341,951
Interest and charges	35,883	-	-	-	-	-	-	35,883
<b>TOTAL IN FOREIGN CURRENCY</b>	<b>366,659</b>	<b>489,693</b>	<b>520,261</b>	<b>1,424,402</b>	<b>256,225</b>	<b>256,225</b>	<b>2,346,898</b>	<b>5,660,363</b>
<b>Overall Total</b>	<b>1,246,567</b>	<b>1,576,423</b>	<b>1,718,941</b>	<b>2,024,319</b>	<b>641,062</b>	<b>626,190</b>	<b>4,130,641</b>	<b>11,964,143</b>

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2016, 2015 and 2014

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### (a) Debentures

Balance as of December 31, 2016 is stated net of borrowings costs in the amount of R\$8,163 (R\$11,514 as of December 31, 2015), which will be amortized during the same maturity period of each contract.

#### (i) Main events

The Company's amortizations totaled R\$663,466 in 2016, mainly referring to:

- 19th issue, partial amortization of the outstanding debentures, upon payment of 60% of the nominal unit value of the debentures, totaling R\$300,000;
- 15th issue series 1, amortization of the first installment of the debentures, totaling R\$94,819;
- 17th issue series 1, amortization of the first installment of the debentures, totaling R\$140,144.

#### (ii) Covenants

For the outstanding contracts, the Company has the following restrictive clauses "covenants":

#### **Applicable to the 10th issue, 14th issue and 18th issue:**

Financial covenants applicable to the financing agreements entered into with the BNDES, except for agreement no. 08.2.0169.1 (PAC):

The financing agreements entered into with the BNDES specify two ranges in which the Company needs to maintain its Adjusted EBITDA / Adjusted Financial Expenses, Adjusted Net Debt / Adjusted EBITDA, and Other Onerous Debt / Adjusted EBITDA ratios.

These agreements also specify a guarantee mechanism in which the Company needs to ensure that a portion of the monthly receivables amount is daily recorded in a fiduciary account linked to the BNDES. In this process, every day, after the BNDES notifies the depositary bank that the Company is not in default, this portion of the monthly receivables amount is transferred to a Company current account.

The renegotiated/amended covenants are:

- A. Maintenance of the following ratios, quarterly calculated and related to accrued amounts over the last 12 months, upon the disclosure of reviewed interim financial statements or audited annual financial statements entails the need to record R\$218 million per month in a fiduciary account linked to the BNDES:

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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- Adjusted EBITDA / Adjusted financial expenses equal to or higher than 3.50;
- Adjusted net debt / Adjusted EBITDA equal to or lower than 3.00;
- Other onerous debt (\*) / Adjusted EBITDA equal to or lower than 1.00.

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

B. In case of failure to comply with one or more ratios specified in item A, in two or more quarters, consecutive or not, within twelve months, the Company will be failing to comply with the first range of ratios and the portion of the monthly receivables to be recorded in a fiduciary account linked to the BNDES will be automatically increased by 20%, if the ratios are maintained in the following range:

- Adjusted EBITDA / Adjusted financial expenses lower than 3.50 and equal to or higher than 2.80;
- Adjusted net debt / adjusted EBITDA equal to or lower than 3.80 and higher than 3.00;
- Other onerous debt / Adjusted EBITDA equal to or lower than 1.30 and higher than 1.00.

C. The failure to achieve one or more than one ratio stipulated in item B, and/or the Company does not comply with the automatic reinforcement of guarantee under the terms of item B, the Company will be failing to comply with the covenant terms and the BNDES may, at its sole discretion:

- require the creation of additional guarantees, within term to be defined by it through notice;
- suspend the release of funds; and/or
- declare the early maturity of the Financing Agreements and/or the Commitment Agreements for the Subscription of Debentures in Private Issues and Other Covenants.

As of December 31, 2016, the amount of R\$218 million was guaranteed for the agreements above (excluding the guarantee of agreement 08.2.0169.1).

### Financial covenants applicable to financing agreement no. 08.2.0169.1 entered into with the BNDES:

- Adjusted EBITDA / adjusted net operating revenue: equal to or higher than 38%;
- Adjusted EBITDA /adjusted financial expenses: equal to or higher than 2.35;
- Adjusted net debt / adjusted EBITDA: equal to or lower than 3.20.

The BNDES will annually verify if the ratios have been complied with by analyzing the annual audited financial statements, which must be presented to the BNDES or published by April 30 of the subsequent year referring to the financial statements. If the Company complies, cumulatively, with the ratios above, the BNDES will reduce the interest stipulated in the agreement from 2.15% p.a. to 1.82% p.a., from June 16 of the year when the analysis is carried out to June 15 of the subsequent year.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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The agreements also have a cross default clause, i.e., the early maturity of any of the Company's debts, the amount of which may anyhow compromise the settlement of its obligations provided for in the Indenture deed shall imply the early maturity of such agreement.

### Applicable to the 12th issue:

Calculated every quarter upon the disclosure of interim or annual financial statements:

- Adjusted current ratio (current assets divided by current liabilities, excluding from current liabilities the current portion of noncurrent debts incurred by the Company that are recorded in current liabilities) higher than 1.0;
- EBITDA to paid financial expenses ratio equal to or higher than 1.5;
- Disposal of operating assets, extinguishment of license, loss of concession or loss of Issuer's capacity to execute and operate the basic sanitation public utilities in areas of the State of São Paulo territory, which considered individually or jointly during the deed's effectiveness, result in a reduction of net sales revenue and/or services revenue of the Issuer exceeding twenty-five percent (25%). The limit established above will be calculated quarterly, taking into account the Issuer's operating income for the twelve (12) months preceding the end of each quarter and applying the financial information disclosed by the Issuer; and

Noncompliance with these obligations only will be characterized when verified in its interim financial statements, during at least, two consecutive quarters, or also two nonconsecutive quarters within a twelve-month period.

In case of noncompliance with the covenants, the trustee should call an extraordinary debenture holders' meeting within 48 hours from the acknowledgement of the noncompliance to resolve on the declaration of early maturity of the debentures.

This issue has an early maturity clause, in case there is a downgrade, by more than two levels, of the "brAA-" risk rating in national scale originally attributed to this issue's Debentures by the Rating Agency, always taking into consideration the Standard & Poor's rating table. As of December 31, 2016, SABESP's rate was "brA+".

The agreement also has a cross default clause, i.e. the early maturity of any of the Company's debts, equal to or exceeding R\$50 million, adjusted by IPCA variation as of the issue date, due to contractual default, the amount of which may anyhow compromise the settlement of the Company's monetary obligations arising from the Issue, shall imply the early maturity of this agreement.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2016, 2015 and 2014

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### Applicable to the 15th issue, 17th issue, 19th issue and 20th issue:

Calculated every quarter upon the disclosure of interim or annual financial statements:

- Adjusted total Debt/Ebitda: lower than or equal to 3.65;
- EBITDA/ paid financial expenses: equal to or higher than 1.5;
- Disposal of operating assets, extinguishment of license, loss of concession or loss of Issuer's capacity to execute and operate the basic sanitation public utilities in areas of the State of São Paulo territory, which considered individually or jointly during the deed's effectiveness, result in a reduction of net sales revenue and/or services revenue of the Issuer exceeding twenty-five percent (25%). The limit established above will be calculated quarterly, taking into account the Issuer's operating income for the twelve (12) months preceding the end of each quarter and applying the financial information disclosed by the Issuer; and

Non-compliance with the covenant clauses, during, at least, two consecutive quarters, or also two nonconsecutive quarters within a twelve-month period shall result in the early maturity of the agreement.

The agreements have a cross acceleration clause, i.e., the early maturity of any of the Company's debts, equal to or exceeding R\$90 million (for the 19th and 20th issues, amount equal to or exceeding R\$120 million), adjusted by IPCA variation as of the issue date, due to contractual default, the amount of which may compromise the settlement of the Company's monetary obligations arising from the Issue, will result in the early maturity of these agreements.

### **(b) Brazilian Federal Savings Bank - CEF**

#### **(i) Main events**

Funding totaled R\$113,310 in 2016, mainly related to the agreements in progress of the Growth Acceleration Program (PAC).

In 2016, amortization totaled R\$52,315.

The guarantee for financing agreements entered into with the Brazilian Federal Savings Bank is the recognition of a portion of tariffs in an account for this purpose with the Brazilian Federal Savings Bank, which should maintain a flow equal to or at least three times the amount of the monthly charges, during the grace period, based on interest, the management fee and the credit risk rate and, during the amortization phase, based on the principal, interest, the management fee and the credit risk rate. Additionally, the Company maintains a reserve account, linked to financing agreements, in the Brazilian Federal Savings Bank, which is maintained during the entire term the agreements, where an amount is accrued equivalent to a monthly charge, composed of, during the grace period, interest, the management fee and the credit risk rate and, during the amortization phase, of the principal, interest, the management fee and the credit risk rate.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2016, 2015 and 2014

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### (ii) Covenants

The agreements have a cross default clause, i.e., the early maturity of any of the Company's debts, due to contractual default, the occurrence of which may anyhow compromise the settlement of its monetary obligations deriving from these contracts shall imply the early maturity.

For the outstanding contracts, formalized between May 28, 2007 and March 13, 2013, the Company has the following restrictive clauses "covenants":

AMD – Performance Improvement Agreement (\*)

The agreements in effect, entered into with the Brazilian Federal Savings Bank and the BNDES (Baixada Santista, PAC, Onda Limpa, PAC II 9751 and PAC II 9752), whose proceeds were obtained through a selection process of the Ministry of Cities, contracted between May 28, 2007 and March 13, 2013, are subject to the financial commitments established in the AMD, calculated upon disclosure of the annual financial statements, as follows:

According to the Normative Ruling no. 05 of January 22, 2008, the agreements which are purpose of investment funds, having as source of fund, the Government Severance Indemnity Fund for Employees ("FGTS") or Worker Support Fund ("FAT"), which go through a selection process of the Ministry of Cities, shall maintain a valid Performance Improvement Agreement ("AMD") with financial and operational ratios targets, yearly projected for the following 5 years, based on the average of the last two years.

The Performance Improvement Agreement, dated May 28, 2007 and amended in August 2012, was signed between SABESP and the federal government and Federal Savings Banks and BNDES as intervening parties. According to this agreement, the Company shall comply with, at least, four of eight operational and financial ratios, stipulated for the period between 2012 and 2016. If the Company fail to comply with five of these ratios, the Federal Savings Bank and BNDES may suspend the disbursements and the Company would be prevented from executing any other credit facility agreement with these institutions, until new targets are negotiated. The possibility of renegotiating the targets, if necessary, is foreseen.

On March 14, 2013, through the Normative Ruling no. 06, the Ministry of Cities revoked the Normative Instruction no. 05 of January 22, 2008, which regulates the Performance Improvement Agreement. Pursuant to Article 2 of the Normative Instruction no. 06, the AMDs signed until March 13, 2013 shall remain valid until the expiration date of their related effectiveness period, not being necessary to execute or renegotiate the AMD in new contracts.

### (c) BNDES



# **Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

## **Notes to the Financial Statements**

**Years ended December 31, 2016, 2015 and 2014**

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Balance as of December 31, 2016 is stated net of borrowings costs in the amount of R\$3,517 (R\$920 on December 31, 2015), which will be amortized during the same maturity period of each contract.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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### (i) Main events

In May 2016 and December 2016, the Company funded R\$80,000 and R\$155,000, respectively, corresponding to a portion of agreement 15.2.0313.1, totaling R\$747,450. The proceeds from BNDES 2015 will be allocated to support the interconnection of the Jaguari dam (located in the Paraíba do Sul River basin) with the Atibainha dam (located in the PJC basin).

In 2016, funding from current contracts totaled R\$70,000, mainly referring to the BNDES TIETÊ III agreement.

In 2016, amortization totaled R\$76,469.

Loans are collateralized by part of revenues from the provision of water and sewage services, up to the total amount of the outstanding balance.

### (ii) Covenants

The agreements entered into with the BNDES have standardized financial covenants, as described in item (a), (ii), covenants applicable to the 10th issue, 14th issue and 18th issue, of this Note.

Operating covenants applicable to Baixada Santista, PAC, Onda Limpa and PAC II 9751, PAC II 9752:

AMD – Performance Improvement Agreement (\*)

(\*) See item (b), (ii) of this note.

### (d) Leasing

The Company has lease agreements signed as Assets Lease. During the construction period, works are capitalized to intangible assets in progress and the lease amount is recorded at the same proportion. Works are estimated to be concluded in 2018.

After startup, the lease payment period starts (240 monthly installments), whose amount is periodically restated by contracted price index.

### (e) Eurobonds

Balance as of December 31, 2016 is net of borrowing costs in the amount of R\$3,290 (R\$4,212 as of December 31, 2015), which will be amortized during the same maturity period of the contract.

### (i) Main events

In November 2016, the Company paid the last installment of the principal and interest of the Eurobond 2016 issue, in the amount of R\$ 454,168.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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### (ii) Covenants

For the outstanding contracts, the Company has the following restrictive clauses “covenants”:

Calculated every quarter upon the disclosure of interim or annual financial statements:

Restrict the funding of new debts so that:

- Adjusted total debt to EBITDA does not exceed 3.65;
- The Company's debt service coverage ratio, determined at the end of each quarter, shall not be lower than 2.35.

Noncompliance with covenants will accelerate the maturity of the agreement.

The agreement has a cross default clause, i.e., the early maturity of any indebtedness in view of the Company's loans or any of its Subsidiaries (\*) with a total principal amount of US\$ 25,000,000.00 or more (or its corresponding amount in other currencies) shall imply this agreement's early maturity.

(\*) As per agreement, subsidiary is: “the company, partnership or another entity from which over 50% of its voting shares are directly or indirectly owned or controlled by any Person or one or other Person's Subsidiaries, or their combination”.

### (f) Deutsche Bank US\$150 million

As of October 26, 2016, the Company funded a US\$150 million loan, corresponding to R\$469,020, with a three-year maturity, at an interest rate corresponding to three-month LIBOR plus 4.50% per year. Interest will be paid on a quarterly basis and amortization will occur in semi-annual installments as of the 18th month. The proceeds were used to settle 2016 Eurobonds, totaling US\$140 million, and other debts due in 2016.

As of December 31, 2016, balance is stated net of borrowings costs in the amount of R\$8,621, which will be amortized during the maturity period of the contract.

### (i) Covenants

The agreement has the following restrictive clauses “covenants”:

Calculated every quarter upon the disclosure of interim or annual financial statements:

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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- Adjusted total debt/EBITDA: lower than 3.65;
- Company's debt service coverage ratio, determined at the end of each quarter, shall not be lower than 2.35.

Noncompliance with covenants for two quarters, consecutive or not, will accelerate the maturity of the agreement.

The agreement has a “cross acceleration” clause, i.e., in the early maturity of any debt of the Company or any of its subsidiaries, with a total principal or aggregate amount equal to or higher than R\$120 million (or its equivalent in another currency), contracted pursuant to the Brazilian law, or with a total principal or aggregate amount equal to or higher than US\$50 million (or its equivalent in another currency), in the case of debts governed by the laws of any other jurisdiction other than Brazil, will result in the early maturity of the agreement.

(\*) Pursuant to the agreement, a subsidiary means any partnership, corporation, company, association or commercial entity in which SABESP or one or more of its subsidiaries directly or indirectly hold more than 50% of the outstanding common shares with voting rights of its respective capital stock.

### **(g) Inter-American Development Bank (BID)**

Balance as of December 31, 2016 is net of borrowing costs amounting to R\$12,770 (R\$9,544 as of December 31, 2015), which will be amortized during the same maturity period of the agreement.

#### **(i) Main events**

In 2016, funding from current contracts totaled R\$113,543, referring to BID 2202 and amortizations in the amount of R\$133,063, among which, the settlement of the BID 896 agreement.

#### **(ii) Guarantees**

Loans obtained from multilateral agencies and from Government Agencies, such as the BID, BIRD and JICA, are guaranteed by the Federal Government, with a counter-guarantee of the São Paulo State government.

#### **(iii) Covenants**

For the outstanding contracts, the Company has the following restrictive clauses “covenants”:

Calculated every quarter upon the disclosure of interim or annual financial statements:

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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- Loan agreements 713 and 1,212 - Tariffs must: (a) produce revenues sufficient to cover the system's operating expenses, including administrative, operating, maintenance, and depreciation expenses; (b) provide a return on property, plant, and equipment no less than 7%; and (c) during project execution, the balances of current loans must not exceed 8.5% of total equity.

These agreements have an early maturity clause, i.e., in the early maturity will occur in the event the Company's fail failure to comply with any obligation therewith or any agreements signed with the Bank related to Project finance.

### **(h) Japan International Cooperation Agency - JICA**

#### **(i) Relevant funding**

Balance as of December 31, 2016 is stated net of borrowing costs amounting to R\$2,971 (R\$2,646 as of December 31, 2015), which will be amortized during the same maturity period of the contract.

#### **(ii) Main events**

In 2016, funding from current contracts, mainly corresponding to the JICA BZ-19 agreement, in the amount of R\$187,825.

In 2016, amortizations totaled R\$73,854, referring to JICA BZ-15 and JICA BZ-18 agreements.

For the guarantees assigned, see item g (ii) of this note.

### **(i) AB Loan (IADB 1983AB)**

The balance stated as of December 31, 2016 is net of borrowing costs amounting to R\$4,641 (R\$5,684 as of December 31, 2015), which will be amortized during the same maturity period of the contract.

#### **(i) Main events**

In 2016, amortization totaled R\$83,247.

#### **(ii) Covenants**

The Company has the following restrictive clauses "covenants":

Calculated every quarter upon the disclosure of interim or annual financial statements:

- The Company's ratio of debt service coverage, determined on a consolidated basis, must be higher than or equal to 2.35; and
- Total adjusted debt over Adjusted EBITDA, determined on a consolidated basis, must be lower than 3.65.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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The agreement has an early maturity clause, i.e., in the event of default, the BID may order the early maturity of the loan or part of it.

The agreement also has a “cross default” clause, i.e., in the event of default of any other Company debt with the BID or with third parties (in this case, higher than US\$25 million), the BID may order the early maturity of the loan.

### **(j) International Bank for Reconstruction and Development - IBRD**

Balance as of December 31, 2016 is stated net of borrowing costs amounting to R\$328 (R\$346 as of December 31, 2015), which will be amortized during the same maturity period of the contract.

#### **(i) Main events**

In 2016, funding totaled R\$59,983.

For the guarantees assigned, see item g (ii) of this note.

#### **(k) Covenants**

As of December 31, 2016 and 2015, the Company had met the requirements set forth by its borrowings and financing agreements.

#### **(l) Exchange rate changes**

In 2016, the US dollar depreciated 16.5%, from R\$3.9048 as of December 31, 2015 to R\$3.2591 as of December 31, 2016, reducing debt by R\$801,936, while the yen depreciated 13.9%, from R\$0.03243 as of December 31, 2015 to R\$0.02792 as of December 31, 2016, reducing debt by R\$259,974.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2016, 2015 and 2014

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### (m) Borrowings and financing – Credit Limited

Agent	December 31, 2016
	(in millions of reais (*))
Brazilian Federal Savings Bank	1,706
Brazilian Development Bank – BNDES	1,743
Inter-American Development Bank – BID	528
Japan International Cooperation Agency – JICA	296
International Bank for Reconstruction and Development – IBRD	65
Other	38
<b>TOTAL</b>	<b>4,376</b>

(\*) Brazilian Central Bank's exchange rate as of December 30, 2016 (US\$1.00 = R\$3.2591; ¥1.00 = R\$0.02792).

SABESP in order to comply with its Capex plan relies on a fund-raising plan.

Financing resources contracted have specific purposes, which have been released for the execution of their respective investments, according to the progress of the works.

### 17 Taxes recoverable/payable

#### (a) Current assets

	December 31, 2016	December 31, 2015
<b>Recoverable taxes</b>		
Income tax and social contribution	32,365	68,978
Withholding income tax (IRRF) on financial investments	7,057	4,914
Other federal taxes	2,961	3,661
Other municipal taxes	250	275
Total	<b>42,633</b>	<b>77,828</b>

The reduction in recoverable taxes is mainly due to decrease in “income tax and social contribution” item, which was offset by Pasep and Cofins payable in the year.

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### (b) Current liabilities

	December 31, 2016	December 31, 2015
<b>Taxes and contributions payable</b>		
Cofins and Pasep	49,132	40,505
INSS (Social Security contribution)	35,376	33,836
IRRF (withholding income tax)	62,771	11,126
Other	21,478	21,828
<b>Total</b>	<b>168,757</b>	<b>107,295</b>

### 18 Deferred taxes and contributions

#### (a) Statement of financial position details

	December 31, 2016	December 31, 2015
<b>Deferred income tax assets</b>		
Provisions	524,129	480,378
Actuarial gain/loss – G1 Plan	85,044	-
Pension obligations - G1	167,922	256,808
Donations of underlying asset on concession agreements	57,317	53,206
Credit losses	266,757	213,171
Tax losses	-	58,829
Other	151,247	121,550
<b>Total deferred tax assets</b>	<b>1,252,416</b>	<b>1,183,942</b>
<b>Deferred income tax liabilities</b>		
Temporary difference on concession of intangible asset	(492,341)	(524,495)
Capitalization of borrowing costs	(374,512)	(309,648)
Profit on supply to governmental entities	(92,365)	(81,055)
Actuarial gain/loss – G1 Plan	-	(33,726)
Construction margin	(91,790)	(94,921)
Borrowing costs	(15,063)	(11,855)
<b>Total deferred tax liabilities</b>	<b>(1,066,071)</b>	<b>(1,055,700)</b>
<b>Deferred tax asset, net</b>	<b>186,345</b>	<b>128,242</b>



# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2016, 2015 and 2014

Amounts in thousands of reais, unless otherwise indicated

### (b) Realization

	<u>December 31, 2016</u>	<u>December 31, 2015</u>
<b>Deferred income tax assets</b>		
to be realized within 12 months	314,725	277,573
to be realized after one year	937,691	906,369
Total deferred tax assets	1,252,416	1,183,942
<b>Deferred income tax liabilities</b>		
to be realized within 12 months	(143,428)	(42,820)
to be realized after one year	(922,643)	(1,012,880)
Total deferred tax liabilities	(1,066,071)	(1,055,700)
Deferred tax asset	<u>186,345</u>	<u>128,242</u>

### (c) Changes

	<u>December 31, 2015</u>	<u>Net change</u>	<u>December 31, 2016</u>
<b>Deferred income tax assets</b>			
Provisions	480,378	43,751	524,129
Actuarial gain/loss – G1	-	85,044	85,044
Pension obligations - G1	256,808	(88,886)	167,922
Donations of underlying asset on concession agreements	53,206	4,111	57,317
Credit losses	213,171	53,586	266,757
Tax losses	58,829	(58,829)	-
Other	121,550	29,697	151,247
Total	<u>1,183,942</u>	<u>68,474</u>	<u>1,252,416</u>
<b>Deferred income tax liabilities</b>			
Temporary difference on concession of intangible asset	(524,495)	32,154	(492,341)
Capitalization of borrowing costs	(309,648)	(64,864)	(374,512)
Profit on supply to governmental entities	(81,055)	(11,310)	(92,365)
Actuarial gain/loss – G1	(33,726)	33,726	-
Construction margin	(94,921)	3,131	(91,790)
Borrowing costs	(11,855)	(3,208)	(15,063)
Total	<u>(1,055,700)</u>	<u>(10,371)</u>	<u>(1,066,071)</u>
Deferred tax asset, net	<u>128,242</u>	<u>58,103</u>	<u>186,345</u>

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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Years ended December 31, 2016, 2015 and 2014

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	December 31, 2014	Net change	December 31, 2015
<b>Deferred income tax assets</b>			
Provisions	524,728	(44,350)	480,378
Pension obligations - G0	85,271	(85,271)	-
Pension obligations - G1	229,266	27,542	256,808
Donations of underlying asset on concession agreements	45,742	7,464	53,206
Credit losses	222,587	(9,416)	213,171
Tax losses	-	58,829	58,829
Other	112,566	8,984	121,550
<b>Total</b>	<b>1,220,160</b>	<b>(36,218)</b>	<b>1,183,942</b>
<b>Deferred income tax liabilities</b>			
Temporary difference on concession of intangible asset	(559,411)	34,916	(524,495)
Capitalization of borrowing costs	(253,581)	(56,067)	(309,648)
Profit on supply to governmental entities	(87,092)	6,037	(81,055)
Actuarial gain/loss – G1	(2,514)	(31,212)	(33,726)
Construction margin	(98,772)	3,851	(94,921)
Borrowing costs	(9,312)	(2,543)	(11,855)
<b>Total</b>	<b>(1,010,682)</b>	<b>(45,018)</b>	<b>(1,055,700)</b>
<b>Deferred tax asset, net</b>	<b>209,478</b>	<b>(81,236)</b>	<b>128,242</b>

	December 31, 2016	December 31, 2015	December 31, 2014
<b>Opening balance</b>	<b>128,242</b>	<b>209,478</b>	<b>114,030</b>
Net change in the year:			
- corresponding entry to the income statement	(60,667)	(50,024)	65,557
- corresponding entry to valuation adjustments to equity (Note 20 (b))	118,770	(31,212)	29,891
<b>Total net change</b>	<b>58,103</b>	<b>(81,236)</b>	<b>95,448</b>
<b>Closing balance</b>	<b>186,345</b>	<b>128,242</b>	<b>209,478</b>

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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### (d) Reconciliation of the effective tax rate

The amounts actually recognized as income tax and social contribution expenses in the financial statements are reconciled to the computed amounts based on the statutory rates, as shown below:

	<u>December 31, 2016</u>	<u>December 31, 2015</u>	<u>December 31, 2014</u>
Profit before income taxes	4,129,054	587,529	1,274,843
Statutory rate	34%	34%	34%
Computed expense at statutory rate	(1,403,878)	(199,760)	(433,447)
Tax benefit of interest on equity	245,637	56,172	100,327
Permanent differences			
Provision – Law 4,819/58 (i)	(63,039)	(54,679)	(48,380)
Donations	(10,987)	(3,153)	(7,080)
GESP Agreement (note 10 (vii))	-	151,465	-
Other differences	50,311	(1,295)	16,720
Actual income tax and social contribution expense	<u>(1,181,956)</u>	<u>(51,250)</u>	<u>(371,860)</u>
Current income tax and social contribution	(1,121,289)	(1,226)	(437,417)
Deferred income tax and social contribution	(60,667)	(50,024)	65,557
Effective rate	29%	9%	29%

(i) Permanent difference related to the provision for actuarial liability (Note 20 b (iii)).

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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### 19 Provisions

#### (a) Lawsuits and proceedings that resulted in provisions

##### (I) Statement of financial position details

The Company is party to a number of claims and legal proceedings arising in the normal course of business, including civil, tax, labor and environmental matters. Management recognizes provisions in the financial statements consistently with the recognition and measurement criteria established in Note 3.15. The ultimate timing and amounts of the payments depends on the outcome of the court cases. The provisions, net of escrow deposits are as follows:

			December 31,		December	
	Provisions	Escrow deposits	2016	Provisions	Escrow deposits	31, 2015
Customer claims (i)	572,210	(97,171)	475,039	561,061	(97,711)	463,350
Supplier claims (ii)	332,667	(251,510)	81,157	296,660	(217,625)	79,035
Other civil claims (iii)	131,286	(12,652)	118,634	124,833	(10,681)	114,152
Tax claims (iv)	69,898	(2,986)	66,912	62,812	(677)	62,135
Labor claims (v)	285,413	(3,202)	282,211	283,991	(3,073)	280,918
Environmental claims (vi)	150,084	(962)	149,122	83,520	(896)	82,624
<b>Total</b>	<b>1,541,558</b>	<b>(368,483)</b>	<b>1,173,075</b>	<b>1,412,877</b>	<b>(330,663)</b>	<b>1,082,214</b>
Current	730,334	-	730,334	631,890	-	631,890
Noncurrent	811,224	(368,483)	442,741	780,987	(330,663)	450,324

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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### (II) Changes

	December 31, 2015	Additional provisions	Interest and inflation adjustment	Use of the accrual	Amounts not used (reversal)	December 31, 2016
Customer claims (i)	561,061	109,540	95,459	(87,334)	(106,516)	572,210
Supplier claims (ii)	296,660	12,885	43,679	(20,018)	(539)	332,667
Other civil claims (iii)	124,833	20,638	19,940	(8,080)	(26,045)	131,286
Tax claims (iv)	62,812	20,716	14,265	(4,621)	(23,274)	69,898
Labor claims (v)	283,991	51,408	29,419	(37,072)	(42,333)	285,413
Environmental claims (vi)	83,520	68,485	23,508	-	(25,429)	150,084
Subtotal	1,412,877	283,672	226,270	(157,125)	(224,136)	1,541,558
Escrow deposits	(330,663)	(38,269)	(27,153)	9,601	18,001	(368,483)
Total	1,082,214	245,403	199,117	(147,524)	(206,135)	1,173,075

	December 31, 2014	Additional provisions	Interest and inflation adjustment	Use of the accrual	Amounts not used (reversal)	December 31, 2015
Customer claims (i)	638,637	34,868	96,735	(92,203)	(116,976)	561,061
Supplier claims (ii)	260,854	7,062	39,143	(5,837)	(4,562)	296,660
Other civil claims (iii)	126,403	13,022	20,643	(12,778)	(22,457)	124,833
Tax claims (iv)	55,554	1,501	8,557	(266)	(2,534)	62,812
Labor claims (v)	235,466	114,499	27,231	(23,431)	(69,774)	283,991
Environmental claims (vi)	226,404	17,072	16,247	(8,081)	(168,122)	83,520
Subtotal	1,543,318	188,024	208,556	(142,596)	(384,425)	1,412,877
Escrow deposits	(322,971)	(16,892)	(21,791)	26,061	4,930	(330,663)
Total	1,220,347	171,132	186,765	(116,535)	(379,495)	1,082,214

	December 31, 2013	Additional provisions	Interest and inflation adjustment	Use of the accrual	Amounts not used (reversal)	December 31, 2014
Customer claims	621,999	66,895	87,987	(74,308)	(63,936)	638,637
Supplier claims	340,100	1,917	18,922	(66,608)	(33,477)	260,854
Other civil claims	129,400	31,224	37,607	(14,507)	(57,321)	126,403
Tax claims	59,659	983	6,818	(2,313)	(9,593)	55,554
Labor claims	156,060	123,631	22,205	(42,107)	(24,323)	235,466
Environmental claims	182,689	53,829	21,257	(13)	(31,358)	226,404
Subtotal	1,489,907	278,479	194,796	(199,856)	(220,008)	1,543,318
Escrow deposits	(309,525)	(24,999)	(21,613)	28,698	4,468	(322,971)
Total	1,180,382	253,480	173,183	(171,158)	(215,540)	1,220,347

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### (b) Lawsuits deemed as contingent liabilities

The Company is party to lawsuits and administrative proceedings relating to environmental, tax, civil and labor claims, which are assessed by Management as contingent liabilities because Management has determined, in consultation with its legal counsel, that in each case, the Company does not have a present obligation and, therefore, no provisions are recognized. Following are descriptions of the significant contingent liabilities:

	<u>December 31, 2016</u>	<u>December 31, 2015</u>
Customer claims (i)	306,500	414,700
Supplier claims (ii)	1,422,000	1,606,100
Other civil claims (iii)	709,400	683,000
Tax claims (iv)	1,143,000	945,400
Labor claims (v)	533,600	483,700
Environmental claims (vi)	3,317,600	1,277,600
Total	<u>7,432,100</u>	<u>5,410,500</u>

### (c) Explanation on the nature of main classes of lawsuits

#### (i) Customer claims

Approximately 1,140 lawsuits were filed by commercial customers, which claim that their tariffs should correspond to other consumer categories, and 710 lawsuits in which customers claim a reduction in the sewage tariff due to losses in the system, consequently requesting the refund of amounts charged by the Company and 50 lawsuits in which customers plead the reduction in tariff under the category as “Social Welfare Entity”. The Company was granted both favorable and unfavorable final decisions at several court levels and provisions were recognized based on the criteria described in Note 3.15. The R\$108,200 decrease in lawsuits deemed as contingent liabilities is mainly related to revision of expectations arising from court decisions in the year.

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### (ii) Supplier claims

These claims include lawsuits filed by some suppliers alleging underpayment of monetary restatements, withholding of amounts related to the understated inflation rates deriving from Real economic plan, and the economic and financial imbalance of the agreements. These lawsuits are in progress at different courts and provisions were recognized based on the criteria described in Note 3.15. The R\$184,100 decrease in lawsuits deemed as contingent liabilities is mainly related to the revision of expectation arising from decisions within the year.

### (iii) Other civil claims

These mainly refer to indemnities for property damage, pain and suffering, and loss of profits allegedly caused to third parties, filed at different court levels. These claims are in progress at different courts and provisions were recognized based on the criteria described in Note 3.15. There has been no significant changes during the year in contingent liabilities.

### (iv) Tax claims

Tax claims refer mainly to issues related to tax collections challenged due to differences in the interpretation of legislation by the Company's management. Provisions were recognized based on the criteria described in Note 3.15. The R\$197,600 increase in lawsuits deemed as contingent liabilities is mainly related to update of lawsuits in progress.

(a) In 2006, the Federal Revenue Service, by means of a tax execution, verified the Company's compliance with the tax obligations related to income tax and social contribution for calendar year 2001, and issued a tax assessment adjusted through December 31, 2016 in the amount of R\$50,203 (R\$47,597 as of December 31, 2015). The Company appealed this recognition and was granted a partial relief in the first administrative instance. In December 2015, it filed a Voluntary Appeal against the part of the decision that was unfavorable to it. Management considers that this administrative proceeding is deemed as a contingent liability.

(b) The municipality of São Paulo through law revoked the services tax exemption which until then the company withheld and thereafter issued tax deficiency notices related to the sewage service and ancillary activities, in the updated amount of R\$501,060 (R\$430,268 as of December 31, 2015), which currently are subject-matter of Tax Foreclosures, deemed by the Management as contingent liabilities. SABESP filed a writ of mandamus against this revocation, which was rejected, and currently is under phase of appealability of Extraordinary Appeal filed. Writs of prevention and actions for annulment were also filed, aiming the suspension of enforceability of credits and the annulment of tax deficiency notices, as it understands that notwithstanding the exemption revocation, the sewage activities and ancillary activities are not included in the list of activities subject to taxation by municipality. Since there is no final court decision on the merits, the Company's Management deemed the proceeding as contingent liability.

(c) The Federal Revenue Service rejected some offset requests made by the Company for the extinction of IRPJ/CSLL payable, using favorable amounts, arising from undue payments of IRPJ/CSLL, which were paid based on monthly estimates. The amount involved was adjusted through December 31, 2016 and is R\$62,039 (R\$57,612 as of December 31, 2015). Management assessed the lawsuit as a contingent liability.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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(d) The Company's request for an authorization to offset taxes was rejected, overdue in the periods of July, August and September 2002 against the amount of IRPJ paid in excess in 1997 and 1998, due to inflation adjustment over the financial statements (Law 8,200/91), which was anticipated in 1996 due to an injunction, after excluded due discontinuance of proceeding and application of Provisional Measure 38/02. The Administrative Council of Tax Appeals rejected the credit from 1997. The amount involved was adjusted through December 31, 2016 and is estimated at R\$49,682 (R\$47,470 as of December 31, 2015). Management assessed the lawsuit as a contingent liability.

(e) On June 23, 2010, the Company and the municipality of São Paulo signed an agreement to provide water supply and sewage services. The negotiation of this agreement led to the extinction of some judicial lawsuits, but others were not part of the referred agreement, and lawsuit proceeds as usual. The remaining judicial lawsuits deemed as contingent liabilities, classified pursuant to item 3.15, are mainly related to taxes and fines. As of December 31, 2016, the amounts of such judicial lawsuits were R\$19,170 (R\$17,772 as of December 31, 2015) and R\$117,941 (R\$87,650 as of December 31, 2015), respectively.

(f) In 2005, the Federal Revenue Service partially rejected the Company's request of offsetting tax credits related to the Corporate Income Tax (IRPJ) and the Social Contribution on Net Income (CSLL) in the amount of approximately R\$56,118, and R\$8,659, respectively, which relate to the period from January to April 2003, for which the Company offset prior year IRPJ and CSLL negative balances. The amounts not ratified by the authority of IRPJ and CSLL are R\$11,164 and R\$698, totaling R\$11,862 million. As the company was granted a partial relief in this matter, it considered the updated amount of R\$8,010 as of December 31, 2016 (R\$7,636 as of December 31, 2015) as a contingent liability and recognized a provision in the amount of R\$1,366 in accordance with the criteria described in Note 3.15 (R\$1,302 as of December 31, 2015).

(g) SABESP filed two writs of mandamus pleading the declaration of unconstitutional municipal laws that levy the collection of taxes deriving from the use of public areas in the water and sewage network installation for the rendering of basic sanitation public utilities. The first writ of mandamus was judged groundless at the lower court and the Court of Justice of São Paulo, in the appeal's records, partially granted relief to recognize the impossibility of charging the monthly contribution, due to unconstitutionality, deeming as valid the need of security and other requirements to issue the Statement of Use Permit- TPU, however, this decision had no effect since the rules, subject-matter of the first writ of mandamus were revoked. The second writ of mandamus was granted partial relief to prohibit the enforceability of public price and the security for the use of public areas deriving from the municipal laws. The municipality's appeal was rejected and is pending judgment at the higher court. Management considered it as a contingent liability, but was not able to estimate the amount involved, given the specificities of the lawsuit.

### (v) Labor claims



# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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The Company is a party to labor lawsuits, involving issues such as overtime, shift schedule, health hazard premium and hazardous duty premium, prior notice, change of function, salary equalization, service outsourcing and other. Part of the amount involved is in provisional or final execution at various court levels, and thus provisions were recognized in accordance with the criteria described in Note 3.15. The R\$49,900 increase in lawsuits deemed as contingent liabilities is mainly due to the increase in the number of lawsuits filed, revision of expectations and updates on lawsuits in progress.

### **(vi) Environmental claims**

Environmental claims refer to several administrative proceedings and lawsuits filed by government entities, including Companhia de Tecnologia de Saneamento Ambiental – Cetesb and the Public Prosecution Office of the State of São Paulo, that aim affirmative and negative covenants and penalty is estimated due to failure to comply in addition to the imposition of indemnity due to environmental damages allegedly caused by the Company. The amounts accrued represent the best estimate of the Company at this moment, however, may differ from the amount to be disbursed as indemnity to alleged damages, in view of the current stage of referred proceedings. The R\$66,498 increase lawsuits for which provisions were recognized in accordance with the criteria described in Note 3.15 (net of escrow deposits), is mainly related to two new claims, in addition to the updates on lawsuits in progress. The R\$2,040,000 increase in lawsuits deemed as contingent liabilities was mainly due to the addition of a new proceeding in the amount of R\$1,969,247. For disclosure purposes, this sum refers to the amount claimed by the opposing party. It has not yet been possible to estimate the amounts involved by the Company, given the initial stage of the lawsuit.

Among the main lawsuits the Company is involved, there are public civil actions the subject-matters of which are: a) sentence SABESP to restrain itself from discharging or releasing sewage without due treatment; b) invest in the water and sewage treatment system of the municipality, under the penalty of paying a fine; c) payment of indemnity due to environmental damages, amongst others.

### **(d) Other concession-related legal proceedings**

The Company is party in concessions-related proceedings, cases in which it can lose the right of operating water supply and sewage collection services in few municipalities, such as follows:

(a) The municipality of Cajobi filed an action to recover possession against SABESP, which was granted relief to maintain the municipality in the possession of water and sewage assets. It is currently awaiting the decision on the internal Interlocutory Appeal filed against the decision that denied the Special Appeal. Meanwhile, SABESP has filed a motion for expedited discovery against the municipality of Cajobi aiming at the enumeration and appraisal of assets, rights and equipment inherent in reversible and non-reversible services, without prejudice to the verification of other amounts, in accordance with concession agreement 03/94, which is in the forensic accounting stage and will support the subsequent filing of an action for damages. This is considered as a contingent liability;

(b) The Company filed a repossession action against the municipality of Álvares Florence, which was deemed groundless in an unappealable judgement on June 3, 2015, and the operation is not maintained. SABESP also filed an action for damages, distributed on February 3, 2016, claiming the payment of an amount corresponding to the sum of all assets reversed with the resumption of the services, in accordance with the terms in the agreement. After the defense and specification of evidence, the claim was partially granted on September 22, 2016 and SABESP filed an appeal. This is considered as a contingent asset;

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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(c) The municipality of Macatuba filed an action to recover possession against SABESP, which was granted relief. SABESP does not operate in the municipality and the probability of it returning to operate in the municipality is remote. Meanwhile, SABESP has filed an ordinary proceeding requesting the payment by the municipality of indemnity for the portions of the investments related to non-amortized or depreciated reversible assets. The action is in the forensic accounting stage, and is deemed as a contingent liability. In this same action, the municipality of Macatuba counterclaimed because it believes that SABESP earned, through the collection of tariffs, more than the amount invested in the water and sewage system, requesting that the Company be sentenced to pay an indemnity to be calculated by forensic experts, which is deemed as a contingent liability;

(d) The Company filed an action to maintain possession against the municipality of Iperó, which was deemed groundless. In view of the formalization of a Program Agreement between SABESP and the municipality, on October 13, 2016, SABESP and the municipality filed a motion to dismiss the lawsuit and the agreement was ratified in court on December 6, 2016;

(e) The municipality of Embaúba filed a repossession action against SABESP, which was granted relief to maintain the municipality in the possession of water and sewage assets and was issued a final and unappealable judgment on May 29, 2015. The indemnity action was judged groundless in first instance. The Company is currently awaiting the sentence on the appeal, which is deemed as a contingent liability;

(f) The municipality of Araçoiaba da Serra filed a repossession action against SABESP, which was granted relief to maintain the municipality in the possession of water and sewage assets and was issued a final and unappealable judgment. SABESP filed an indemnity action against the municipality, which is in progress, in the forensic expert stage, which is deemed as a contingent liability;

(g) The municipality of Itapira filed a repossession action against SABESP, which was granted relief to maintain the municipality in the possession of water and sewage assets. SABESP filed an indemnity action against the municipality and, at the same time, requested a provisional relief, which was rejected in the lower court. SABESP filed an appeal and this decision was upheld in the other courts. While the relief was being litigated, the main lawsuit was pending. We are currently awaiting a decision from the court on the continuity of this lawsuit, which is deemed as a contingent liability;

(h) The municipality of Tuiuti, through a declaratory judgment action, obtained the right to remain in charge of water and sewage services. However, in a counter-claim, the municipality was sentenced to pay an indemnity, to be restated as of March 1996, as a final decision that became an execution object by SABESP. As of December 7, 2016, an official communication was issued requesting the payment of the award. SABESP no longer operates in the municipality. In the counter-claim, we consider it as a contingent liability.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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The amount of the intangible assets related to the municipalities mentioned in the lawsuits mentioned above is R\$28.273 as of December 31, 2016 (December 31, 2015 - R\$33,502). If any of these municipalities is awarded a final and unappealable favorable sentence, allowing it to repossess sanitation service assets and operations, the Brazilian legislation provides for the indemnity of the Company's investments. Nevertheless, due to the solid track record of concession renewal and, therefore, the continuity of services, the investments made and not recovered through services rendered, within original term of the contract, are recognized as intangible assets.

### (e) Guarantee insurance for escrow deposit

During the second quarter of 2015, the Company contracted guarantee insurance for escrow deposit totaling R\$500 million. Such insurance will be used in legal claims where instead of making immediate cash disbursement by the Company, such insurance is used until the conclusion of these proceedings or up to three-year effectiveness term of the agreement.

In 2016, the Company used R\$134,377 of the total contracted amount (R\$238,540 in 2015).

## 20 Employees benefits

### (a) Health benefit plan

The health benefit plan is managed by Sabesprev and consists of optional, free choice, health plans sponsored by contributions of SABESP and the active participants, as follows:

- Company: 7.3% (December 31, 2015 – 7.4%) on average, of gross payroll;
- Participating employees: 3.21% of base salary and premiums, equivalent to 2.6% of payroll, on average.

### (b) Pension plan benefits

	December 31, 2016	December 31, 2015
<b>Funded plan – G1 (i)</b>		
Present value of defined benefit obligations	2,465,721	2,252,204
Fair value of the plan assets	(1,712,551)	(1,586,930)
Net liabilities recognized for defined benefit obligations	753,170	665,274
<b>Unfunded plan – Go (iii)</b>		
Present value of defined benefit obligations	2,512,080	2,166,942
Net liabilities recognized for defined benefit obligations	2,512,080	2,166,942
<b>Liability as per statement of financial position – pension obligations (*)</b>	<b>3,265,250</b>	<b>2,832,216</b>

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The increase of liabilities in 2016 is mainly due to the decrease in the discount rate to the G1 and Go plans to 5.74% and 5.71% in 2016, versus 7.23% and 7.25% in 2015, respectively.

Pursuant to IAS19, the Company recognizes (gains)/losses, due to changes in assumptions under equity, as valuation adjustments to equity, as shown below:

	<u>G1 Plan</u>	<u>Go Plan</u>	<u>Total</u>
As at December 31, 2016			
Actuarial gains/(losses) on obligations	(541,783)	(241,711)	(783,494)
Gains/(losses) on financial assets	192,458	-	192,458
Total gains/(losses)	(349,325)	(241,711)	(591,036)
Deferred income tax and social contribution - G1 Plan	118,770	-	118,770
Valuation adjustments to equity	(230,555)	(241,711)	(472,266)

	<u>G1 Plan</u>	<u>Go Plan</u>	<u>Total</u>
As at December 31, 2015			
Actuarial gains/(losses) on obligations	228,191	(24,224)	203,967
Gains/(losses) on financial assets	(136,389)	-	(136,389)
Total gains/(losses)	91,802	(24,224)	67,578
Deferred income tax and social contribution - G1 Plan	(31,212)	-	(31,212)
Valuation adjustments to equity	60,590	(24,224)	36,366

	<u>G1 Plan</u>	<u>Go Plan</u>	<u>Total</u>
As at December 31, 2014			
Actuarial gain /(loss) on obligations	(113,727)	(198,192)	(311,919)
Gains /(losses) on financial assets	28,208	-	28,208
Other	(2,397)	-	(2,397)
Total gains /(losses)	(87,916)	(198,192)	(286,108)
Deferred income tax and social contribution – G1 Plan	29,891	-	29,891
Valuation adjustments to equity	(58,025)	(198,192)	(256,217)

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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### (i) G1 Plan

The Company sponsors a defined benefit pension plan for its employees ("G1 Plan"), which is managed by Sabesprev, receives similar contributions established in a plan of subsidy of actuarial study of Sabesprev, as follows:

- 1.21% of the portion of the salary of participation up to 20 salaries; and
- 10.24% of the surplus, if any, of the portion of the salary of participation over 20 salaries.

As of December 31, 2016, SABESP had a net actuarial liability of R\$753,170 (R\$665,274 as of December 31, 2015) representing the difference between the present value of the Company's defined benefit obligations to the participating employees, retired employees, and pensioners; the fair value of the plan's assets.

	<b>2016</b>	<b>2015</b>
Defined benefit obligation, beginning of the year	2,252,204	2,249,794
Current service cost	35,845	46,355
Interest cost	285,227	286,735
Actuarial (gains)/losses recorded as other comprehensive income	541,783	(228,191)
Effect of the plan migration – early reduction/curtailment	(525,992)	-
Benefits paid	(123,346)	(102,489)
Defined benefit obligation, end of the year	<u>2,465,721</u>	<u>2,252,204</u>

Below, the change of fair value of the plan during the year:

	<b>2016</b>	<b>2015</b>
Fair value of the plan's assets, beginning of the year	1,586,930	1,573,723
Expected return on the plan assets	201,779	205,981
Expected Company's contributions	23,046	23,052
Expected participants' contributions	23,525	23,052
Benefits paid	(123,347)	(102,489)
Actuarial gains/(losses) included in other comprehensive income (loss)	192,458	(136,389)
Effect of the plan migration – early reduction/curtailment	(191,840)	-
Fair value of the plan's assets, end of the year	<u>1,712,551</u>	<u>1,586,930</u>
(Deficit)/Surplus	<u>(753,170)</u>	<u>(665,274)</u>

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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The amounts recognized in the income statement are as follows:

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Current service cost	13,562	23,303	9,513
Interest cost rate	285,227	287,334	199,528
Expected return on the plan assets	(201,778)	(205,981)	(144,678)
Total expenses	<u>97,011</u>	<u>104,656</u>	<u>64,363</u>

In 2016, the expenses related to defined pension plan amounting to R\$60,263, R\$7,982 and R\$24,557, were reported in operating costs, selling and administrative expenses, respectively. The amount of R\$4,209 was capitalized in assets.

### Early reduction (Curtailement)

In order to remedy the deficit referring to the G1 Defined Benefit Pension Plan (BD), as of August 2016, SABESP and Sabesprev continued with the migration process whereby 3,572 participants chose to change from a defined benefit plan to a Defined Contribution Pension Plan - "Sabesprev Mais". The process was carried out based on the exact terms of the migration started in 2010, i.e. it resumed migrations without changing any clause and in compliance with the rules in the regulation.

The Company recorded a gain due to the migration process ("curtailment"), with the partial settlement of the present value of the defined benefit liabilities and the fair value of the plan's assets, in the amount of R\$334,152, and paid R\$30,891 corresponding to non-recurring contribution and incentive to the participants who migrated in August 2016.

Estimated expenses	<b>2017</b>
Current service cost	17,582
Interest cost rates	260,409
Participants contribution	(52,675)
Net profitability on financial assets	(183,689)
Expense to be recognized by the employer	<u>41,627</u>

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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Actuarial assumptions:

	2016	2015	2014
Discount rate – actual rate (NTN-B)	5.74% p.a.	7.23% p.a.	6.11% p.a.
Inflation rate	4.87% p.a.	6.49% p.a.	6.49% p.a.
Expected rate of return on assets	10.89% p.a.	14.19% p.a.	13.00% p.a.
Future salary increase	6.97% p.a.	8.62% p.a.	8.62% p.a.
Mortality table	AT-2000	AT-2000	AT-2000

The number of active participants as of December 31, 2016 was 4,547 (8,130 as of December 31, 2015), and of inactive participants was 6,896 (6,956 as of December 31, 2015).

The benefit to be paid of G1 pension plan, expected for 2017 is R\$152,638.

The contributions of the Company and participants of Plan G1 in 2015 were R\$24,288 (R\$23,651 in 2015) and R\$21,895 (R\$24,216 in 2015), respectively.

Since December 2016, the Company began to pay the actuarial deficit for the G1 pension plan with an initial contribution of R\$2,963.

**Sensitivity analysis of the defined benefit pension plan as of December 31, 2016 regarding the changes in the main assumptions are:**

Funded plan – G1	Change in assumption	Impact on present value of the defined benefit obligations
Discount rate	Increase of 1.0%	Decrease of R\$248,941
	Decrease of 1.0%	Increase of R\$290,801
Wage increase rate	Increase of 1.0%	Increase of R\$40,775
	Decrease of 1.0%	Decrease of R\$35,314
Life expectation	Increase of 1 year	Increase of R\$31,478
	Decrease of 1 year	Decrease of R\$42,306

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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### Plan's assets

The plan investment policies and strategies are aimed at getting consistent returns and reduce the risks associated to the utilization of financial assets available on the Capital Markets through diversification, considering factors, such as the liquidity needs and the long-term nature of the plan liability, types and availability of financial instruments in the local and international markets, general economic conditions and forecasts as well as requirements under the law. The plan's asset allocation management strategies are determined with the support of reports and analysis prepared by Sabesprev and independent financial advisors:

		<u>December 31, 2016</u>	<u>December 31, 2015</u>
Fixed income			
- NTNBs		997,027	834,535
- NTNCs		141,405	141,104
- NTNFs		5,803	6,201
- LTNs		-	23,537
Government bonds in own portfolio	(a)	<u>1,144,235</u>	<u>1,005,377</u>
Fixed income fund quotas	(b)	95,854	99,664
Private credit investment fund quotas	(c)	139,665	129,317
Debentures		<u>3,940</u>	<u>4,330</u>
Total fixed income		1,383,694	1,238,688
Equities			
Stocks investment fund quotas	(d)	180,721	174,794
Shares		<u>15,467</u>	<u>2,121</u>
Total equities		196,188	176,915
Structured investments			
Equity investment fund quotas	(e)	76,680	89,165
Real estate investment fund quotas	(f)	18,428	25,885
Multimarket investment fund quotas	(g)	<u>31,195</u>	<u>4,313</u>
Total structured investments		126,303	119,363
Other	(h)	6,366	51,964
Fair value of the plan assets		<u><u>1,712,551</u></u>	<u><u>1,586,930</u></u>



# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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(a) Fixed income: it is composed of government bonds issued by the National Treasury, between 2024 and 2055. These instruments are indexed by NTN-b indexed by IPCA (Extended Consumer Price Index), NTN-c indexed by IGPM (General Market Price Index) and NTN-f which has a fixed index.

(b) Fixed Income Fund Quotas: investment funds that seek return on fixed income assets and shall have at least, 80% of the portfolio in directly related assets, summed up via derivatives to the risk factor.

(c) Private Credit Investment Fund Quotas: funds that seek return by means of the acquisition of operations representing corporate debts or disseminated receivables portfolios (rights or bonds), originated and sold by several assignors who anticipate funds and have receivables from several business activities as guarantee.

(d) Equities: equity fund composed of Brazilian companies' stocks listed at BM&FBovespa.

(e) Equity Investment Fund Quotas: it is composed of a closed-ended investment fund. The assets under its management are destined to the acquisition of stocks, debentures, warrants or other securities convertible or swappable into shares issued by publicly- or closely-held companies.

(f) Real Estate Investment Fund Quotas: Funds investing in real estate projects (commercial buildings, shopping centers, hospitals, etc.). The return on capital invested occurs by sharing the Fund's proceeds or sale of its quotas in the Fund.

(g) Multimarket Investment Fund Quotas: they can be classified as Multimercados Referenciados DI or Multimercado Long & Short, they seek a basic return of CDI or share arbitration, respectively.

(h) Other: Foreign investment (investment fund quotas in global companies' stocks, mostly US companies), borrowings, real estate, operational liabilities, contingent liabilities, etc.

Restrictions with respect to asset portfolio investments, in the case of federal government securities:

- i) papers securitized by the National Treasury will not be permitted;
- ii) derivative instruments must be used for hedge.

Restrictions with respect to asset portfolio investments, in the case of variable-income securities for internal management, are as follows:

- i) day-trade operations will not be permitted;
- ii) sale of uncovered share is prohibited;

# **Companhia de Saneamento Básico do Estado de São Paulo - SABESP**

## **Notes to the Financial Statements**

**Years ended December 31, 2016, 2015 and 2014**

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iii) swap operations without guarantee are prohibited

iv) leverage will not be permitted, i.e., operations with derivatives representing leverage of asset or selling short, such operations cannot result in losses higher than invested amounts.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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At the end of 2016, Sabesprev had in its investment portfolio debentures issued by the Company in the amount of R\$3,937 (R\$4,330 as of December 31, 2015). The real estate held in the portfolio is not used by the Company.

The Brazilian capital market was positively affected in 2016 by the expectation of structural macroeconomic adjustments. The assets' consolidated profitability came to 15.99% in 2016, exceeding its actuarial target, which stood at 12.44% in the same period. In 2015, profitability came to 12.82%.

Concerning Fixed Income, the strategies focused on government bonds prevailed, which had a appreciation given the above-mentioned expectation of approval of structural reforms.

Concerning Equities, following the same dynamics, shares of Brazilian companies traded on the BM&FBovespa appreciated, anticipating expected profit growth arising from a possible economic recovery. In 2016, the return of main Brazilian stock index, the Ibovespa, recorded 38.94%, against -13.31% in 2015.

Structured Investments depreciated slightly due to investments in Private Equity Funds, which require initial investments before generating the expected returns from the sale of the investees after development and appreciation.

Investments Abroad fell 15.6% in 2016, due to the depreciation of the U.S. Dollar against the real. The same portfolio valued by 50.4% in 2015.

### **(ii) Private pension plan benefits – Defined contribution**

As of December 31, 2016, Sabesprev Mais plan, based on defined contribution, had 9,453 active and assisted participants (5,213 as of December 31, 2015).

With respect to the Sabesprev Mais plan, the contributions from the sponsor represent 100% over the total basic contribution from the participants. In 2016, expenses related to the obligation of defined contribution, totaling R\$5,954, R\$814 and R\$2,601, were allocated to operating costs, selling expenses and administrative expenses. The amount of R\$1,381 was capitalized in assets. In August 2016, the Company concluded the migration process initiated in 2010 and paid R\$30,891, corresponding to a non-recurring contribution and incentive to participants who migrated, and R\$7,214, corresponding to the previous balance, related to the migration that began in 2010.

The Company has made contributions in the amount of R\$10,750 in 2016 (R\$9,472 as of December 31, 2015).

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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### (iii) Plan Go

Pursuant to Law 4,819/58, employees who started providing services prior to May 1974 and were retired as an employee of the Company acquired a legal right to receive supplemental pension payments, which rights are referred as "Plan Go". The Company pays these supplemental benefits on behalf of the State Government and makes claims for reimbursements from the State Government, which are recorded as accounts receivable from related parties, limited to the amounts considered virtually certain that will be reimbursed by the State Government. As of December 31, 2016, the Company recognized a defined benefit obligation for Plan Go of R\$2,512,080 (R\$2,166,942 as of December 31, 2015).

	<b>2016</b>	<b>2015</b>
Defined benefit obligation, beginning of the year	2,166,942	2,053,527
Current interest expense and service costs	282,117	248,054
Actuarial (gains)/losses recorded as other comprehensive income	241,711	24,224
Benefits paid	(178,690)	(158,863)
Defined benefit obligation, end of the year	<u>2,512,080</u>	<u>2,166,942</u>

The amounts recognized in the income statement are as follows:

	<b>2016</b>
Current interest expense and service costs	282,117
Amount received from GESP (undisputed amount)	(96,709)
Total expenses	<u>185,408</u>

In 2016, the expense related to the defined benefit obligation under Plan Go was included in administrative expenses.

	<b>2017</b>
Interest cost rate	262,873
Expense to be recognized	<u>262,873</u>

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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The main actuarial assumptions used:

	2016	2015	2014
Discount rate – actual rate (NTN-B)	5.71% p.a.	7.25% p.a.	6.09% p.a.
Inflation rate	4.87% p.a.	6.49% p.a.	6.49% p.a.
Future salary increase	6.97% p.a.	8.62% p.a.	8.62% p.a.
Mortality table	AT-2000	AT-2000	AT-2000

The number of active participants of Plan - Go as of December 31, 2016 was 13 (15 as of December 31, 2015). The number of beneficiaries, retirees and survivors as of December 31, 2016 was 2,200 (2,186 as of December 31, 2015).

The benefit payable from the Go pension plan expected for 2017 is R\$186,997.

**The sensitivity analysis of defined benefit pension plan as of December 31, 2016 to the changes in the main assumptions is:**

Plan – Go	Changes in assumption	Impact on present value of the defined benefit obligations
Discount rate	Increase of 1.0%	Decrease of R\$223,664
	Decrease of 1.0%	Increase of R\$263,501
Wages growth rate	Increase of 1.0%	Increase of R\$271,054
	Decrease of 1.0%	Decrease of R\$233,253
Life expectation	Increase of 1 year	Increase of R\$67,572
	Decrease of 1 year	Decrease of R\$68,100

### (c) Profit sharing

The Company has a profit sharing program in accordance with an agreement with labor union and SABESP. The period covered represents the Company fiscal year, commence in January to December. The limit of the profit sharing is one month salary for each employee, depending on performance goals reached. As of December 31, 2016, the Program's balance payable was recorded under "salaries, payroll charges and social contributions" in the amount of R\$83,687 (R\$76,634 as at December 31, 2015).

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

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### 21 Services payable

The services account records the balances payable, mainly from services received from third parties, such as supply of electric power, reading of hydrometers and delivery of water and sewage bills, cleaning, surveillance and security services, collection, legal counsel services, audit, marketing and advertising and consulting services, among others. This account also records the amounts payable from the percentage in the revenues of São Paulo local government (Note 14 (d) (v)). The balances as of December 31, 2016 and 2015 were R\$460,054 and R\$387,279, respectively.

### 22 Equity

#### (a) Authorized capital

The Company is authorized to increase capital by up to R\$15,000,000 (R\$15,000,000 as of December 31, 2015), based on a Board of Directors' resolution, after submission to the Fiscal Council.

In the event of capital increase, issue of convertible debentures and/or warrants by means of private subscription, shareholders will have preemptive right in the proportion of number of shares held, pursuant to Article 171 of Law 6,404/76.

#### (b) Subscribed and paid-in capital

Subscribed and paid-in capital is represented by 683,509,869 registered, book-entry common shares without par value as of December 31, 2016 and 2015, held as follows:

	December 31, 2016		December 31, 2015	
	Number of shares	%	Number of shares	%
State Department of Finance	343,524,285	50,26%	343,524,285	50.26%
Companhia Brasileira de Liquidação e Custódia	206,955,305	30,28%	199,719,739	29.22%
The Bank of New York ADR Department (equivalent in shares) (*)	132,401,813	19,37%	139,637,913	20.43%
Other	628,466	0,09%	627,932	0.09%
	<u>683,509,869</u>	<u>100,00%</u>	<u>683,509,869</u>	<u>100.00%</u>

(\*) each ADR corresponds to 1 share.

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### (c) Distribution of earnings

Shareholders are entitled to a minimum mandatory dividend of 25% of the adjusted net income under Brazilian GAAP, calculated according to the Brazilian corporate law. The dividends do not bear interest and the amounts not claimed within three years from the date of the Shareholders' Meeting that approved them mature in favor of the Company.

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Profit for the year	2,947,098	536,279	902,983
(-) Legal reserve - 5%	(147,355)	(26,814)	(45,149)
	<u>2,799,743</u>	<u>509,465</u>	<u>857,834</u>
Minimum mandatory dividend – 25% (R\$1.0240, R\$0.1863 and R\$0.3138 as of December 31, 2016, 2015 and 2014 per share and per ADS)	<u>699,936</u>	<u>127,366</u>	<u>214,458</u>

On April 29, 2016, the Shareholders' General Meeting approved the distribution of dividends as interest on capital amounting to R\$149,893, for the 2015 fiscal year. Therefore, the amount of R\$22,527 related to the surplus minimum mandatory dividends of 25%, set forth in the Bylaws, recorded in the 2014 equity under "Additional proposed dividends" was transferred to current liabilities. These amounts started being paid in June 2016.

The Company proposed dividends as interest on capital in the amount of R\$699,936 and additional proposed dividends in the amount of R\$123,557, totaling R\$823,493, corresponding to R\$1.2048 per common share, to be resolved on the Shareholders' Meeting to be held on April 29, 2017.

The Company declared dividends payable as interest on capital in the amount of R\$699,936, which considers the minimum dividend amount set forth in the Bylaws. The amount exceeding the minimum mandatory dividend due in the year of R\$123,557 was reclassified into equity to the "Additional proposed dividends" account, this amount includes the withholding income tax of R\$60,838.

Pursuant to CVM Resolution nº 207/1996, the Company imputed interest on capital to the minimum dividend by its net value of withholding income tax. The amount of R\$60,838 referring to the withholding income tax was recognized in current liabilities, in order to comply with tax liabilities related to the credit of interest on capital.

The interest on capital balance payable as of December 31, 2016, totaling R\$700,034, refers to the amount of R\$699,936 declared in 2016, net of withholding income tax and R\$98 declared in previous years.

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### (d) Legal reserve

Earnings reserve - legal reserve is a requirement for all Brazilian corporations and represents accrual of 5% of annual net income determined based on Brazilian law, up to 20% of capital. However, we are not required to make any allocations to our legal reserve in a year in which the legal reserve, when added to our other established capital and earnings reserves, exceeds 30% of our capital stock. The amounts allocated to such reserve may only be used to increase our capital stock or to offset losses and are not available for the payment of dividends.

### (e) Investments reserve

Earnings reserve - investments reserve is specifically formed by the portion corresponding to own funds assigned to the expansion of the water supply and sewage treatment systems, based on capital budget approved by the Management.

As of December 31, 2016 and 2015, the balance of investment reserve totaled R\$5,249,830 and R\$3,273,580, respectively.

Pursuant to Paragraph four of Article 28 of the by-laws, the Board of Directors may propose to the Shareholders' Meeting that the remaining balance of profit for the year, after deducting the legal reserve and minimum mandatory dividends, be allocated to an investment reserve that will comply with the following criteria:

- I- its balance, jointly with the balance of the other earnings reserves, except for reserves for contingencies and realizable profits, may not exceed the capital stock;
- II- the reserve is intended to guarantee the investment plan and its balance may be used:
  - a) to absorb losses, whenever necessary;
  - b) to distribute dividends, at any moment;
  - c) in share redemption, reimbursement or purchase transactions authorized by law;
  - d) in incorporation to the capital stock.



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### (f) Allocation of profit for the year

	2016	2015	2014
Profit			
(+) Profit for the year	2,947,098	536,279	902,983
(-) Legal reserve – 5%	147,355	26,814	45,149
(-) Minimum mandatory dividends	699,936	127,366	214,458
(-) Additional proposed dividends	123,557	22,527	37,846
Investment reserve recorded in	1.976.250	359,572	605,530

The Management will send for approval at the Shareholders' Meeting, a proposal to transfer the retained earnings balance, in the amount of R\$1,976,250 to the Investment Reserve account, in order to meet the investment needs foreseen in the Capital Budget.

### (g) Retained earnings

Retained earnings (accumulated losses): the statutory balance of this account is zero as all retained earnings must be distributed or allocated to an earnings reserve.

### (h) Other comprehensive loss

Unrealized gains and losses arising from changes in the actuarial assumptions are accounted for as equity valuation adjustments, net of income tax and social contribution effects. See Note 20 (b), the breakdown of amounts recognized in 2016 and 2015.

	G1	G0	Total
Balance as of December 31, 2015	65,470	(418,852)	(353,382)
Actuarial losses for the year (Note 20 (b))	(230,555)	(241,711)	(472,266)
Balance as of December 31, 2016	(165,085)	(660,563)	(825,648)

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### 23 Earnings per share

#### Basic and diluted

Basic earnings per share is calculated by dividing the equity attributable to Company's owners by the weighted average number of outstanding common shares during the year. The Company does not have potentially dilutive common shares outstanding or debts convertible into common shares. Accordingly, basic and diluted earnings per share are equal.

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Equity attributable to Company's owners	2,947,098	536,279	902,983
Weighted average number of common shares issued	683,509,869	683,509,869	683,509,869
Basic and diluted earnings per share (reais per share)	<u>4.31</u>	<u>0.78</u>	<u>1.32</u>

### 24 Operating segment information

In 2016, the Company started to provide water connections only to customers (residential, commercial and industrial) who also requested a connection to the sewage system. Prior to that, the Company offered water connections even if the customer did not request a sewage connection.

The objective of this measure, which has been applied to all municipalities operated by SABESP, is to reduce the pollution caused by the disposal of sewage in streams, rivers, beaches and phreatic zones, and to expand the benefits to the environment and the health of the population.

The decision to offer water connections only to customers who also connect to the sewage system was taken by the main operating decision maker, which in the case of SABESP is the Board of Executive Officers, since it believes that the Company must provide sanitation services rather than individual water and sewage services only.

This structural change in the business has also changed the focus on decision making. In this way, the analysis of the activities was carried out on a consolidated basis, i.e., the Company has only one operating segment – sanitation – rather than the previously presented segments, water and sewage, as shown below:

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### Result

	2016		
	Sanitation (i)	Reconciliation to the financial statements (ii)	Balance as per financial statements
Gross operating revenue	11,122,232	3,732,877	14,855,109
Gross sales deductions	(756,901)	-	(756,901)
Net operating revenue	10,365,331	3,732,877	14,098,208
Costs, selling and administrative expenses	(7,026,699)	(3,651,364)	(10,678,063)
Income from operations before other operating expenses, net and equity accounting	3,338,632	81,513	3,420,145
Other operating income / (expenses), net			4,722
Equity accounting			4,740
Financial result, net			699,447
Income from operations before taxes			<u>4,129,054</u>
Depreciation and amortization	1,146,626	-	1,146,626

(i) See note 31 for further information about non-cash items, other than depreciation and amortization that impact segment results, and for additional to long-lived asset information;

(ii) Construction revenue and related costs not reported to the CODM.

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	2015 (Restated)		Balance as per financial statements
	Sanitation (i)	Reconciliation to the financial statements (ii)	
Gross operating revenue	8,946,825	3,336,716	12,283,541
Gross sales deductions	(571,972)	-	(571,972)
Net operating revenue	8,374,853	3,336,716	11,711,569
Costs, selling and administrative expenses	(5,550,122)	(3,263,808)	(8,813,930)
Income from operations before other operating expenses, net and equity accounting	2,824,731	72,908	2,897,639
Other operating income / (expenses), net			143,755
Equity accounting			2,597
Financial result, net			(2,456,462)
Income from operations before taxes			587,529
Depreciation and amortization	1,074,032	-	1,074,032

(i) See note 31 for further information about non-cash items, other than depreciation and amortization that impact segment results, and for additional to long-lived asset information;

(ii) Construction revenue and related costs not reported to the CODM.

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	2014 (Restated)		Balance as per financial statements
	Sanitation (i)	Reconciliation to the financial statements (ii)	
Gross operating revenue	8,905,335	2,918,036	11,823,371
Gross sales deductions	(610,155)	-	(610,155)
Net operating revenue	8,295,180	2,918,036	11,213,216
Costs, selling and administrative expenses	(6,441,050)	(2,855,516)	(9,296,566)
Income from operations before other operating expenses, net and equity accounting	1,854,130	62,520	1,916,650
Other operating income / (expenses), net			(3,488)
Equity results			(2,453)
Financial result, net			(635,866)
Income from operations before taxes			1,274,843
Depreciation and amortization	1,004,471	-	1,004,471

(i) See note 31 for further information about non-cash items, other than depreciation and amortization that impact segment results, and for additional to long-lived asset information;

(ii) Construction revenue and related costs not reported to the CODM. Explanation on the reconciliation items for the Financial Statements.

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The impacts on gross operating revenue and costs are as follows:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Gross revenue from construction recognized under IFRIC 12 (a)	3,732,877	3,336,716	2,918,036
Construction costs recognized under IFRIC 12 (a)	<u>(3,651,364)</u>	<u>(3,263,808)</u>	<u>(2,855,516)</u>
Construction margin	<u>81,513</u>	<u>72,908</u>	<u>62,520</u>

(a) Revenue from concession construction contracts is recognized in accordance with IAS 11 - Construction Contracts, using the percentage-of-completion method. See Notes 14 (c) and (f).

## 25 Insurance

The Company has insurance that covers fire and other damage to its assets and office buildings, and liabilities to third parties, among others. It also has civil liability insurance for the members of the Board of Directors and Board of Executive Officers (“D&O insurance”) and guarantee insurance for escrow deposit (as described in Note 19 (e)) and traditional guarantee insurance. The Company contracts insurance through biddings processes with the participation of the main Brazilian and international insurance companies that operate in Brazil.

As of December 31, 2016, the Company’s insurance coverage is as follows:

	<u>Amount insured</u>
Specified risks – fire	2,007,040
Engineering risk	1,814,000
Guarantee insurance for escrow deposit	500,000
Traditional guarantee insurance	100,000
Civil liability– D&O (Directors and Officers)	100,000
Civil liability – works	71,590
Domestic and international transportation	55,040
Civil liability – operations	3,000
Other	29
Total	<u>4,650,699</u>

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### 26 Operating revenue

#### (a) Revenue from sanitation services:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Metropolitan region of São Paulo	7,749,694	6,021,949	6,235,276
Regional Systems (i)	3,372,538	2,924,876	2,670,059
Total (ii)	<u>11,122,232</u>	<u>8,946,825</u>	<u>8,905,335</u>

(i) Including the municipalities operated in countryside and at the coast of the State of São Paulo.

(ii) The gross operating revenue from water and sewage, totaling R\$11,122,232, not including construction revenue, increased by R\$2,175,407, or 24.3%, when compared to the R\$8,946,825 recorded in 2015.

The main factors responsible for the increase were the 15.2% tariff adjustment (7.8% ordinary tariff adjustment and 6.9% extraordinary tariff revision) since June 2015, the 8.4% tariff adjustment since May 2016 and an increase of 4.4% in the Company's total billed volume in 2016 compared to 2015.

Revenue was also impacted by the Water Consumption Reduction Incentive Program (Bonus), decreasing from R\$926,057 in 2015 to R\$187,405 in 2016, and by the application of the Contingency Tariff, from R\$499,730 in 2015 to R\$224,724 in 2016.

#### SABESP's Water Consumption Reduction Incentive Program (Bonus) and Contingency Tariff (Tax)

ARSESP Resolution 469/2014 approved SABESP's Water Consumption Reduction Incentive Program ("Bonus"), designed to offer an economic incentive to encourage the Greater São Paulo population to reduce water consumption. The measure was adopted given the record high temperatures and the lack of rain that caused the water crisis in 2014 and 2015.

On January 7, 2015, ARSESP published the Resolution nº 545, through which it authorizes the contingency tariff to the users whose monthly consumption exceeds the average seen in the period between February 2013 and January 2014.

As of March 30, 2016, ARSESP published Resolutions 640 and 641, which respectively cancelled the application of the Contingency Tariff (Tax) and SABESP's Water Consumption Reduction Incentive Program ("Bonus") as of May 1, 2016.

#### (b) Reconciliation between gross operating revenue and net operating revenue:

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	<u>2016</u>	<u>2015</u>	<u>2014</u>
Revenue from sanitation services	11,122,232	8,946,825	8,905,335
Construction revenue (Note 14 (c))	3,732,877	3,336,716	2,918,036
Sales tax	(756,901)	(571,972)	(610,155)
Net operating revenue	<u>14,098,208</u>	<u>11,711,569</u>	<u>11,213,216</u>

## 27 Costs and expenses by nature

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Cost of services			
Salaries, payroll charges and benefits	1,718,199	1,503,383	1,494,147
Pension obligations	(131,469)	75,247	47,855
Construction costs (Note 14 (c))	3,651,364	3,263,808	2,855,516
General supplies	173,224	172,561	191,723
Treatment supplies	279,150	269,294	261,205
Outside services	845,334	791,156	856,960
Electricity	932,435	815,164	597,454
General expenses	471,965	369,213	404,367
Depreciation and amortization	<u>1,072,918</u>	<u>1,000,937</u>	<u>926,372</u>
	9,013,120	8,260,763	7,635,599
Selling expenses			
Salaries, payroll charges and benefits	271,690	237,848	236,109
Pension obligations	(17,941)	9,761	6,225
General supplies	3,585	3,692	4,549
Outside services	278,565	247,687	252,628
Electricity	751	770	579
General expenses	93,180	86,064	86,590
Depreciation and amortization	9,729	9,883	10,339
Bad debt expense, net of recoveries (Note 9 (c))	<u>90,488</u>	<u>2,420</u>	<u>139,589</u>
	730,047	598,125	736,608
Administrative (income) expenses			
Salaries, payroll charges and benefits	194,357	182,215	180,845
Pension obligations	136,358	185,206	158,114
GESP Reimbursement – benefits paid (Note 10 (a) (vii))	-	(696,283)	-
General supplies	2,585	2,340	5,861
Outside services	154,926	123,802	205,341
Electricity	1,848	1,596	1,032
General expenses	289,862	11,467	228,737
Depreciation and amortization	63,979	63,212	67,760
Tax expenses	<u>90,981</u>	<u>81,487</u>	<u>76,669</u>
	934,896	(44,958)	924,359

Total costs and expenses



Salaries, payroll charges and benefits	2,184,246	1,923,446	1,911,101
Pension obligations	(13,052)	270,214	212,194
GESP Reimbursement – benefits paid (Note 10 (a) (vii))	-	(696,283)	-
Construction costs (Note 14 (c))	3,651,364	3,263,808	2,855,516
General supplies	179,394	178,593	202,133
Treatment supplies	279,150	269,294	261,205
Outside services	1,278,825	1,162,645	1,314,929
Electricity	935,034	817,530	599,065
General expenses	855,007	466,744	719,694
Depreciation and amortization	1,146,626	1,074,032	1,004,471
Tax expenses	90,981	81,487	76,669
Bad debt expense, net of recoveries (Note 9 (c))	90,488	2,420	139,589
	<u>10,678,063</u>	<u>8,813,930</u>	<u>9,296,566</u>

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### 28 Financial Income (Expenses)

	2016	2015	2014
Financial expenses			
Interest and charges on borrowings and financing – local currency	(317,379)	(326,315)	(272,975)
Interest and charges on borrowings and financing – foreign currency	(113,268)	(127,352)	(92,180)
Other financial expenses (i)	(86,372)	(149,902)	(104,060)
Income tax over international remittance	(18,823)	(20,389)	(14,334)
Inflation adjustment on loans and financing (ii)	(121,036)	(171,735)	(98,309)
Inflation adjustment on Sabesprev Mais deficit	(891)	(1,529)	(1,169)
Other inflation adjustments (iii)	(48,634)	(20,594)	(10,597)
Interest and inflation adjustments on provisions (iv)	(133,488)	(41,916)	(118,669)
<b>Total financial expenses</b>	<b>(839,891)</b>	<b>(859,732)</b>	<b>(712,293)</b>
Financial income			
Inflation adjustment gains	152,154	166,887	91,930
Income on short-term investments (v)	209,376	170,551	202,898
Interest income (vi)	99,068	44,358	125,757
Cofins and Pasep	(23,535)	(7,947)	-
Other	11,647	21,385	2,147
<b>Total financial income</b>	<b>448,710</b>	<b>395,234</b>	<b>422,732</b>
<b>Financial income (expenses), net before exchange rate changes</b>	<b>(391,181)</b>	<b>(464,498)</b>	<b>(289,561)</b>
Net exchange gains (losses)			
Exchange rate changes on borrowings and financing (vii)	1,090,466	(1,992,019)	(345,105)
Other exchange rate changes	(209)	(720)	(625)
Exchange gains	371	775	(575)
<b>Exchange rate changes, net</b>	<b>1,090,628</b>	<b>(1,991,964)</b>	<b>(346,305)</b>
<b>Financial income (expenses), net</b>	<b>699,447</b>	<b>(2,456,462)</b>	<b>(635,866)</b>

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- (i) Other financial expenses decreased, especially due to the lower accounting of interest of the PPP agreement of Sistema Produtor Alto Tietê – CAB – SPAT.
- (ii) The inflation adjustment derives mainly from the lower variation of the IPCA in 2016, versus 2015 (6.29% and 10.67%, respectively). In 2015, the inflation adjustments derives from increase in the indexes defined in the loan agreements, such as TR and IPCA, corresponding to 1.8% and 10.7%, respectively, in 2015 (0.9% and 6.4% in 2014).

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- (iii) The increase was essentially due to the restatement of liabilities related to the commitments required by public-private partnerships and leases.
- (iv) The variation was mainly due to the recognition of higher interest and inflation adjustment on the 2016 lawsuits, due to the revision of the estimated probability of loss, arising from decisions that were unfavorable to the Company.
- (v) The increase is due to the higher average balance of investments in 2016 compared to 2015.
- (vi) The R\$54,710 increase in interest income is essentially due to lower interest on installment agreements in 2015.
- (vii) The change in expenses mainly reflects the depreciation of the U.S. dollar against the real in 2016 (16.5% and 13.9%, respectively), compared to the appreciation presented in 2015 (47.0% and 45.9%, respectively). In 2015, higher expenses mainly reflect the increase in the debt balance due to the US dollar and the Yen appreciation, of 47.0% and 45.9%, respectively, in 2015 (13.4% of US dollar and 0.4% depreciation of the Yen in 2014).

### 29 Other operating income (expenses), net

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Other operating income, net	62,570	190,840	109,329
Other operating expenses	<u>(57,848)</u>	<u>(47,085)</u>	<u>(112,817)</u>
Other operating income (expenses), net	<u>4,722</u>	<u>143,755</u>	<u>(3,488)</u>

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Other operating income is comprised by sale of property, plant and equipment, sale of contracts awarded in public bids, right to sell electricity, indemnities and reimbursement of expenses, fines and collaterals, property leases, reuse water, PURA projects and services.

Other operating income decreased by R\$128.3 million, mainly due to: (i) the decline in revenue from property sales (R\$47.4 million); (ii) the decrease in the sale of surplus electricity (R\$42.8 million); (iii) the lower amount received from the State Program to Support Water Recovery (R\$22.6 million); and (iv) lower income from contractual fines charged from suppliers (R\$16.8 million).

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

### 30 Commitments

The Company has agreements to manage and maintain its activities, as well as agreements to build new projects aiming at achieving the objectives proposed in its target plan. Below, the main committed amounts as of December 31, 2016:

	1 year	1-3 years	3-5 years	More than 5 years	Total
Contractual obligations – Expenses	1,357,861	1,582,538	412,312	1,299,950	4,652,661
Contractual obligations – Investments	1,328,780	2,298,758	1,012,006	6,305,057	10,944,601
Total	2,686,641	3,881,296	1,424,318	7,605,007	15,597,262

The main commitment refers to São Lourenço PPP. See Note 14 (h).

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

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### 31 Supplemental cash flow information

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Total additions to intangible assets (Note 14 (b))	3,855,831	3,604,442	3,236,781
Items not affecting cash (see breakdown below)	<u>(1,747,664)</u>	<u>(1,207,090)</u>	<u>(577,924)</u>
Total additions to intangible assets as per statement of cash flows	2,108,167	2,397,352	2,658,857
Investments and financing operations affecting intangible assets but not cash:			
Interest capitalized in the year (Note 14 (e))	700,743	466,544	278,265
Contractors payable	57,431	(57,041)	48,547
Program contract commitments	4,262	136,543	62,250
Public Private Partnership - São Lourenço PPP (Note 14 (h))	893,181	548,978	22,245
Leases	10,534	36,877	104,097
Construction margin (Notes 14 (f) and 24)	81,513	72,908	62,520
Other	-	2,281	-
Total	<u>1,747,664</u>	<u>1,207,090</u>	<u>577,924</u>

### 32 Events after the reporting period

- **Tariff revision**

As of January 19, 2017, the São Paulo State Sanitation and Energy Regulatory Agency (ARSESP) published ARSESP Resolution 706 that addresses the beginning of SABESP's second ordinary tariff revision.

- **Santa Branca**

Since February 6, 2017, SABESP started providing sanitation services in Santa Branca. The agreement, signed on November 9, 2016, is valid for 30 years.

# Companhia de Saneamento Básico do Estado de São Paulo - SABESP

## Notes to the Financial Statements

Years ended December 31, 2016, 2015 and 2014

Amounts in thousands of reais, unless otherwise indicated

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- **Implementation of SAP ERP - Enterprise Resource Planning System**

As of April 10, 2017, SABESP implement the Enterprise Resource Planning - SAP ERP, that comprises a series of programs, integrating all information of the Company's processes in a single data base. With the implementation of SAP ERP, SABESP will increase its operational automation and standardization through allowing access to a solid and robust base of corporate information, streamlining and optimizing management procedure, in line with the best market practices.

- **Protocol of Intentions with the municipality of Guarulhos**

As of April 10, 2017, SABESP executed a Protocol of Intentions with the municipality of Guarulhos for the preparation of studies and evaluations aiming to resolve commercial relations and existing debts between the municipality and the Company.

- **News published by the press concerning alleged irregularities in two contracts with Odebrecht**

On April 25, 2017, the Company issued a Notice to the Market about news published by the press concerning alleged irregularities in two contracts with Odebrecht, as per statements made by one of its former executives in a plea bargain deposition.

Internal procedures were carried out to determine if there were indications of alleged irregularities in the contracts mentioned and it was concluded that there is no evidence of irregularities in these contracts.

Any new fact or indication will lead to new diligence on the part of the Company.

- **Sabesp's Second Ordinary Tariff Revision - New Schedule**

On April 26, 2017, the Regulatory Agency of Sanitation and Energy of the State of São Paulo (ARSESP - Agência Reguladora de Saneamento e Energia do Estado de São Paulo) published a Notice changing the timeline for the initial stage of the Sabesp's Tariff Revision.

The Preliminary Maximum Average Tariff ("Preliminary Po") will be disclosed up until June 30, 2017.

The Final Maximum Average Tariff ("Final Po") will be maintained up until April 10, 2018.

- **General Shareholders Meeting**

On April 28, 2017 it was held the Annual Shareholders' Meeting, which made the following decisions:

- Approval of the Company's financial statements for the fiscal year ended December 31, 2016;
- Allocation of the profit for the year 2016;
- Election of Mr. Francisco Luiz Sibut Gomide to compose the Board of Directors; and
- Election of effective and alternate members of the Fiscal Council.

- **Second Ordinary Tariff Revision of Sabesp**

On May 10, 2017, the Company's Board of Executive Officer resolved to file, on May 11, 2017, a formal request to the Regulatory Agency for Sanitation and Energy of the State of São Paulo (ARSESP - Agência Reguladora de Saneamento e Energia do Estado de São Paulo) to postpone, for 30 days, the schedule of the currently ongoing tariff revision, with the following objectives:

- consider, in this stage, the technical report prepared by Sabesp regarding the exclusion of pipelines carried out during the first cycle, requesting its incorporation in the calculation of the preliminary Po; and
- provide additional clarifications and information on the Business Plan, as requested by ARSESP.

- **Second Ordinary Tariff Revision of Sabesp**

On May 11, 2017, the Regulatory Agency for Sanitation and Energy of the State of São Paulo (ARSESP - Agência Reguladora de Saneamento e Energia do Estado de São Paulo), regarding Sabesp's request, published Resolution No. 722, in which ARSESP:

- (i) grants to the Company the additional time requested to supplement and submit the information for the initial stage of the preliminary tariff revision process; and
- (ii) announces that it will disclose, up to May 19, the new schedule for the initial stage of the 2nd Ordinary Tariff Revision of Sabesp, as a result of the additional time granted to submit the information.

- **Memorandum of understanding with the municipality of Santo André**

On May 11, 2016, the Company entered into a Memorandum of Understanding with the municipality of Santo André, in order to prepare studies and evaluations to govern commercial relations and debts between the municipality and the Company.

- **21<sup>st</sup> issue of debentures**

On May 12, 2017, Sabesp's Board of Directors approved the issuance of the 21<sup>st</sup> issue of simple, non-convertible unsecured debentures in up to two (2) series, for public distribution, with restricted placement efforts, Pursuant to CVM Instruction 476 of January 16, 2009, in the total amount of R \$ 500,000. The proceeds from the issuance of the Debentures will be allocated to the refinancing of outstanding financial commitments in 2017 and to the Company's cash recovery.

- **Studies for the Company's Capitalization**

On May 12, 2017, Sabesp announces to its shareholders and to the market in general that, the State Privatization Program's Board, established by the State Law 9.361, dated as of July 5th, 1996, unanimously resolved, on this date ("Resolution"):

- (i) To proceed with studies on alternatives for the Capitalization of Sabesp ("Capitalization");
- (ii) The hiring, by Sabesp, of the International Finance Corporation ("IFC"), an institution bound to the World Bank; and
- (iii) The conclusion of an agreement between Sabesp and the São Paulo State Government, through the Secretariat of Sanitary and Water Resources and the Secretariat of Finance, to delineate the scope of the IFC's hiring and to govern the relationship between the contracting parties, including proportional reimbursement of expenses.

The proposed Capitalization provides the establishment of a new company to exercise Sabesp's direct corporate control after the conference of the totality of share interest owned by the São Paulo State Government into the stock capital of the new company. São Paulo State Government will continue, under any circumstances, to hold sufficient shareholding interest to assure the exercise of Sabesp's majority corporate control, as provided by law. The purpose of the Capitalization is to overcome financial restrictiveness and preserve the expansion of the activities of universalization of basic sanitation services promoted by the Company.

If further studies are implemented, new information will be disclosed regarding the possible Capitalization, which, if continued, may provide for the admission of institutional investors in order to fund the new company's share capital, allowing to strengthen Sabesp's corporate governance and business efficiency in order to preserve the development of its activities of universal sanitation services in the São Paulo State.

During this process the Company will disclose any relevant developments over this subject.



## CERTIFICATION

I, Jerson Kelman, certify that:

1. I have reviewed this annual report on Form 20-F of Companhia de Saneamento Básico do Estado de São Paulo - Sabesp;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - a) designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on evaluation; and
  - d) disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and to the audit committee of the company's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: May 15, 2017

By: /s/ Jerson Kelman  
Name: Jerson Kelman  
Title: Chief Executive Officer

## CERTIFICATION

I, Rui de Britto Álvares Affonso, certify that:

1. I have reviewed this annual report on Form 20-F of Companhia de Saneamento Básico do Estado de São Paulo - Sabesp;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - a) designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on evaluation; and
  - d) disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and to the audit committee of the company's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: May 15, 2017

By: /s/ Rui de Britto Álvares Affonso

Name: Rui de Britto Álvares Affonso

Title: Chief Financial Officer and Investor Relations Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE U.S. SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Companhia de Saneamento Básico do Estado de São Paulo – Sabesp (the “Company”) on Form 20-F for the fiscal year ended December 31, 2016, as filed with the U.S. Securities and Exchange Commission on the date hereof (the “Report”), I, Jerson Kelman, Chief Executive Officer, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the U.S. Sarbanes Oxley Act of 2002, that to the best of my knowledge:

- (i) the Report fully complies with the requirements of section 13(a) or 15(d) of the U.S. Securities Exchange Act of 1934; and
- (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 15, 2017

By:     /s/Jerson Kelman      
Name: Jerson Kelman  
Title: Chief Executive Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE U.S. SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Companhia de Saneamento Básico do Estado de São Paulo – Sabesp (the “Company”) on Form 20-F for the fiscal year ended December 31, 2016, as filed with the U.S. Securities and Exchange Commission on the date hereof (the “Report”), I, Rui de Britto Álvares Affonso, Chief Financial Officer and Investor Relations Officer, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the U.S. Sarbanes Oxley Act of 2002, that to the best of my knowledge:

- (i) the Report fully complies with the requirements of section 13(a) or 15(d) of the U.S. Securities Exchange Act of 1934; and
- (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 15, 2017

By: /s/ Rui de Britto Álvares Affonso  
Name: Rui de Britto Álvares Affonso  
Title: Chief Financial Officer and Investor Relations Officer

May 15, 2017

Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-7561  
United States of America

Dear Sirs/Madam:

We have read Item 16F of Companhia de Saneamento Básico do Estado de São Paulo–SABESP’s Annual Report on Form 20-F for the year ended December 31, 2016, dated May 15, 2017 (the “Annual Report”), and have the following comments:

1. We agree with the statements made in the paragraphs 1, 2, 3, 4, 5, 10, 11 and 12 of Item 16F of the Annual Report.
2. We disagree with the statements made in the paragraphs 6, 7, 8 and 9 of Item 16F of the Annual Report.
3. We have no basis on which to agree or disagree with the statements made in the paragraphs 13 and 14 of Item 16F of the Annual Report.

Yours truly,

/s/ DELOITTE TOUCHE TOHMATSU  
DELOITTE TOUCHE TOHMATSU  
Auditores Independentes

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